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Via e-mail to rule-comments@sec.gov

Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

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

Dear Ms. Murphy:

Invesco Mortgage Capital Inc. (the "Company") is a publicly traded real estate investment trust ("REIT"). We are pleased to provide this comment letter to the Securities and Exchange Commission (the "Commission") in response to the Commission's solicitation for comment on its concept release entitled *Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments* (the "Release").[1] We commend the Commission's interest in providing clarity, consistency and regulatory certainty to the mortgage industry in a manner that facilitates capital formation, and we hope that our comments will assist the Commission in its efforts.

As discussed in more detail below, we respectfully submit that the Commission should affirm the 30-year old position of its staff (the "Staff") that whole pool certificates ("agency whole pool certificates") issued or guaranteed by federally-chartered corporations[2] or U.S. Government agencies[3] are "mortgages and other liens on and interests in real estate" ("Qualifying Interests") for purposes of the Section 3(c)(5)(C) exclusion (the "Exclusion") from the definition of "investment

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1 76 Fed. Reg. 55,300 (Sept. 7, 2011) (to be codified at 17 C.F.R. pt. 270).

2 Federally-chartered corporations are government-sponsored enterprises ("GSEs") such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac").

3 An example of a U.S. Government agency that issues or guarantees agency whole pool certificates is the Government National Mortgage Association ("Ginnie Mae").

company" under the Investment Company Act of 1940 (the "Investment Company Act"). We believe such treatment and the exclusion of agency whole pool certificates is consistent with the Exclusion and congressional intent underlying the Exclusion.

We also respectfully submit that the mortgage industry and investors would greatly benefit from clarification of whether certain other assets constitute Qualifying Interests and, in that regard, we encourage the Commission deem certificates that represent less than the entire ownership interest in a mortgage pool (whether an agency mortgage pool or a private mortgage pool, "partial pool certificates") to be Qualifying Interests. We believe that partial pool certificates should be Qualifying Interests because (i) all payments of interest and repayments of principal on the partial pool certificates are derived from mortgages and, therefore, the owners are subject to default and prepayment risks on the underlying mortgages; (ii) the owners of partial pool certificates must assess the risks of the underlying mortgage loans by appraising and monitoring the underlying mortgages; and (iii) mortgage pools are passive vehicles created to finance the real estate industry and, as such, the owners of partial pool certificates are not relying on the efforts of others engaged in a real estate business.

We believe taking these actions is appropriate because mortgage REITs like the Company are more similar to lenders than investment companies regulated under the Investment Company Act and are already subject to substantial regulatory requirements that protect investors. We believe that taking these actions would also help the Commission achieve its stated goals of:

(i) being consistent with congressional intent underlying the Exclusion;

(ii) ensuring the Exclusion is administered in a manner consistent with the purposes and policies underlying the Investment Company Act, in particular, Section 3(c)(5)(C);

(iii) providing greater clarity, consistency and regulatory certainty; and

(iv) facilitating capital formation.[4]

Failing to affirm the Staff's long-held position that agency whole pool certificates are Qualifying Interests would devastate an entire sector of the mortgage REIT industry that has developed in reliance on the Staff's 30 years of guidance and has grown to be an important source of private capital for both the residential and commercial mortgage industries without significant regulatory or financial issues; it would also harm the investors in those mortgage REITs and would frustrate Congress' intent in creating the Exclusion. Failure to deem partial pool certificates to be Qualifying Interests would adversely affect the mortgage industry, frustrate the Commission's efforts to enhance capital formation and undermine Congress' intent in creating the Exclusion.

I. The Company's History

We are primarily focused on acquiring, financing and managing residential mortgage-backed securities ("RMBS"), commercial mortgage-backed securities ("CMBS," and together with RMBS, "MBS") and mortgage loans. We were incorporated in Maryland and commenced operations in July 2009. We have elected to be taxed as a REIT for United States federal income tax purposes. Our common stock is listed on the New York Stock Exchange (the "NYSE") under the symbol "IVR." Our shareholders generally seek exposure to the real estate mortgage market on a leveraged basis primarily for dividend returns. Our shareholders include institutional stock holders, such as money managers, insurance companies, financial institutions, hedge funds, index funds and retail investors. With the current interest rate environment at historically low levels, investor demand for dividend-yielding stocks such as ours has increased.

We are externally managed and advised by Invesco Advisers, Inc. (our "Manager"), an investment adviser registered with the Commission under the Investment Advisers Act of 1940 (the "Advisers Act") and an indirect, wholly-owned subsidiary of Invesco Ltd., an independent global investment company listed on the NYSE under the symbol "IVZ."

We generally finance our MBS portfolio through short-term borrowings structured as repurchase agreements. In addition, we have historically

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[4] The Release, 76 Fed. Reg. at 55,301.

financed our CMBS portfolio with financings under the U.S. Government's Term Asset-Backed Securities Loan Facility, which we repaid and replaced with repurchase agreements during 2010. We have also financed our acquisition of certain RMBS that are not issued or guaranteed by a U.S. government agency or federally-chartered corporation, CMBS and residential and commercial mortgage loans by contributing capital to a partnership that invests in public-private investment funds managed by our Manager as part of the Public-Private Investment Program created by the U.S. Treasury in conjunction with the Federal Deposit Insurance Corporation (the "FDIC") and the U.S. Federal Reserve.

As of September 30, 2011, we had outstanding balances under repurchase agreements with 23 separate lenders.[5] While we are not required to maintain any particular debt-to-equity ratio, we generally target a total debt-to-equity ratio ranging from 3-to-1 to 7-to-1. As of September 30, 2011, our total debt-to-equity ratio was 6.3-to-1.[6]

The MBS we own trade in liquid markets and, as such, we obtain daily third-party valuations of those assets. We follow our Manager's pricing policy to ensure that we use the proper valuations for our portfolio. In addition, we undergo an annual independent audit and quarterly reviews of our financial statements that includes a review of the valuations we assign to our assets and our process for determining their fair value. In order to prevent misappropriation of and to safeguard our assets, we have retained a third-party custodian who holds all of our MBS assets.

Our operations are overseen by our board of directors (our "Board"). Currently, three of our five directors are "independent directors" (as defined by the NYSE Listed Company Manual).[7] Our Board has an audit committee, a

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5 Invesco Mortgage Capital Inc., Quarterly Report (Form 10-Q) at 16 (Nov. 4, 2011).

6 *Id.* at 39.

