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November 14, 2011

U.S. 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:

This letter is submitted on behalf of the Federal Regulation of Securities Committee and the Securitization and Structured Finance Committee (the "Committees") of the Business Law Section of the American Bar Association (the "ABA") 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").[1]

The comments expressed in this letter represent the views of the Committees only and have not been approved by the ABA's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, this letter does not represent the official position of the ABA Business Law Section.

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 that are 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

[1] 76 Fed. Reg. 55300 (August 31, 2011).

area. The Commission's goals in this effort are to: (1) be consistent with the Congressional intent underlying the exclusion from regulation under the 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.[2]

This letter will focus primarily on interpretive issues relating to the status of mortgage-related pools under the Act, including topics as to which comment is requested on the current state of guidance concerning Section 3(c)(5)(C). We leave it to other commenters, such as trade groups and industry associations, to respond to the requests for information about the companies that rely on Section 3(c)(5)(C). Such groups are in a better position to describe the types of such companies; how such companies are operated; the types of investors that invest in such companies; and the roles of such companies in the mortgage markets. For the same reason, we are not addressing the types of potential abuses that the Investment Company Act was intended to prevent, which might be associated with mortgage-related pools or whether, or to what extent, such potential abuses are addressed by any industry practices or other regulatory schemes that may be applicable to mortgage-related pools.

I. GUIDANCE AND INTERPRETATION WITH RESPECT TO SECTION 3(c)(5)(C) TO DATE

In our view, the guidance and interpretation regarding Section 3(c)(5)(C) issued by the Commission and the staff to date have properly observed established principles of statutory interpretation and have not gone beyond the intended scope of the exclusion nor been inconsistent with investor protection.

A. Application of the "Plain Meaning Rule" to Section 3(c)(5)(C).

1. *The "plain meaning rule" is an established principle for statutory interpretation.*

Under the plain meaning rule, it is not appropriate to turn to the legislative history of a statute when the statutory language is plain on its face.[3] As explained by Justice Scalia in INS v. Cardoza-Fonseca, 480 U.S. 421, 452-53 (1987): "Judges interpret laws rather than reconstruct legislators' intentions. Where the language of those laws is clear, we are not free to replace it with an unenacted legislative intent." We believe that the same rule is appropriate to guide the Commission in issuing interpretations of Section 3(c)(5)(C) and, except as set forth below, the

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

[3] Yule Kim, *Statutory Interpretation: General Principles and Recent Trends*, Congressional Research Service (August 31, 2008), at 39.

Commission and the staff have generally followed this rule in issuing guidance and interpretations to date.

2. *The 55% test and interpretations on "qualifying interests" have followed the plain meaning rule.*

a. *The staff's development of the 55% test to determine if an entity is "primarily engaged" in activities within the scope of the Section 3(c)(5)(C) activities is an example of applying the plain meaning rule to interpret the exclusion.*

As stated in the Concept Release, in providing guidance on Section 3(c)(5)(C) the staff generally has focused on whether at least 55% of the issuer's assets will consist of mortgages and other liens on and interests in real estate ("qualifying interests") and the remaining 45% of the issuer's assets will consist primarily of real estate-type interests ("real estate-type interests") (the "55% test").[4] In creating the 55% test, the staff focused on the plain meaning of "primarily" along with the language "[engaged in the business of] purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." This language contemplates an asset-based test with more than a majority of such assets constituting mortgages and other qualifying interests. The staff did not depart from the language itself to delve into the legislative history of Section 3(c)(5)(C) to determine if Congress intended the language to apply only to the types of mortgages and other liens on real estate in existence at the time of enactment of the Act in 1940 or to the types of companies engaged in the mortgage banking business at that time.

b. *Similarly, the Commission and the staff have properly focused on the language "mortgages and other liens on and interests in real estate" to determine what instruments constitute qualifying interests.*

Under the plain meaning approach, the staff has required that qualifying interests represent either (i) loans or liens fully secured by real estate or actual interests in real estate; or (ii) assets that can be viewed as the functional and economic equivalent of such loans or liens or interests in real estate.

c. *Consistent with the Commission's view expressed in the 1960 Release, the staff has taken the position that assets representing "indirect" interests generally are not considered qualifying interests, with the two exceptions noted in the Concept Release.*

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[4] 76 Fed. Reg. 55300 (August 31, 2011). We believe that issuers generally take the view that they must satisfy the 55% test on a continuous basis (that is, at all points in time) in order to qualify for the exclusion. The plain language of Section 3(c)(5)(C), however, would also appear to permit other asset-based tests such as a weighted average over a specified time period.

