MFA FINANCIAL, INC.

November 7, 2011

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:

We appreciate the opportunity to provide these comments in response to the request of the Securities and Exchange Commission (the "Commission") for comment on its concept release entitled *Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments* (the "Release"). 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.

I. Executive summary

This letter addresses the Commission's request for comments on whether "whole pool" certificates ("agency whole pool certificates") that are issued or guaranteed by federally chartered corporations or U.S. Government agencies ("Agency MBS")[1] should be treated as "mortgages and other liens on and interests in

[1] Examples of federally chartered corporations are government-sponsored enterprises ("GSEs") such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan

350 Park Avenue, New York, NY 10022
Direct: 212-207-6400 Fax: 212-207-6420 website: www.mfa-reit.com
MFA listed NYSE

real estate" ("Qualifying Interests") for purposes of the exclusion afforded by Section 3(c)(5)(C) (the "Exclusion") from the definition of investment company under the Investment Company Act of 1940 (the "1940 Act").[2] We respectfully submit that the Commission should affirm the 30 year-old position of its staff (the "Staff") that agency whole pool certificates are Qualifying Interests. We believe such treatment is consistent with the Exclusion and the congressional intent underlying the Exclusion. We also respectfully request that the Commission deem certificates that represent less than the entire ownership interest in a mortgage pool ("partial pool certificates") to be Qualifying Interests.

Taking these actions would help the Commission achieve its stated goals of (i) being consistent with the congressional intent underlying the Exclusion; (ii) ensuring that the Exclusion is administered in a manner consistent with the purposes and policies underlying the 1940 Act and Section 3(c)(5)(C), in particular; (iii) providing greater clarity, consistency and regulatory certainty; and (iv) facilitating capital formation.[3] Failing to affirm the Staff's long-held position that agency whole pool certificates are Qualifying Interests would significantly damage an entire sector of the mortgage REIT industry that has developed in reliance on the Staff's guidance and has grown to be an important source of private capital for the residential mortgage industry without significant regulatory or financial issues, would harm the investors in those mortgage REITs and would also frustrate the congressional intent underlying the Exclusion. Failure to deem partial pool certificates are 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.

II. Information about MFA Financial, Inc.

MFA Financial, Inc. ("MFA") is an internally managed, New York-based real estate investment trust ("REIT"). We are primarily engaged in the business of investing in Agency MBS (both in whole pool and partial pool form) and non-agency partial pool certificates representing interests in pools of residential mortgages that are not insured or guaranteed by federally chartered corporations or U.S. Government agencies ("non-Agency MBS" and, together with Agency MBS,

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Mortgage Corporation ("Freddie Mac"). An example of a unit of the U.S. Government is the Government National Mortgage Association ("Ginnie Mae").

[2] *See* 15 U.S.C. § 80a-3(c)(5)(C).

[3] The Release, 76 Fed. Reg. 55,300, 55,301 (Sept. 7, 2011) (to be codified at 17 C.F.R. pt. 270).

"MBS"). We employ a relatively low debt-to-equity ratio, which, as of September 30, 2011, was approximately 3.5-to-1.[4] Our leverage ratio was lower than other participants in the mortgage market and significantly lower than that employed by banks and other finance companies in general.[5] We currently own approximately $12 billion of mortgage-related assets and have a market capitalization of approximately $2.4 billion.

We were incorporated in Maryland on July 24, 1997 and began operations on April 10, 1998. We have elected to be taxed as a REIT for U.S. federal income tax purposes under the Internal Revenue Code of 1986 (the "Code"). We are internally managed and employ 34 professionals dedicated to the management and monitoring of our portfolio of MBS. Our common stock is listed on the New York Stock Exchange ("NYSE") under the symbol "MFA." We are subject to and comply with applicable NYSE rules and are subject to the requirements of various securities laws, including, without limitation, the Securities Act of 1933 (the "Securities Act"), which requires us to file Form S-11 with the Commission, a registration form approved by the Commission specifically for REITs; the Securities Exchange Act of 1934 (the "Exchange Act"), which requires us to file annual reports on Form 10-K, quarterly reports on Form 10-Q and interim reports on Form 8-K; and the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley").