7 *See* Invesco Mortgage Capital, Inc., Proxy Statement (Schedule 14A) at 9 (Mar. 30, 2011) (the "2011 Proxy") ("A majority of our Board of Directors is 'independent,' as determined by the requirements of the NYSE and the regulations of the SEC."); *see also New York Stock Exchange Listed Company Manual*, § 303A.02 (2011) (listing standards for qualifying directors as "independent"); Invesco Mortgage Capital, Inc., Investor Relations/Board of Directors, Invesco, *available at* http://www.invescomortgagecapital.com/index.html (go to "Investor Relations," then "Officers & Directors" under "Corporate Overview" in side menu).

compensation committee and a nominating and corporate governance committee.[8] Each of these committees is composed solely of our three independent directors.[9]

The responsibilities of our audit committee include (i) assisting our Board in fulfilling its responsibility to oversee the Company's financial reporting, auditing and internal control activities, including the integrity of the Company's financial statements; (ii) seeking to ensure compliance with legal and regulatory requirements; and (iii) reviewing the independent auditor's qualifications and independence and the performance of the Company's internal audit function and independent auditor.[10] Our audit committee also complies with the other requirements of the NYSE and has appointed a third-party independent auditor to audit our financial statements.[11]

We also comply with various other NYSE rules and securities laws, including, without limitation, the Securities Act of 1933 (the "Securities Act"), the Securities and Exchange Act of 1934 (the "Exchange Act") and the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"). In an effort to comply with the various regulatory requirements applicable to our business, we have implemented a comprehensive compliance policy and adopted, among others, corporate governance guidelines, a code of business conduct and ethics, a Related Party Transaction Policy and an Insider Trading Policy. In addition, our Manager has adopted an Investment Allocation Policy which ensures the Manager equitably allocates investment opportunities and applicable transaction costs among the accounts that it advises.

II. Congressional Intent

The Staff's exclusion of mortgage REITs such as the Company from investment company status is consistent with the underlying intent of the Exclusion. As the Commission acknowledges in the Release, the Exclusion does not have an

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[8] 2011 Proxy, *supra* note 7, at 9. Charters for these committees are publicly available on the Company's web site, http://www.invescomortgagecapital.com (go to "Investor Relations," then "Committee Charting" in side menu).

[9] 2011 Proxy, *supra* note 7, at 9.

[10] *Id.* at 11.

[11] *Id.* at 23.

extensive legislative history.[12] The few statements in the legislative history that address the Exclusion indicate that Congress intended to exclude companies that own or otherwise acquire mortgages and other interests in real estate based upon the composition of a company's assets. Congressional reports and transcripts of congressional hearings provide alternative descriptions of the Exclusion as being created for "companies dealing in mortgages,"[13] "companies [that have] portfolios of securities in the form of . . . mortgages and other liens on and interests in real estate,"[14] and "mortgage companies, although they in essence deal in securities."[15]

We respectfully submit that the limited discussion regarding the Exclusion was intentional given that one of the primary purposes of the Investment Company Act was to protect investors from unscrupulous investment companies and investment trusts (collectively, "investment companies") whose investments were almost exclusively limited to the common equity and debt securities of U.S. corporations[16] and to eliminate the abuses and deficiencies which then existed in investment companies.[17] According to a report on investment companies prepared by the Commission (the "Commission Report"), investment companies of the type

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12 *See* the Release, 76 Fed. Reg. at 55,301.

13 S. Rep. No. 76-1775, at 12-13 (1940); *accord* H.R. Rep. 76-2639, at 12 (1940).

14 S. Rep. No. 91-184, at 34 (1969).

15 Investment Trusts and Investment Companies: Hearings on S. 3580 Before the Subcomm. of the S. Comm. on Banking and Currency, 76th Cong. 181 (1940) (statement of David Schenker, Staff Counsel).

16 *See* U.S. Sec. & Exch. Comm'n, *Investment Trusts and Investment Companies: Report of the Securities and Exchange Commission, Part One: The Nature, Classification, and Origins of Investment Trusts and Investment Companies* 16 (1939) (the entire study, the "SEC Study") (noting that the SEC Study focused only on companies whose "main and primary business" was ownership of securities of other corporations and not on companies like banks and insurance companies because their primary businesses were banking and insurance, respectively, and "not ownership of securities").

17 *See* S. Rep. No. 76-1775, at 11-12 (1940) (stating that the Investment Company Act was required because existing legislation was "insufficient to eliminate the abuses and deficiencies which exist in investment companies" and also stating that "the protection of investors against unscrupulous management and the necessity for the prevention of the recurrence of the abuses disclosed by the Commission's study and the committee hearings made indispensable the immediate enactment of adequate legislation regulating investment companies").

that the Investment Company Act was intended to regulate did not begin forming in significant numbers until the practice of investing in the common equity of U.S. corporations by the general public gained popularity.[18] Prior to the proliferation of such investment vehicles, retail investors generally restricted their personal investments to assets such as mortgages and real estate.[19] The Commission Report also noted that many investment companies began to "peddle" investment company securities to investors in an effort to exploit the general public's interest in the stock market.[20] We believe that the decision to exclude companies that primarily own or otherwise acquire mortgages and other liens on and interests in real estate was not in need of extensive congressional discussion or debate because mortgages and real estate were viewed as a separate asset class, and the mortgage and real estate industries were viewed as separate industries from the investment industries the Investment Company Act sought to regulate.

Approximately three decades after the enactment of the Investment Company Act, Congress considered and subsequently adopted amendments to the Investment Company Act in order to "facilitate, update and improve the administration and enforcement of" the Investment Company Act.[21] This review occurred after mortgage REITs were created, as the amendments to the Internal Revenue Code (the "Code") that created REITs were adopted in 1960[22] and the first

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18 "The concept of a company formed to invest in a cross section of securities, particularly common stock, and to be supervised by professional managers, was an innovation to the public. Up to . . . World War [I], investors of moderate means are generally believed to have confined their investments to mortgages, real estate, deposits in savings accounts, insurance policies, annuities, bonds, and occasional preferred stocks." The SEC Study, Part One, *supra* note 16, at 37.

19 *Id.*

20 *See* U.S. Sec. & Exch. Comm'n, *Investment Trusts and Investment Companies: Report of the Securities and Exchange Commission, Part Three: Abuses and Deficiencies in the Organization and Operation of Investment Trusts and Investment Companies* 11-12 (1939).

21 S. Rep. No. 91-184, at 1 (1969).

22 *See* Act of Nov. 14, 1960, Pub. L. No. 86-779, § 10. We note that the legislative history accompanying these amendments to the Code provide further evidence that Congress was well aware of the similarities between the operations of registered investment companies and REITs, but has nevertheless maintained Section 3(c)(5)(C) as a purely asset-based exclusion from regulation under the Investment Company Act. *See* Real Estate Investment Trusts, H.R. Rep. No. 86-2020, at 3-4 (1960) ("The equality of the tax treatment between the beneficiaries of real estate investment trusts and the shareholders of regulated investment companies is desirable since in

public mortgage REIT began trading on the NYSE in 1965.[23] Congress could have amended or repealed the Exclusion to make it unavailable to mortgage REITs or available only for certain types of mortgage REITs or only if mortgage REITs satisfied certain requirements. Instead, Congress continued to recognize and reaffirmed that it did not intend for the Investment Company Act to regulate companies primarily engaged in the business of owning or otherwise acquiring "portfolios of . . . mortgages and other liens on and interests in real estate . . . because they do not come within the generally understood concept of a conventional investment company investing in stocks and bonds of corporate issuers."[24] In connection with its review, the only amendment Congress adopted to the Exclusion was to prohibit companies relying on the Exclusion from issuing redeemable securities, the one structural element of mutual funds the absence of which Congress thought was adequate to differentiate mortgage REITs from investment companies.[25] Congress deemed such action to be adequate to ensure that companies relying on the Exclusion did not confuse the public by bearing a resemblance to mutual funds.