Agency whole pool certificates are deemed qualifying interests based on the functional equivalent approach. This is a reasonable interpretation of the statutory language because the holder has the same economic experience as an investor that purchases the underlying mortgages directly, as pointed out in the Concept Release. In our view, the presence of Agency guarantees with respect to such whole pool certificates does not change the analysis. Many commercial mortgage loans carry guarantees of the developers/promoters, but the presence of such guarantees would not generally be thought to preclude the status of such mortgage loans as qualifying interests.

Similarly, certain subordinate participations in commercial real estate first mortgage loans are also deemed to be qualifying interests, as representing the functional equivalent of a direct interest in real estate.

In both exception cases, the staff has properly followed the plain meaning rule, focusing on the attributes of a "mortgage" or "interest in real estate." The staff did not turn to legislative history to seek to determine whether these types of instruments were the types intended by Congress to be covered by the statutory language.

II. FUTURE GUIDANCE BASED ON LEGISLATIVE HISTORY

A. Concept Release Requests Comments on Legislative History Approach.

The Concept Release states that the "Commission is concerned that certain types of mortgage-related pools today . . . may not be the kind of companies that were intended to be excluded from regulation under the Act by Section 3(c)(5)(C)."[5] In the Proposing Release to Rule 3a-7, in discussing the legislative history of the Act the Commission stated that Section 3(c)(5)(C) "originally was intended to exclude issuers engaged in the commercial finance and mortgage banking industries."[6]

The Concept Release invites input on how the characteristics of mortgage-related pools may serve to distinguish them from traditional investment companies and whether a test could be devised that would differentiate companies primarily engaged in the real estate and mortgage banking business from companies that resemble traditional investment companies.[7]

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[5] 76 Fed. Reg. 55301 (August 31, 2011).

[6] 76 Fed. Reg. 55304, Footnote 38 (August 31, 2011).

[7] 76 Fed. Reg. 55307 (August 31, 2011).

B. Legislative History Should Not Be Basis for Future Guidance on Section 3(c)(5)(C).

1. *The Commission and the staff should continue to follow the plain meaning rule.*

In our view, any attempt to alter existing guidance based on the legislative history of Section 3(c)(5)(C) would be inappropriate. The Commission and the staff should continue to embrace the plain meaning rule. In adopting Section 3(c)(5)(C), Congress chose language that focuses on the assets held by a company. 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 what type of companies would qualify for the exclusion, Congress did not. In our view, it would be inappropriate for the Commission or the staff to issue guidance that attempts to do what Congress could have done but did not.

Even if it were appropriate to look to the legislative history of Section 3(c)(5)(C) to support future guidance, it would appear that such legislative history is not a fruitful source of information on which detailed, bright-line guidance could be based. Based on the excerpts from the 1970 House Report and the PPI Report included in the Concept Release, there is little legislative history of the intent of Congress beyond the thought that the types of companies excluded by Section 3(c)(5)(C) were outside of "the generally understood concept of a conventional investment company investing in stocks and bonds of corporate issuers."[8]

2. *Fact that Congress has not acted to amend Section 3(c)(5)(C) is also relevant.*

The fact that Congress has not acted to amend Section 3(c)(5)(C) supports the approach taken to date by the Commission and the staff in issuing interpretations and guidance on Section 3(c)(5)(C). For example, in adopting amendments to many of the Federal securities laws as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress left Section 3(c)(5)(C) untouched.