III. Exclusion of companies that invest primarily in agency whole pool certificates from investment company status is consistent with congressional intent

The exclusion of companies that invest primarily in agency whole pool certificates from investment company status is consistent with the congressional intent underlying the Exclusion. As noted in the Release, the Exclusion does not have an extensive legislative history.[6] The few statements in the legislative history that address the Exclusion indicate that Congress intended it to exclude companies that own mortgages and other interests in real estate based upon a company's asset composition. In congressional reports and transcripts of congressional hearings, the

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[4] MFA Financial, Inc., Quarterly Report (Form 10-Q, filed November 7, 2011) at 40.

[5] By contrast, as of June 30, 2011, the average debt-to-equity ratio for all institutions insured by the Federal Deposit Insurance Corporation was just under a 10-to-1. *See* 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. 3, 2011).

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

Exclusion was described alternatively as being for "companies dealing in mortgages,"[7] "companies [that have] portfolios of securities in the form of . . . mortgages and other liens on and interests in real estate"[8] and "mortgage companies, although they in essence deal in securities."[9]

We respectfully submit that the relative lack of discussion about the Exclusion was intentional given that the primary intent of promulgating the 1940 Act was to protect investors from unscrupulous investment companies and investment trusts whose investments were almost exclusively limited to the common equity and debt securities of U.S. corporations[10] and to eliminate the abuses and deficiencies which then existed in investment companies.[11] The Commission's report on investment companies noted that investment companies of the type that the 1940 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.[12] Prior to that time, individual investors typically limited their

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

8 S. Rep. No. 91-184, at 34 (1969) ("1970 Senate Report").

9 *Investment Company Act of 1940: Hearings on S. 3580 Before a Subcomm. of the Comm. on Banking and Currency*, 76th Cong. 181 (1940) (statement of David Schenker, Chief Counsel, SEC).

10 *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) ("SEC Study Part One"; 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").

11 *See* 1940 Senate Report at 12 (stating that the 1940 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 [SEC] Study and the committee hearings made indispensable the immediate enactment of adequate legislation regulating investment companies.").

12 "The concept of a company formed to invest in a cross section of securities, particularly common stocks, 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." SEC Study Part One at 37.

personal investments to assets such as mortgages and real estate.[13] The promotional literature of many investment companies sought to harness the general public's growing fascination with common stock investments, in particular.[14] The Commission's report noted that investment companies seized upon the public's growing interest in common stock investments to "peddle" investment company securities.[15] We believe that the decision to exclude companies that primarily own mortgages and other liens on and interests in real estate was not one in need of extensive 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 1940 Act sought to regulate.

Congress reviewed the Exclusion after mortgage REITs were created and could have narrowed the Exclusion if it had found a regulatory need to do so. However, Congress maintained the Exclusion without much change to its original intent of excluding companies that own or otherwise acquire mortgages and other liens on and interests in real estate. The amendments to the Code that created REITs were adopted in 1960[16] and the first public mortgage REIT began trading on the NYSE in 1965.[17] When Congress amended the Exclusion in 1970, it continued to recognize and reaffirmed that it did not intend for the 1940 Act to regulate companies primarily in the business of owning or otherwise acquiring portfolios of

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13 *Id.*

14 SEC Study Part One at 61.

15 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 (1939).

16 *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 1940 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 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.").