The Release characterizes the legislative history of the Investment Company Act as indicating that Section 3(c)(5)(C) was meant to exclude companies

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both cases the methods of investment constitute pooling arrangements whereby small investors can secure advantages normally available only to those with larger resources. These advantages include the spreading of risk of loss by the greater diversification of investment which can be secured through the pooling arrangements; the opportunities to secure the benefits of expert investment counsel; and the means of collectively financing projects which the investors could not undertake singly.").

[23] *See* NAREIT, REIT Industry Timeline: Celebrating 50 years of REITs and NAREIT, *available at* http://www.reit.com/timeline/timeline.php (last visited Nov. 1, 2011).

[24] S. Rep. No. 91-184, at 34 (1969); *accord* H.R. Rep. No. 91-1382, at 17 (1969).

[25] The Release states that some mortgage-related pools, like PennyMac Mortgage Investment Trust ("PennyMac"), were "perceived" by the "media" as being investment companies. *See* the Release, 76 Fed. Reg. at 55,303. In support of this claim, the Release quotes an article criticizing PennyMac for being "a hedge fund dressed up as a real estate investment trust" even before it had its initial public offering. *Id.* at 55,303, n. 28 (citation omitted). However, even a casual review of PennyMac's portfolio and financial statements would reveal that it has never had any of the characteristics of a hedge fund. For example, unlike a typical hedge fund, PennyMac does not short investments. It utilizes significantly less leverage than is used by the average hedge fund, and it tends to hold its investments for longer terms, whereas hedge funds typically trade their investments constantly. *See* PennyMac Mortgage Investment Trust, Quarterly Report (Form 10-Q), at 50-51 (Aug. 5, 2011).

"engaged in the mortgage banking business."[26] However, in no instance were we able to find a reference to the phrase "mortgage banking business" in the legislative history or the Commission Report. We respectfully submit that it is inaccurate to characterize the legislative history as suggesting Section 3(c)(5)(C) was in any way intended to exclude only companies in the "mortgage banking business." That phrase implies that a company seeking to rely on the Exclusion may need to be engaged in the business of originating or underwriting mortgages, a proposition that is not supported by the legislative history. The language of the legislative history clearly indicates that owning or otherwise acquiring mortgages and other liens on and interests in real estate, and not any operating characteristic, is the basis for an entity's exclusion from investment company status under the Investment Company Act.[27] The Staff previously has recognized this fact and granted enforcement relief to companies whose purposes were limited to holding mortgage loans and not originating or underwriting them.[28]

The structure of Section 3(c)(5) also supports our view that the Exclusion was meant to be an asset-based test. Section 3(c)(5) has three subsections that exclude three types of businesses from investment company status, only one of which, Section 3(c)(5)(B), suggests in any way that a company may need to be actively engaged in making loans to rely on the exclusion.[29] When Congress intended to require a company to be engaged in certain business lines or activities in

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[26] The Release, 76 Fed. Reg. at 55,301.

[27] We note that certain releases and publications since 1992 have also asserted that Section 3(c)(5)(C) was originally intended to exclude companies engaged in a mortgage banking business. *See, e.g.*, *Exclusion From the Definition of Investment Company for Certain Structured Financings*, 57 Fed. Reg. 23,980, 23,980-981 (June 5, 1992) (to be codified at 17 C.F.R. pt. 270) (proposing Rule 3a-7; Section 3(c)(5)(C) "originally was intended to exclude issuers engaged in the . . . mortgage banking industries"); Division of Investment Management, U.S. Sec & Exch. Comm'n, *Protecting Investors: A Half Century of Investment Company Regulation*, at 100 (May 1992) ("Protecting Investors") (Section 3(c)(5)(C) "was intended to except mortgage bankers that originated, serviced, and sold mortgages"). As noted above, there is no support in the legislative history for these assertions.

[28] *See* CDW Mortgage Securities, Inc., SEC No-Action Letter, 1987 WL 108326 (Aug. 4, 1987); McDonald & Co. Securities, SEC No-Action Letter, 1983 WL 28867 (Dec. 14, 1983).

[29] Even with respect to Section 3(c)(5)(B), the Staff has issued no-action letters stating that merely owning the necessary types of loans is sufficient to rely on such exclusion. *See* Woodside Group, Inc., SEC No-Action Letter, 1982 WL 29947, at *1-2 (Apr. 14, 1982).

order to rely on one of the exclusions provided in Section 3(c), it knew how to do so. For example, a company seeking to rely on the exclusion provided by Section 3(c)(2) is required to be "engaged in the business of underwriting and distributing securities issued by other persons, selling securities to customers, acting as broker, and acting as market intermediary."[30] Similarly, a company seeking to rely on the exclusion provided for banks or insurance companies by Section 3(c)(3) is required to satisfy the definitions for such types of entities, which require them to be regulated by certain regulators and/or be engaged in certain activities, such as taking deposits or writing insurance.[31] Section 3(c)(4) excludes only companies "substantially all of whose business is confined to making small loans, industrial banking, or similar businesses."[32] Section 3(c)(5)(C), on the other hand, only requires a company to "purchas[e] or otherwise acquir[e]" mortgages and other liens on and interests in real estate.[33] Section 3(c)(5)(C) says nothing about originating or underwriting those assets. Accordingly, the Staff has historically imposed an asset-based test on companies seeking to rely on clause (C) rather than requiring them to engage in certain business lines or activities. The Staff's current asset-based test requires such companies to invest (i) at least 55% of their assets in Qualifying Interests[34] and (ii) at least an additional 25% of their assets in additional Qualifying Interests or real estate-related assets.[35] We believe the asset-based test imposes a more stringent requirement on companies seeking to rely on clause (C) than the requirements placed on companies seeking to rely on the other exclusions under Section 3(c) and adequately ensures that only those companies primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate can rely on the Exclusion. Accordingly, we respectfully submit that the Commission should affirm the Staff's position.

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30 15 U.S.C. § 80a-3(c)(2)(A).

31 *See* 15 U.S.C. § 80a-3(c)(3).

32 *See* 15 U.S.C. § 80a-3(c)(4).

33 15 U.S.C. § 80a-3(c)(5)(C).

34 *See* NAB Asset Corp., SEC No-Action Letter, 1991 WL 176787, at *2 (June 20, 1991) (the "NAB Letter").

35 Citytrust, SEC No-Action Letter, 1990 SEC No-Act Lexis 1389, at *5, n.5 (Dec. 19, 1990).

We believe that Congress did not explicitly exempt MBS primarily because they did not exist when the Investment Company Act was adopted. At that time, however, Congress used broad language to exempt not only companies that purchase mortgage loans, but also companies that "otherwise acquire" mortgage loans and "other liens on and interests in real estate." We believe Congress used this broad language not only to exempt companies that purchase mortgages, but also to exempt companies that finance real estate transactions by otherwise acquiring indirect interests in mortgages, which today would include partial pool certificates. As discussed further in the following discussion of the modern mortgage market, the majority of mortgage loans today are held within securitizations, and we believe that a failure to treat MBS, including partial pool certificates, as Qualifying Interests would thwart Congress' original intent.