3. *Legislative history may be appropriate for developing new legislative proposals for Congress.*

We believe that information received from responses to the Concept Release on the legislative history-related topics may be useful to the Commission in informing any proposals to amend Section 3(c)(5)(C) that the Commission may determine to pursue with Congress.

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[8] 76 Fed. Reg. 55304, Footnote 38 (August 31, 2011).

III. NEED FOR COMMISSION INTERPRETATION AND GUIDANCE

Although we leave to others to supply quantitative support, we believe that mortgage-related pools, particularly mortgage REITs, play an important role in the mortgage market. Some of these entities originate and service mortgage loans while others invest in mortgage loans, providing liquidity to the mortgage market. Congress is currently in the process of evaluating the role that Fannie Mae and Freddie Mac should play, if any, in the future of the residential mortgage markets. If Congress ultimately determines to reduce the role of the government-sponsored entities, the importance of the mortgage-related pools will be significantly increased, as will the need for clarity and certainty in the applicability of the Section 3(c)(5)(C) exclusion. We believe that the Commission's future guidance and interpretations in this area should be guided by and supportive of Congress' ultimate decision on the future composition of the mortgage market.

A. Further Guidance With Respect to Section 3(c)(5)(C).

As noted above, we commend the Commission and the staff for acting in a manner generally consistent with the plain meaning of the statute and Congressional intent, and in a manner consistent with the purposes of the Act, the public interest and protection of investors. We believe, however, that the Commission could take steps to provide greater clarity, consistency and regulatory certainty in this area, which would facilitate capital formation.

The Commission itself has not addressed the scope of Section 3(c)(5)(C) since 1960, when it issued a release discussing the applicability of the federal securities laws to REITs.[9] For a number of years, the staff has provided guidance to the industry through the no-action letter process. In recent years, the staff has also issued new interpretations of the law through the registration statement comment process.

Much of the uncertainty about Section 3(c)(5)(C) arises from questions about the way in which various assets should be classified for purposes of the 55% test. From time to time, the industry has been forced to change course as the staff has decided that an instrument that would appear to be a qualifying interest cannot be treated as a qualifying interest unless it satisfies new criteria articulated by the staff in a no-action letter or, more frequently in recent years, in the staff's comments with respect to a registration statement.[10] This "regulation by registration" has led to uncertainty in the marketplace, thereby hindering capital formation.

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[9] *Real Estate Investment Trusts*, Investment Company Act Release No. 3140 (Nov. 18, 1960) (discussing Section 3(c)(6)(C), which was subsequently redesignated as Section 3(c)(5)(C)).

[10] One example is the SEC correspondence leading up to the effectiveness of JER Investors Trust Inc.'s registration statement. The view of the industry at that time is reflected in the correspondence dated May 16, 2005, in which the staff was asked to concur with the view that a company that holds a majority interest in the most subordinate class of a commercial mortgage backed securities issuance where the holder is granted control rights, including the unilateral right to foreclose, could count its entire investment in that CMBS issuer as qualifying interests.

For that reason, we believe that it would be more appropriate for the Commission to take action to clarify its interpretation of Section 3(c)(5)(C) in a manner that permits the public, including investors, to provide meaningful input and comment. We urge the Commission to work with the industry to establish a set of principles-based rules, based on the language of the statute, that will provide companies and their counsel with guidance on what instruments constitute qualifying assets. Establishing such a rule will not be easy because it must be flexible enough to accommodate product innovation and other changes in the industry that inevitably will occur over time. Nonetheless, we believe that establishing a set of principles in the context of a rule, with notice and comment permitted by the public, including issuers and investors, is the right way to approach this issue.