17 *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).

mortgages and other real estate interests, because such companies did not fit the mold of an investment company that the 1940 Act was intended to regulate: a "conventional investment company investing in the stocks and bonds of corporate issuers."[18] Congress could have amended or repealed the Exclusion so as 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, the only amendment to the Exclusion adopted by Congress was to prohibit companies relying on the Exclusion from issuing redeemable securities, which was deemed adequate by Congress to ensure that companies relying on the Exclusion did not confuse the public by bearing a resemblance to mutual funds. The issuance of redeemable securities was the one structural element of mutual funds the absence of which Congress thought was adequate to differentiate mortgage REITs from investment companies.[19]

The Release characterizes the legislative history of the 1940 Act as indicating that Section 3(c)(5)(C) was meant to exclude companies engaged in the "mortgage banking business."[20] However, in no instance were we able to find a reference to the phrase "mortgage banking business" in the legislative history or the Commission's report to Congress on investment companies and investment trusts.[21] We respectfully submit that it is inaccurate to characterize the legislative history as suggesting Section 3(c)(5)(C) was meant in any way 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 which is not supported by the legislative history. The language of the legislative history clearly indicates that owning or

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[18] 1970 Senate Report at 34; *accord* H.R. Rep. No. 91-1382, at 17 (1970).

[19] 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 cites an editorial criticizing PennyMac for being "dressed up as a" hedge fund even before it had its initial public offering. *Id.* at 55,303 n.28. 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. PennyMac utilizes significantly less leverage than is used by the average hedge fund, and it tends to hold its investments for longer terms, whereas the typical hedge fund tends to trade its investments frequently. *See* PennyMac Mortgage Investment Trust, Quarterly Report (Form 10-Q) at 50-51 (Aug. 5, 2011).

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

[21] The SEC Study.

otherwise acquiring mortgages and other liens on and interests in real estate, and not any operating characteristic, is the basis for an entity's eligibility for the Exclusion.[22]

The structure of Section 3(c)(5) also supports the conclusion that the Exclusion was meant to be an asset-based test. Section 3(c)(5) excludes 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.[23] When Congress intended to require a company to be engaged in certain conduct in 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."[24] Similarly, a company seeking to rely on the exclusion provided for "banks" and "insurance companies" 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.[25] Section 3(c)(4) excludes only companies "substantially all of whose business is confined to making small loans, industrial banking, or similar businesses."[26] Section 3(c)(5)(C), on the other hand, requires a company to "purchas[e] or otherwise acquir[e]" mortgages and other liens on and interests in real estate.[27] It says nothing about originating or underwriting those assets. Accordingly, the Staff has historically imposed an asset-

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22 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.

23 Even with respect to Section 3(c)(5)(B), the Staff has issued a no-action letter 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 (Apr. 14, 1982).

24 15 U.S.C. § 80a-3(c)(2)(A).

25 *See* 15 U.S.C. § 80a-3(c)(3).

26 15 U.S.C. § 80a-3(c)(4).

27 *See* 15 U.S.C. § 80a-3(c)(5)(C).

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[28] and (ii) at least an additional 25% of their assets in additional Qualifying Interests or real estate-related assets. 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 that are 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.

IV. Consistency with the purposes and policies of the 1940 Act requires retention of the whole pool exclusion

We are a company primarily engaged in owning or otherwise acquiring mortgages and other interests in real estate. Although we generally do not directly own individual mortgages, by acquiring and holding agency whole pool certificates, we own 100% of the beneficial interests in all of the mortgages constituting a pool, which is a means of "otherwise acquiring" those mortgages and also constitutes an "other interest in" real estate.[29] As discussed above, Congress has consistently indicated that companies that are primarily engaged in owning or otherwise acquiring mortgages and other interests in real estate are not the type of companies that the 1940 Act was meant to regulate.

Congress effectuated its intent by drafting the Exclusion so that it not only applies to companies directly acquiring mortgages, but also to companies *otherwise acquiring* mortgages and to companies that own *other interests in* real estate.[30] An agency whole pool certificate is a 100% beneficial interest in a pool of individual mortgages, not a partial participation or fractionalized interest in a mortgage or pool of mortgages. As a result, an agency whole pool certificate provides its holder with an indirect means of obtaining the same economic experience as owning the underlying mortgages directly, on an insured or guaranteed basis. As the Staff recognized in *Protecting Investors*, such economic experience

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[28] *See* NAB Asset Corp., SEC No-Action Letter, 1991 WL 176787, at *2 (June 20, 1991).