III. The Modern Mortgage Market

Mortgage loans provide the funding necessary for real estate owners to construct and operate the properties in which we live, sleep, work, eat, shop and vacation. Prior to 1970, real estate finance in the United States was dominated by regional lenders who, after originating mortgage loans, typically either held them on their respective balance sheets as part of a portfolio or packaged and sold them as whole loans. In the 1970s, after simply trading whole loans or un-securitized mortgages, financial innovation lead to residential loans being packaged into bonds which were supported by the principal and interest payments of the loans. In 1968, Ginnie Mae guaranteed the first mortgage pass-through securities which pass the principal and interest payments on mortgages through to investors. In an effort to promote homeownership by fostering a secondary mortgage market, Ginnie Mae securitizations were soon followed by Freddie Mac in 1971 and Fannie Mae in 1981. The success of these agency securitizations spurred the development of the first private label securitizations shortly thereafter, and private label securitizations became widely accepted over the next few years.[36]

Today, two-thirds of the domestic $11 trillion residential mortgage market is securitized in either agency or private label form. In either form, an owner of mortgages transfers them to a grantor trust, special purpose vehicle or other similar bankruptcy remote entity (collectively, "SPVs"). SPVs are passive, pass-through financing vehicles. To purchase the mortgage loans from the owner, the

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[36] *See The Handbook of Mortgage-Backed Securities* (Frank J. Fabozzi ed., 6th ed. 2006).

SPV issues securities into the private market. The modern mortgage market depends on private capital purchasing these securities to fund the origination of new loans.

The servicing of the loans is governed by a pooling and servicing agreement or other similar agreement. The SPV also hires a trustee to ensure that the interest and principal payments on the underlying loans are distributed pursuant to the governing documents, and that the servicer handles delinquent and foreclosed properties. An investor's returns are dependent on its ability to (i) source and screen MBS based on the quality of their underlying mortgage loans; (ii) analyze economic and market forces that will effect the value of the underlying mortgage loans; and (iii) analyze the quality, reputation and resources of the agents servicing the underlying mortgage loans.

After the real estate recession of the late 1980s and early 1990s, many traditional commercial real estate lenders exited the business. The exit of traditional lenders spurred the application of securitization to the commercial real estate mortgage market. In the mid-to-late 1980s, issuers began offering CMBS collateralized by single properties. Eventually, bonds collateralized by large diversified pools emerged when the Resolution Trust Corporation securitized non-performing loans from bankrupt financial institutions.

From its primitive beginnings in 1970, securitization has revolutionized the way both residential and commercial properties are financed. Since the 1970s, securitization has experienced significant growth and currently provides approximately two-thirds of long-term funding for residential and commercial properties in the United States. Today, the MBS market benefits from wide acceptance by investors of securitizations, and such securitizations serve as a vital component of real estate finance.

Given the efficiencies MBS provide the real estate market, MBS have become the norm for acquiring interests in mortgages. Regardless of whether an entity originates mortgage loans or acquires them by purchasing interests in a mortgage pool, its economic outcome is dependant on its ability to underwrite the mortgage loans if purchasing them directly or to re-underwrite the mortgage loans if acquiring an indirect interest in them by purchasing MBS. Similarly, regardless of whether an entity acquires mortgage loans directly or otherwise acquires an interest in them by purchasing MBS, the holder:

(i) provides a source of capital or, said differently, is acting as a mortgage lender;

(ii) faces default and prepayment risks associated with owning a pool of mortgages;

(iii) assesses the risks of the loans by analyzing the underlying properties;

(iv) determines whether the borrower/property has sufficient cash flow after expenses to service its debt; and

(v) determines the valuation of the underlying property and its potential impact on loan performance.

In today's securitization market, investors understand the importance of loan-level analysis as mortgage lenders reserve the option to either originate mortgages for securitization or to hold them to maturity.

IV. The Commission Should State that Certain Interests in Mortgages and Mortgage Pools are Qualifying Interests

The Commission has requested comments from industry participants on whether it should "define the term 'liens on and other interests in real estate' for purposes of Section 3(c)(5)(C)."[37] In order to clarify the meaning of this phrase, we respectfully submit that the Commission should affirm the Staff's no-action position that agency whole pool certificates and general partnership interests in companies investing in residential or commercial mortgage loans are Qualifying Interests. We also respectfully submit that the Commission should find and state that partial pool certificates are Qualifying Interests. We further believe the Commission should direct the Staff to work with the mortgage and securitization industries to recognize additional Qualifying Interests as the mortgage and securitization markets evolve.

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[37] The Release, 76 Fed. Reg. at 55,307.

For over 30 years the Staff has taken the position that agency whole pool certificates are Qualifying Interests.[38] The Staff has also taken the position that general partnership interests in companies investing in residential or commercial mortgage loans are Qualifying Interests.[39] We note that, in connection with the registration of offerings under the Securities Act, the Staff also has permitted mortgage REITs to count contiguous controlling classes of CMBS as Qualifying Interests.[40] We respectfully submit that the Commission should affirm each of these positions.

While we are aware that the Staff has taken the position that partial pool certificates that are not (i) controlling classes of MBS or (ii) certain classes contiguous to those controlling are not Qualifying Interests,[41] we disagree with the Staff's position and respectfully submit that all MBS partial pool certificates should also be treated as Qualifying Interests. The Staff's stated rationale for excluding partial pool certificates from Qualifying Interests is that "an investor in partial pool certificates obtains greater diversification and is subject to different prepayment risk than an investor who purchases the underlying mortgages directly. An investment in partial pool certificates is viewed as being more like an investment in the securities

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38 *See, e.g.*, American Home Finance Corp., SEC No-Action Letter, 1981 WL 26376 (May 11, 1981).

39 The Staff has stated that a general partnership interest in a partnership that owns a fee interest in real estate or owns mortgage loans is a Qualifying Interest where the general partner participates in the day-to-day management and control of the partnership and, in the case of a partnership that owns mortgage loans, has the unilateral right to cause the partnership to foreclose on those loans. *See* the NAB Letter, *supra* note 34, at *3; United States Property Investments, NV, SEC No-Action Letter, 1989 WL 246071 (May 1, 1989) (the "USPI Letter"); Capital Trust, Inc., SEC No-Action Letter, 2007 WL 1657352 (May 24, 2007) (citing the USPI Letter). The Staff has also permitted a general partnership interest to be a Qualifying Interest where the general partnership interest provided the applicant with substantial control over certain decisions of the partnership and did not merely render the applicant a general partner in form only. *See* MSA Realty Corp., SEC No-Action Letter, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,610 (Mar. 19, 1984).

40 *See, e.g.*, JER Investors Trust Inc., Amendment No. 6 to Registration Statement (Form S-11/A) at 65-66 (filed July 11, 2005); Starwood Prop. Trust, Inc., Amendment No. 5 to Registration Statement (Form S-11/A) at 102-03 (filed Aug. 11, 2009); Colony Fin., Inc., Registration Statement (Form S-11) at 118-19 (filed Jan. 15, 2010).