B. Further Guidance With Respect to Section 3(c)(6).

Another example of uncertainty in this area arises not from the definition of "qualifying assets," but with another aspect of assessing compliance with the statute. Until around 2005, we believe that most companies were assessing their compliance with the Section 3(c)(5)(C) exclusion by analyzing the nature of their assets on a consolidated basis under generally accepted accounting principles ("GAAP"). We believe that this consolidated approach was based on Section 3(c)(6) of the Investment Company Act, which provides in pertinent part that a company primarily engaged, directly or through majority owned subsidiaries, in one or more activities specified in Sections 3(c)(3), (4) or (5) of the Act is also excluded from the definition of investment company. The staff appears to have shared this view.[11]

Around 2005, however, the staff began to espouse a different view: that in a complex corporate structure the parent and each subsidiary must separately satisfy the 55% test based on an assessment of each such entity's non-consolidated assets under GAAP or satisfy the conditions of another exclusion from registration as an investment company.[12] This change of view was communicated through the registration statement review and comment process on filings by mortgage-related issuers. As word of this change spread through the market,

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Although the staff did not concur with the industry view, a new rule emerged from subsequent correspondence dated May 23, 2005: "Qualifying Real Estate Assets [include] classes of CMBS senior to the Controlling Class of a CMBS issuance, provided that: [the company] acquires 100% of the Controlling Class of the CMBS issuance; and [the company] acquires 100% of the class of the CMBS issuance treated as a Qualifying Real Estate Asset and of each class junior to such class but senior to the Controlling Class . . . up to the most senior contiguous class of the CMBS issuance owned 100% by [the company]." Staff correspondence relating to Registration Statement on Form S-11 (333-122802) and prospectus included therein of JER Investors Trust, Inc.

[11] See NAB Asset Corporation, SEC Staff No-Action Letter (June 20, 1991).

[12] Bergdolt and Le Duc, *Public Nontraded Mortgage REITS – Issues and Opportunities*, Journal of Taxation of Financial Products, V. 7, Issue 2, 47, at 49 (2008).

companies relying on the consolidated approach scrambled to ensure that they were in compliance with the 55% test as applied in this new manner; and today, we understand that most companies with these kinds of complex corporate structures are following the staff's new approach. We are concerned, however, that such a significant new approach to interpreting Section 3(c)(5)(C) was disseminated through the registration statement review and comment process, without benefit of input from the public, including investors, issuers and others.

We believe that interpretative guidance on how Sections 3(c)(6) and 3(c)(5)(C) should be applied in the context of complex corporate structures is another appropriate area with respect to which the Commission should take action through a formal rulemaking process. Critical details in how to apply the accepted method can be addressed as part of the rulemaking process and will lead to more certainty in the application of the Section 3(c)(5)(C) exclusion and clarity in the disclosures by issuers of their compliance with the Act.

C. Informal Guidance Through Registration Statement Staff Comments.

Whatever direction the Commission may take with respect to future guidance and interpretation regarding the Section 3(c)(5)(C) exclusion, we recommend that the staff cease its current practice of implementing new interpretations through the informal registration statement comment letter process. We believe that it is inappropriate for the staff to introduce, for example, new interpretations of what instruments constitute qualifying interests under Section 3(c)(5)(C) and how Section 3(c)(6) should be interpreted in the context of Section 3(c)(5)(C) through the registration statement review and comment process under the Securities Act. Unlike the no-action letter process, this process lacks the opportunity for meaningful dialogue between the staff and the issuer, since the issuer is under pressure to have the registration statement declared effective. Moreover, new interpretations disseminated through the registration statement comment process are initially known only by the issuer, its counsel and other participants in the offering. Dissemination beyond that small group is dependent solely upon word-of-mouth and deciphering disclosures set forth in registration statements. While interpretations contained in no-action letters are readily available and can be efficiently researched using one of a number of available research services, there is no effective method of researching interpretations issued through the registration statement comment process. In our view, new interpretations and guidance in this area should be limited to final rule-making, interpretive releases and the no-action letter process.

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Once again, the Committees appreciate the opportunity to submit these comments and we respectfully request that the Commission consider our recommendations. Members of the Committees are available to meet and discuss these matters with the Commission and its staff and to respond to any questions.

Very truly yours,

/s/ Jeffrey W. Rubin
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Chair, Federal Regulation of Securities Committee

/s/ Martin Fingerhut
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