[29] *See* American Home Finance Corp., SEC No-Action Letter, 1981 WL 26376 (May 11, 1981) (the "American Home Letter").

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

includes "the receipt of both principal and interest payments and the risk of prepayment on the underlying mortgage loans."[31] In *Protecting Investors*, the Staff noted that a guarantee by a federally chartered corporation or a unit of the U.S. Government on an underlying mortgage loan does not detract from the economic experience of owning the mortgage loan.[32] We concur. When we own an agency whole pool certificate, we do not share any interest in any of the mortgages in our pool with any other class of investor or with a holder of another interest in the pool that may conflict with our interest. As a result, the hallmarks of the economic experience that the owner of multiple mortgage loans experiences are hallmarks we experience fully and exclusively with respect to the mortgages underlying our agency whole pool certificates. Ownership of an agency whole pool certificate is the functional equivalent of otherwise acquiring and owning the underlying mortgages and acquiring insurance on the mortgages.[33] We respectfully submit it would be illogical and would frustrate Congress' intent to treat a mortgage as a Qualifying Interest but to take the view that certificates representing 100% of the ownership interests in a pool of mortgages somehow are not Qualifying Interests.

The Commission and Staff have stated that a non-controlling interest in a person engaged in a real estate business may not be a Qualifying Interest.[34] This position should not be used as a basis to repeal the Staff's longstanding position that agency whole pool certificates are Qualifying Interests. As noted above, an agency whole pool certificate is a 100% beneficial interest in a pool of mortgages. The pool is a passive entity formed for administrative convenience to facilitate the transfer of mortgage titles among investors, the servicing of the underlying mortgage loans and the provision of a guarantee from a federally chartered corporation or U.S.

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[31] Protecting Investors, *supra* note 22, at 72 & n.267 (citing the American Home Letter, *supra* note 29); *see also* Investors GNMA Trust, Inc., SEC No-Action Letter, 1983 WL 28500, at *3 (July 22, 1983) (counsel opined that that issuer's ownership of GNMA Mortgage Pass-Though Securities representing 100% beneficial interests in mortgage pools constitutes an investment in mortgages within the meaning of Section 3(c)(5)(C) because ownership of these securities "is the functional equivalent of ownership of the underlying mortgage loans").

[32] Protecting Investors, *supra* note 22, at 72 & n.267.

[33] In the American Home Letter, *supra* note 29, the applicant likened the guarantees of mortgage loans by GNMA to private mortgage insurance, which was used to insure mortgage loans that were the subject of a letter from a previous applicant in which the Commission had granted relief. *See* U.S. Home Finance Corp., SEC No-Action Letter, 1980 WL 15058 (May 30, 1980). The Commission granted relief to the applicant in the American Home Letter.

[34] *See, e.g.*, Real Estate Investment Trust, Investment Company Act Release No. 3140, 25 Fed. Reg. 12178 (Nov. 18, 1960); Realex Capital Corp., SEC No-Action Letter, 1984 WL 44978 (Mar. 19, 1984).

Government agency. While title transfer services, loan servicing and insurance could be purchased by a mortgage investor on a mortgage-by-mortgage basis, it could only be done on a much less efficient basis and at a much greater cost. Accordingly, an agency whole pool certificate is not an interest in an entity actively managed by a third-party who is in the real estate business in which the return is dependent primarily on the real estate management skills of others. Instead, it is a 100% beneficial interest in a passive entity holding mortgages, the returns of which are derived primarily from interest and principal payments on the underlying mortgages.

In 2010, the vast majority of all newly originated residential mortgages became part of an agency-sponsored pool of mortgages. Adopting a position that agency whole pool certificates are not Qualifying Interests would effectively eliminate residential mortgages from the Exclusion, a result that would not accord with the congressional intent in adopting the Exclusion because, as demonstrated above, agency whole pool certificates are a means of "otherwise acquiring" mortgages and do not change the economic experience of the owner from owning mortgages to owning securities issued by someone engaged in a real estate business.