41 *See, e.g.*, *Protecting Investors*, *supra* note 27, at 73.

of an issuer, rather than an investment in the underlying mortgages."[42] We believe this rationale is misguided and that partial pool certificates should be Qualifying Interests.

We do not believe that partial pool certificates should be denied status as Qualifying Interests because they alter the payment streams from the underlying mortgages or because they provide their owners with a diversified risk profile. As discussed at length in this letter, all payments on an MBS are directly linked to and based on payments of interest and repayments of principal on the mortgage loans underlying the MBS. The only source of payment not derived from the underlying mortgage loans are any payments received from a guarantor of the MBS, if any, which payment source is also present with respect to agency whole pool certificates which have been recognized by the Staff as Qualifying Interests for over 30 years. The fact that the securitization structure of a pool permits us to increase our diversification across more mortgages with the same amount of money invested or to pick a more or less senior position in a mortgage pool's capital structure does not alter the fact that an MBS is still an interest in real estate because the economics of the investment are based on a passive pool of underlying mortgages.

We believe that Qualifying Interests should include any security collateralized by a perfected interest in a passive pool of residential or commercial real estate loans because the unique features of MBS make them more similar to owning real estate interests than interests in the nature of a passive investment in a person engaged in a real estate business. Because the underlying pool of mortgages in a MBS is not actively managed, MBS owners actively approach and treat the investments as though they were direct real estate investments. Our ability to profit from an investment in a partial pool certificate derives primarily from our ability to analyze the pool of mortgages underlying the certificates. As illustrated by the recent credit crisis and continued economic malaise, partial pool interests, including senior classes of MBS, are subject to real losses of principal as mortgage loan defaults escalated, in some cases even at the AAA-rated credit level. Partial pools, including senior classes of MBS, like whole pools and their respective underlying mortgages, are affected by changes in regional or local economic conditions or specific industry segments, declines in regional or local real estate values, declines in regional or local rental or occupancy rates, increases in interest rates, real estate tax rates and other operating expenses. Accordingly, we perform a loan-by-loan

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[42] *Id.*

underwriting on mortgage loans underlying our MBS regardless of whether they are whole pool or partial pool interests. As a result, our return on an MBS investment is not at all based on the efforts of others, which the Commission suggested is a criterion for determining whether an asset is a Qualifying Interest when it stated that Qualifying Interests do not include investments in REITs (which are actively managed pools of real estate interests) or other entities engaged in a real estate business.[43]

We believe that the broad language used by Congress in drafting Section 3(c)(5)(C) encompasses MBS because it applies to all "other . . . interests in real estate."[44] As discussed above, Congress has consistently indicated that the Investment Company Act was not intended to regulate companies that are primarily engaged in the business of owning and otherwise acquiring mortgages and other interests in real estate. The Exclusion applies not only to companies directly acquiring mortgages, but also to companies primarily engaged in the business of "*otherwise acquiring* mortgages and *liens on and other interests in* real estate."[45]

We further believe that the decision to treat MBS as Qualifying Interests cannot turn on whether they are securities for purposes of the Investment Company Act but rather must turn on whether they are sufficiently real estate related. Congress has recognized that companies relying on the Exclusion invest in securities, but has nevertheless excluded them from regulation as investment companies.[46] In other words, Congress has determined that companies that primarily

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[43] Real Estate Investment Trust, Investment Company Act Release No. 3140, 25 Fed. Reg. 12178 (Nov. 18, 1960).

[44] 15 U.S.C. § 80a-3(c)(5)(C).

[45] *Id.* (emphasis added).

[46] *See* S. Rep. No. 91-184, at 34 (1969) (stating that the Exclusion was for "companies [that] have portfolios of securities in the form of . . . mortgages and other liens on and interests in real estate"); *see also* Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth, H.R. Rep. No. 89-1046, at 328 (Dec. 2, 1966) (stating that although companies relying on the Exclusion are engaged in "acquiring mortgages and other interests in real estate – thus acquiring investment securities, such activities are generally understood not to be within the concept of a conventional investment company which invest in stocks and bonds of corporate issuers"). If the assets in which a REIT was expected to invest were not securities for purposes of the Investment Company Act, the Exclusion would be unnecessary.

invest in securities in the nature of mortgages or that otherwise acquire liens on and interests in real estate are not similar to investment companies and should not be regulated under the Investment Company Act.

In order to properly determine which assets constitute Qualifying Interests, we respectfully submit that the Commission needs to consider (i) the overall composition of the United States mortgage market and how it has evolved and will continue to evolve over time and (ii) the congressional intent underlying both the Investment Company Act and the creation of Fannie Mae, Freddie Mac, Ginnie Mae and the Federal Housing Administration, each of which was created to promote the real estate industry. As discussed above, mortgage origination is now, and will be in the future, largely supported and propagated by the securitization process in one form or another. In order to be successful in the mortgage market, investors participating in the securitization process must be experienced in real estate, utilize the same tools lenders use to evaluate the borrowers and underlying properties and be willing to put forth private capital to support their investments in real estate. Furthermore, the capital we invest in MBS is subsequently used to finance the future origination or purchase of additional mortgages.

In light of the foregoing, we respectfully submit that it would frustrate congressional intent to treat a mortgage as a Qualifying Interest but not certificates representing an ownership interest in a passive pool of mortgages and that the Commission should find and state that partial pool certificates are Qualifying Interests. Partial pool certificates are interests in passively held pools of mortgages. Our returns on those interests do not depend primarily on the efforts of others. Instead, they depend primarily on our ability to analyze the underlying pool of mortgages and their related risks, which is the same analysis we would undertake if we purchased or underwrote the mortgages directly. MBS have become the primary means of acquiring interests in mortgages and financing the mortgage industry. As such, it would frustrate congressional intent to deny MBS status as Qualifying Interests.

In addition, we encourage the Commission to direct the Staff to work with the mortgage and securitization industries to recognize additional Qualifying Interests as the mortgage and securitizations markets evolve. Such collaboration is necessary to provide clarity to the mortgage and securitization industries in light of the constantly evolving environment.

For example, we note the following current developments in the mortgage securitization industry: (i) the Commission, along with other regulators, has proposed rules requiring securitization sponsors to retain a portion of the credit risk in the assets that they securitize;[47] (ii) in October 2011, Freddie Mac announced that it may commence issuing subordinated tranches of agency MBS to investors as a template for future agency MBS[48]; and (iii) the Obama administration's recent white paper on housing finance reform[49] also advanced the concept of subordinated tranches of agency MBS to investors in an effort to attract private capital and reduce the U.S. taxpayer's risk associated with mortgage securitizations guaranteed by GSEs such as Freddie Mac. Any of the foregoing actions would eliminate the whole pool certificate concept and require the acceptance of partial pool certificates as Qualifying Interests in order for the Exclusion to be meaningful and effect congressional intent. Unless the Commission and its Staff collaborate with the mortgage and securitization industries to identify new Qualifying Interests, innovation of real estate products and capital formation will be stymied.

