LEGG MASON
CAPITAL MANAGEMENT

November 7, 2011

Via Electronic Delivery

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

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

Dear Ms. Murphy:

Legg Mason Capital Management is pleased to have the opportunity to respond to the Commission's request for comment on the interpretation of Section 3(c)(5)(C) of the Investment Company Act of 1940 (the "Act") and the application of the Act to mortgage-related real estate investment trusts and other similarly managed mortgage pools ("mortgage-related pools"). Legg Mason Capital Management is a federally registered investment adviser that invests in a wide range of securities including equity and fixed income instruments on behalf of its client accounts.

We applaud the Commission's effort to review this increasingly important asset class and to provide greater regulatory certainty with respect to the application of Section 3(c)(5)(C). In their current form, mortgage-related pools provide hundreds of billions of dollars of liquidity in the form of stable, private capital that would not otherwise exist. At a time when the government is looking for ways to extract itself from the mortgage market, we believe that the mortgage-related pools, in their current form, stand poised to help the government accomplish that goal. However, further regulatory risk, significantly higher costs of doing business or threats to the business model could jeopardize this possibility.

While we encourage the SEC to require mortgage-related pools to provide more detailed disclosure in their public filings, we ask that the Commission affirm that these companies may continue to rely on the exclusion from the definition of "investment company" provided in Section 3(c)(5)(C). Subjecting these companies to regulation under the Act, including the limits on borrowing contained in Section 18, would significantly alter the day-to-day operations of the group. The use of leverage allows equity investors in mortgage-related pools to earn their cost of capital, and it provides the management teams of the mortgage-related pools with the required flexibility to run their businesses in a wide range of market environments.

Equity Investors Require Greater-than-Investment-Company Leverage to Earn Their Cost of Capital. The Commission requested comment on how mortgage-related pools differ from traditional investment companies that are not excluded from regulation under the Act. First and foremost, most mortgage-related pools and other real-estate-related assets do not allow equity investors to earn their cost of capital without leverage. One of the great benefits of the current interpretation of Section 3(c)(5)(C) by mortgage-related pools is that it provides hundreds of billions of dollars of liquidity to the mortgage markets by allowing equity investors to earn their required returns. Legg Mason Capital Management would not invest in this asset class on behalf of its clients were it not for the use of leverage. Traditional investment companies already allow equity investors to earn their cost of capital. Such vehicles include unlevered mutual funds holding equity assets that already employ more leverage than do many mortgage-related pools exempt from the Act.

The Market Already Limits Leverage. As investors in mortgage-related pools, we do not believe that today's leverage is excessive. The market already limits the extent of leverage with regard to each business's operating characteristics. Mortgage-related pools that use the highest amounts of leverage today are those that invest in and borrow against securities for which government agencies guarantee the payment of principal and interest. Lenders are willing to extend the most credit against these securities, thanks to the guarantee and the low price volatility that comes with it.

Today's "haircuts," or the lender's margin of safety between loaned funds and collateral value, have been steady at ~5% on agency collateral despite all the turmoil in European credit markets. A haircut of 5% means that an agency pool could technically lever up to a debt-to-equity ratio in the high teens. Agency mortgage pools, however, have maintained significantly more conservative debt-to-equity ratios. This means that the companies have ample liquidity and excess collateral and borrowing capacity. This is a function of what investors and the management teams deem prudent.

We believe that applying new regulation to prevent business practices that the market already limits could be an ineffective and costly exercise not only for the Commission, but for mortgage-related pools and their investors.

Regulatory Uncertainty Has Influenced Investors. Publicly-traded mortgage-related pools have been under significant pressure since the Commission announced on August 31st that it was requesting public comment on the asset class's exemption from the Act. Since the announcement, the five largest publicly traded mortgage-related pools have collectively lost billions of dollars in market capitalization, and some now trade at or below liquidation value. While we don't think this is the only factor weighing on shares, we believe that the introduction of regulatory uncertainty is influencing equity investors who fear they may not be able to earn their cost of capital in this asset class if the leverage limits in the Act are applied. We respectfully request that the Commission affirm that mortgage-related pools, as currently constituted, may continue to rely on the exclusion from the definition of "investment company" provided by Section 3(c)(5)(C).

We Encourage Efforts to Expand Required Disclosure. Perhaps the best way to help the markets better assess the risks associated with mortgage-related pools would be to require more comprehensive disclosure from these companies. Some mortgage-related pools currently provide investors with much more information on their assets and hedge positions than do their peers. The firms with the best disclosure itemize the value of every security and hedge in their portfolios each quarter, similar to the way a business development company lists every position in its portfolio on a quarterly basis. Hedges are also broken down by counter-party, which is particularly helpful given that hedges are susceptible to counter-party risk.

Some publicly-traded mortgage-related pools only provide high-level portfolio characteristics in quarterly filings. We believe that providing shareholders with complete information on the portfolio once per quarter would not only benefit investors, but it should also help firms in times of stress, when investors tend to avoid companies with less transparency. More complete disclosure should also require minimal, if any, incremental costs, given that the managers of mortgage-related pools track their positions and manage around them daily.

We appreciate the opportunity to comment on the application of the Act to mortgage-related pools and the availability of the exclusion provided by Section 3(c)(5)(C). We also commend the Commission for actively seeking to provide greater clarity and regulatory certainty for investors.

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Legg Mason Capital Management