V. Mortgage REITs are More Similar to Lenders than Investment Companies Registered under the Investment Company Act

The Commission requested comments on the differences between mortgage-related pools and traditional investment companies.[50] We respectfully submit that mortgage REITs are more similar to lenders than investment companies regulated by the Investment Company Act based on mortgage REITs' involvement in the underwriting, management and monitoring of MBS. In addition, the owners of MBS (both in whole pool and partial pool form):

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47 *See, e.g.*, Section 15G of the Exchange Act (requiring the Commission and various financial and housing regulators to proposed joint regulations regarding credit risk retention in securitizations); Credit Risk Retention, 76 Fed. Reg. 24090 (April 29, 2011) (proposing credit risk-retention rules).

48 Jody Shenn, *Freddie Mac Eyeing Risk-Sharing in Home-Loan Bonds, CEO Says*, Bloomberg.com, *available at* http://www.bloomberg.com/news/2011-10-11/freddie-mac-eyeing-risk-sharing-in-home-loan-bonds-ceo-says.html (last visited Nov. 7, 2011).

49 *See* The Dep't. of the Treas. & U.S. Dep't. of Hous. & Urb. Dev., *Reforming America's Housing Market: A Report to Congress* (Feb. 2011).

50 *See* the Release, 76 Fed. Reg. at 55,304, 55,307.

(i) have economic experiences dependant on the performance of the underlying mortgages given that all the cash flows from the certificates are derived from mortgages;

(ii) must have the capability to appraise and monitor the underlying mortgages; and

(iii) are harmed when there is a default and only a partial or no recovery is received, thereby reducing the owner's collateral or causing its asset to be written down.

Our Manager and its affiliates have a team of approximately 15 professionals dedicated to the underwriting, managing and monitoring of our MBS. The team's primary purpose is to re-underwrite the pools of residential and commercial loans underlying our MBS investments and to monitor their performance. In addition, team members are responsible for determining the credit worthiness of borrowers and the value of real estate underlying mortgage loans.

Our Manager's residential mortgage team uses a residential loan database (First American CoreLogic) to formulate assumptions on the basic drivers of mortgage credit performance, default, prepayment, and loss in the event of default. We believe that no matter the original rating on a MBS, a detailed credit underwriting process is required to form an opinion regarding the anticipated performance of the underlying mortgage loans. A complete and thorough valuation must be assigned to each property, and the mortgage interest must be priced according to the ultimate expected performance of the underlying mortgage loan. That fact requires the team to approach each underlying mortgage loan as a mortgage originator would in analyzing loss reserves and available credit enhancements. The same general process is applied for our CMBS investments and our RMBS investments. Our Manager underwrites each underlying property in a loan pool using both an income-based and a comparables-based approach and has invested heavily in an array of tools and resources needed to accomplish this process, including: CoStar, Trepp and Morningstar (formerly Realpoint).

Each aforementioned activity is also undertaken by lenders that invest in mortgages. In fact, there are very few discernable differences in the investment approaches undertaken by the investment teams for mortgage REITs and lenders.

VI. The Commission Should Not Seek to Regulate Leverage Employed by Mortgage REITs

In the Release, the Commission noted that mortgage REITs often employ leverage in excess of the limitations imposed on registered investment companies by the Investment Company Act.[51] We are not aware of any authority for the Commission to impose substantive limits on the use of leverage by companies excluded by Congress from regulation as investment companies. Furthermore, substantially all other financial companies excluded from registration as investment companies under Section 3(c) of the Investment Company Act employ leverage that is not only in excess of the limitations imposed on registered investment companies but also in excess of the levels of leverage typically employed by mortgage REITs, yet the Commission has not sought to regulate the amount of leverage such companies can employ. In this regard, we note that we and our peer mortgage REITs are, on average, less leveraged than many of the types of financial companies that the Investment Company Act also does not regulate. For example, we are considerably more collateralized than the average U.S. bank.[52] While it may be argued that the amount of leverage of many of the FDIC-insured institutions does not necessitate regulation under the Investment Company Act because they are subject to other statutory and regulatory frameworks and supervision by other federal agencies, this is not true for other types of financial companies exempt from regulation under the Investment Company Act, such as sales finance companies[53] and consumer finance companies.[54] Even in interest rate environments where there was considerably less interest rate risk than in the current environment, our leverage was lower than that

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[51] *See* the Release, 76 Fed. Reg. at 55,302, nn.19-20.

[52] As of June 30, 2011, our debt-to-equity ratio was 6-to-1 – approximately a 84.13 debt ratio. *See* Invesco Mortgage Capital Inc., Quarterly Report (Form 10-Q) at 1 (filed Aug. 9, 2011) (debt ratio calculated by dividing total liabilities by total assets). By contrast, as of June 30, 2011, the average debt ratio for all institutions insured by the FDIC was 88.70 – just under a debt-to-equity ratio of 10-to-1. Fed. Dep. Ins. Corp., *Statistics at a Glance as of June 30, 2011*, *available at* http://www.fdic.gov/bank/statistical/stats/2011jun/industry.html (last visited Nov. 4, 2011). The FDIC, when calculating the leverage ratio for insured institutions, makes certain minor subtractions and additions to the GAAP-reported equity and assets amounts (e.g., equity does not include non-controlling (minority) interests in consolidated subsidiaries). "GAAP" refers to U.S. Generally Accepted Accounting Principles.

[53] *See* 15 U.S.C. § 80a-3(c)(5)(A)-(B).

[54] *See* 15 U.S.C. § 80a-3(c)(4).

employed by banks and other financial companies, which we believe have riskier businesses than ours. We respectfully submit that the Commission should not single out mortgage REITs from all of the other types of financial companies excluded from regulation as investment companies by Section 3(c) in order to impose leverage limitations similar to those imposed on registered investment companies.

Assuming *arguendo* that the Commission had the authority to adopt a rule under Section 3(c)(5)(C) imposing leverage limits on mortgage REITs comparable to the leverage limits imposed on registered investment companies, we believe that any such rule would have a material adverse impact on the mortgage REIT industry, have a material adverse effect on the more than $30 billion worth of common stock issued by mortgage REITs[55] and owned by investors and harm the ability of our financial institutions to engage in mortgage lending. Consequently, we respectfully submit that the Commission would need to carefully and extensively study the economic impact of any such rule on existing mortgage REITs, the mortgage industry and the economy, that the Commission likely would be unable to satisfy the requirements imposed on it by the Administrative Procedure Act[56] and, consequently, that any such attempted rule making likely would be vacated by the courts.[57]

We are unaware of any empirical evidence that the amount of leverage used by publicly traded REITs like the Company has unduly put investors at risk. The Release errs in its characterization of Carlyle Capital Corp. (the "Carlyle Fund") as a mortgage REIT. Not only was the Carlyle Fund not a REIT, but it was not even a mortgage pool; instead, it was a Euronext[58] listed corporation that was

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55 NAREIT, Historical REIT Industry Market Capitalization: 1972-2010, *available at* http://www.reit.com/IndustryDataPerformance/MarketCapitalizationofUSREITIndustry.aspx (last visited Nov. 4, 2011) ("NAREIT").

56 5 U.S.C. §§ 551-559.

57 *See, e.g.*, Bus. Roundtable v. SEC, 647 F.3d 1144, 1148-49 (D.C. Cir. 2011); Goldstein v. SEC, 451 F.3d 873 (D.C. Cir. 2006); Chamber of Commerce v. SEC, 412 F.3d 133, 143-44 (D.C. Cir. 2005). In addition, Section 2(c) of the Investment Company Act requires the Commission to consider in connection with any potential rulemaking not only investor protection, but also whether the rule will promote efficiency, competition and capital formation. 15 U.S.C. § 80a-2(c).

58 Euronext is a European equities and derivatives exchange that is a part of NYSE Euronext, Inc., a New York-based corporation that operates the NYSE and other stock exchanges.

publicly offered outside the United States. It was designed to invest generally in fixed-income instruments that happened to invest in non-whole pool MBS at the height of the financial crisis just as the value of its assets declined precipitously.[59] Moreover, regardless of the type of investments the Carlyle Fund made, it never relied on Section 3(c)(5)(C) for its exclusion from the Investment Company Act. The Carlyle Fund was organized and publicly offered only outside the United States. The Carlyle Fund's securities were privately placed inside the United States only to sophisticated investors, and the Carlyle Fund was excluded from registration as an investment company under the Investment Company Act by Section 3(c)(7). In other words, even if the Commission had implemented rules and restrictions on companies relying on the Exclusion prior to the Carlyle Fund's offering, such regulations would not have been applicable to the Carlyle Fund or limited its operations or private placement to investors in the United States and would not have prevented the losses suffered by its investors.

Our leverage policies are overseen and monitored by our Board and are set and adjusted from time to time with a view towards the best interests of our shareholders. The amount of leverage we incur is also influenced by the market. If we become over-leveraged, our share price may be adversely affected and our access to financing may become limited because our lenders may no longer lend to us or lend only on terms that are so onerous that the additional leverage becomes uneconomical.

In light of Congress' determination to exclude companies that primarily own or otherwise acquire mortgages and other liens on and interests in real estate from regulation as investment companies, we respectfully submit that the Commission should not now seek to impose restrictions, such as leverage limitations, on mortgage REITs that are similar to restrictions applicable to registered investment companies. Instead, if the Commission believes that additional regulation of the use of leverage by mortgage REITs is necessary for investor protection, the best way to provide that protection would be through enhanced disclosure requirements, an area clearly within the Commission's purview.

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[59] *See* Henry Sender, *Leverage Levels a Fatal Flaw in Carlyle Fund*, Fin. Times, Nov. 30, 2009, *available at* http://www.ft.com/intl/cms/s/0/1590c700-dde8-11de-b8e2-00144feabdc0.html#axzz1b6X5I118 (last visited Oct. 18, 2011).

We regularly disclose our leverage policies and the amount of leverage we incur to our shareholders. These disclosures are included in our prospectuses, registration statements, and filings on Forms 10-Q and 10-K. Mortgage pools like the Company are acutely aware of the material impact that changes in interest rates can have on the performance of our stock.[60] We support efforts to ensure that mortgage REITs clearly and fully disclose their leverage policies and leverage usage and attendant sensitivity to changes in interest rates so that investors can be fully aware of the leverage risks associated with mortgage REITs and make informed investment decisions.

VII. Publicly Traded Mortgage REITs Like the Company Protect Investors by Employing Corporate Governance Standards and a Registered Investment Adviser

Regulation of mortgage REITs like the Company as investment companies is unnecessary in light of the numerous investor protections that exist in our structure and operations. Currently applicable regulations and our policies and procedures minimize potential abuses and protect investors. We are subject to extensive regulatory regimes that prevent us from engaging in many of the practices intended to be addressed by the Investment Company Act even though we are not regulated as investment companies. In addition, we are not aware of any wellspring of public or congressional concern that mortgage REITs, which have been offered to investors for over 40 years and structured in reliance on the Staff's longstanding interpretations of the Exclusion, pose a risk to investors that the Investment Company Act was designed to protect against. We also are not aware of any evidence that mortgage REITs present a regulatory risk. In fact, the enforcement actions cited in the Release generally did not involve publicly traded mortgage REITs, and the one that did involved a violation of disclosure and reporting requirements under the Exchange Act.[61] The regulation of mortgage REITs as

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[60] The 10-K includes extensive risk factors on interest rates, leverage and mortgage market conditions. *See* Invesco Mortgage Capital Inc., Annual Report (Form 10-K) (filed Mar. 14, 2011).

[61] The one enforcement action cited in the Release involving a REIT was instituted as a result of an executive of a REIT and some of its related parties failing to file a Schedule 13D, as a group, in connection with an investment in a non-REIT company. The Release cites this action for the concern that REIT insiders may engage in "overreaching." The Release, 76 Fed. Reg. at 55,303. We respectfully submit that the failure of an officer of a company to appropriately identify

investment companies at a time when there is no evidence that such regulation is necessary to protect investors would only harm the investors that today own more than $30 billion of common stock issued by mortgage REITs[62] and would adversely affect the mortgage industry at a challenging time when federal policy makers are seeking ways to increase the flow of private capital to the industry.

As discussed above, our Manager is registered as an investment adviser under the Advisers Act. Investment advisers owe their clients fiduciary duties and are subject to the Commission's regulatory oversight, including requirements to adopt and adhere to a robust compliance program, including, among others, a code of ethics,[63] an annual compliance review,[64] insider trading policy[65] and investment allocation policies whereby investment decisions are made in a fair and equitable manner with respect to all clients and subject to fiduciary duties owed to those clients. Our shareholders benefit from the regulation of our Manager because the regulations create transparency and add an additional layer of protection in the Manager's treatment of our assets. For example, the Commission can already protect our shareholders through its oversight of our Manager. In the event our Manager breaches its fiduciary duties by engaging in prohibited activities such as misvaluing or misappropriating our investments, the Commission would have the authority to bring an enforcement action against our Manager in an effort to protect our shareholders.[66]

As a publicly traded REIT, we are also subject to the requirements of Sarbanes-Oxley, the registration requirements imposed by the Securities Act, the disclosure and reporting requirements of the Exchange Act and Maryland state law. We also are subject to the NYSE Rules and Listing Requirements, including the requirement that a majority of our directors be independent.

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himself as part of a Section 13(d) group is not the type of "overreaching" the Investment Company Act was intended to address and that citing this enforcement action does not support the suggestion that mortgage REITs might appropriately be regulated as investment companies.

62 *See* NAREIT, *supra* note 53.

63 17 C.F.R. § 275.204A-1 (2011).

64 17 C.F.R. § 275.206(4)-7 (2011).

65 *See* 15 U.S.C. § 80b-4a.

66 *See* 15 U.S.C. §§ 80b-6, § 80b-9.

Additionally, we maintain stringent internal controls over financial reporting in order to provide our shareholders with reasonable assurance regarding the reliability of our financial reports and the preparation of financial statements in accordance with GAAP. As part of this process, we have retained an independent registered public accounting firm responsible for auditing our financial statements.[67] Our auditor reviews and opines upon our internal control environment based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

As discussed above, we have also adopted several policies designed to protect our shareholders. Our compliance program, including our Code of Ethics, Related Party Transaction Policy and Insider Trading Policy ensures that our directors and officers adhere to the highest legal and ethical standards when performing their duties.

These practices, which today are required by the regulatory regimes of the federal securities laws, achieve one of the principal goals of the Investment Company Act when it was adopted: eliminating the past practice of investment companies of engaging in unsound and misleading accounting and financial practices and avoiding independent third-party scrutiny.

VIII. Leveraged Mortgage Pools are Critical to Capital Formation in the Mortgage Industry

Regulation by the Commission of mortgage REITs like the Company would run counter to the Commission's stated goal of facilitating capital formation. Mortgage REITs provide a significant conduit for private capital to enter into the mortgage market. Approximately 30 years ago, Congress enacted laws designed to increase private participation in what had been a mortgage finance market dominated by GSEs and U.S. Government agencies.[68] However, since the onset of the 2008

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[67] *See* 2011 Proxy, *supra* note 7, at 23.

[68] *See* Secondary Mortgage Market Enhancement Act of 1984, S. Rep. No. 98-293, at 2 ("Due to the projected magnitude of the demand for mortgage credit, the existing Federal agencies simply will not be able to provide all of the liquidity for mortgages that will be required during the remainder of this century. . . . The clearly defined course of action for this Committee became, therefore, one of seeking to broaden the number of participants channeling investor capital to the homebuyer. If Fannie Mae and Freddie Mac have met the objectives for which they were

financial crisis, federally-chartered corporations and U.S. Government agencies like the Federal Housing Administration have in fact become responsible for an even larger share of mortgage-related credit.[69] The cost of credit from non-governmental sources has remained relatively high, and private lenders have continued to adhere to tight lending standards that have made access to non-guaranteed credit difficult.[70]

The securitization market provides the capital necessary to facilitate the origination of new mortgage loans as evidenced by the fact that approximately two-thirds of the $11 trillion U.S. mortgage market is securitized in some form.[71] In addition, for the first quarter of 2011, approximately 97% of mortgages originated were GSE securitizations.[72] While this represents an increase from 2010 when 87.5% of all mortgages originated in the U.S. were GSE securitizations,[73] this trend is inconsistent with the congressional and U.S. Treasury's intent of diminishing the role of GSEs in the mortgage market.

Given the current economic environment, we believe that private participation in the U.S. mortgage market is critical to the resumption of large scale lending (and securitization of those loans) and the future health and stability of the housing market. The Exclusion, along with the unique tax status of REITs, makes the mortgage REIT industry uniquely suited to aid the U.S. Government in reducing the role of the GSEs in the mortgage market. The mortgage REIT industry can also aid in creation of new loans through actively purchasing MBS and/or originating new loans, thus reducing the role of the GSEs and decreasing the U.S. Government's financial exposure to the mortgage market. Further restriction of the Exclusion's

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originally created, then the foundation is in place for the private sector to assume a more significant market role.").

69 *See* Credit Suisse Group AG, Agency MBS Trends, Presentation to the Mortgage Bankers Association, at 2, 12 (May 2010), *available at* http://www.mortgagebankers.org/files/Conferences/2010/NationalSecondary/SMKT10AgencyMBSTrends.pdf (last visited Sept. 28, 2011).

70 *See id.* at 13.

71 Bank of America & Merrill Lynch, The Mortgage Credit Round-up, Presentation, at tbl. 2 (Sept. 5, 2011).

72 Amherst Securities Group, LP, Outlook and Opportunities in the US RMBS Market, Presentation, at 5 (Sept. 2011).

73 *Id.*

availability to mortgage REITs like the Company, however, would harm the potential for mortgage REITs to buoy the domestic mortgage market as the economy continues to sputter and as the U.S. Government reexamines its role in the mortgage market. Such harm would likely damage the mortgage market as a whole, and the effects of such damage could spread to the entire domestic economy, of which the ailing housing market is and will remain a significant piece.

In addition, we believe that restricting or reducing the amount of leverage mortgage REITs can incur as a result of regulation under the Investment Company Act would negatively impact the domestic economy. Implementing leverage restrictions on mortgage REITs would reduce the amount of capital available for real estate investment. This would increase borrowing costs to potential homeowners, dampening demand for housing and placing downward pressure on housing prices. A drop in housing prices would further harm existing homeowners, as the value of their homes decrease towards, and potentially below, the balance on their mortgages, causing homeowners to reduce their spending elsewhere in their budget.

IX. Conclusion

We are a company primarily engaged in owning or otherwise acquiring mortgages and other liens on and interests in real estate. We adhere to the highest standards of fiduciary duty to our shareholders. Our Manager is registered and regulated by the Commission as a registered investment adviser, and our audit committee, which is comprised entirely of independent board members, must approve all related party transactions. An independent, third party determines the market value of our assets, and our independent, external auditor ensures such valuations are accurate and reflected in our filings with the Commission. Our assets are held in custody by an independent custodian to ensure protection of our shareholders' interests.

We utilize leverage that is lower than other similar financial companies. Leverage levels are approved by our Board, our lenders, and ultimately our shareholders through our public disclosures.

Congress has recognized and reaffirmed on several occasions that it did not intend the Investment Company Act to regulate companies primarily engaged in the business of owning or otherwise acquiring mortgages and other liens on and interests in real estate because they do not come within the generally understood

concept of a conventional investment company investing in stocks and bonds of corporate issuers. We reiterate that the phrase "mortgage banking business" does not appear in the legislative history of the Investment Company Act or the Commission Report.

The Staff, through its long history of no-action letters, has confirmed that agency whole pools and general partnership interests in companies investing in residential or commercial mortgage loans are Qualifying Interests. The Staff, in connection with the registration of offerings under the Securities Act, has also permitted mortgage REITs to count contiguous controlling classes of MBS as Qualifying Interests. We respectfully submit that the Commission should affirm the Staff's historical position regarding these real estate assets.

We also respectfully submit that the Commission should state that any MBS investment, including a partial pool certificate, is a Qualifying Interest if it represents a beneficial interest in a passive pool of mortgages, such that the returns on the MBS are primarily derived from the underlying pool of mortgages.

We are pleased to have provided this comment letter to the Commission in response to the Commission's solicitation for comment on the Release. We again commend the Commission's interest in providing clarity, consistency and regulatory certainty to the mortgage industry in a manner that facilitates capital formation and hope that our comments will assist the Commission in its efforts.

Please contact me with any questions relating to this comment letter.

Very truly yours,

Richard J. King
President and Chief Executive Officer

cc: Mary L. Shapiro, Chairman
Elisse B. Walter, Commissioner

Elisse B. Walter, Commissioner
Luis A. Aguilar, Commissioner
Troy A. Paredes, Commissioner
Eileen Rominger, Director, Division of Investment Management