V. The Commission should state that certain interests in mortgages and mortgage pools are Qualifying Interests and direct the Staff to work with the mortgage and securitization industries to identify new Qualifying Interests as the markets evolve

The Commission has requested comments from industry participants on whether it should define the phrase "liens on and other interests in real estate" for purposes of Section 3(c)(5)(C).[35] In order to clarify the meaning of the phrase, we respectfully submit the Commission should find and state that agency and non-agency partial pool certificates are Qualifying Interests because, like agency whole pool certificates, they are the economic equivalent of holding an interest in the underlying mortgages. We further believe the Commission should direct the Staff to remain flexible in its understanding of Qualifying Interests and work with the mortgage and securitization industries to recognize additional Qualifying Interests as the mortgage and securitization markets evolve.

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

While we are aware that the Staff has taken the position that partial pool certificates are not Qualifying Interests,[36] we respectfully submit that the Commission should reconsider the Staff's position. 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 risks 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 of an issuer, rather than an investment in the underlying mortgages."

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. All payments on a partial pool certificate 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 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 a holder of a partial pool certificate may be subject to prepayment risk demonstrates that the partial pool certificate is directly tied to the performance of the underlying mortgages. Moreover, the fact that the securitization structure of a pool permits 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 a MBS is still an interest in real estate because the economics of the investment are based on a passive pool of underlying mortgages. Given the Staff's longstanding position that mortgage instruments that represent the economic equivalent of owning the underlying mortgages are Qualifying Interests, we respectfully submit that the Commission should find and state that both forms of partial pool certificates are Qualifying Interests.

We believe that the broad language used by Congress in drafting Section 3(c)(5)(C) encompasses partial pool certificates. As discussed above, Congress has consistently indicated that the 1940 Act was not intended to regulate companies that are primarily engaged in the business of owning and otherwise

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[36] *See, e.g.*, Protecting Investors, *supra* note 22, at 73. 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 risks 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 of an issuer, rather than an investment in the underlying mortgages." *Id.*

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 (emphasis added).[37]

We further believe that the decision to treat MBS as Qualifying Interests can not turn on whether they are securities for purposes of the 1940 Act but rather 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.[38] In other words, Congress has determined that companies that primarily invest in securities that are in the nature of mortgages or other liens on and interests in real estate are not similar to investment companies and should not be regulated under the 1940 Act.

In order to properly determine which assets constitute Qualifying Interests, we respectfully submit that the Commission should 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 1940 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. Mortgage origination is now, and will likely 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 future originations and purchases of additional mortgages.

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

[38] *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.

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. They 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. 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.

VI. The Commission does not regulate the operation of excluded entities and should not impose leverage limitations on a particular class of excluded entity, the mortgage REIT

Section 3(c) of the 1940 Act excludes various types of financial companies from regulation as "investment companies." Among others, Section 3(c) excludes underwriters and broker-dealers,[39] banks,[40] insurance companies,[41] consumer finance companies[42] and companies that primarily own purchase money and factoring loans,[43] in addition to companies like MFA that own or otherwise acquire mortgages and other liens on and interests in real estate. Some of these types

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39 *See* 15 U.S.C. § 80a-3(c)(2)(A).

40 *See* 15 U.S.C. § 80a-3(c)(3).

41 *See id.*

42 *See* 15 U.S.C. § 80a-3(c)(4).

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

of companies, such as banks and insurance companies, are subject to oversight by regulators other than the Commission, and others, such as broker-dealers, are subject to regulation by the Commission under federal securities laws other than the 1940 Act and by regulators other than the Commission. And finally, others, such as companies that primarily own purchase money financing and factoring loans, are not subject to oversight by other regulators. Nevertheless, Congress elected to exclude each of the types of companies excluded by Section 3(c)(5) from regulation as "investment companies" under the 1940 Act because of the nature of their assets.

In the Release, the Commission noted that mortgage REITs often employ leverage in excess of the limitations imposed on registered investment companies by the 1940 Act.[44] While true, substantially all other financial companies excluded from registration as investment companies under Section 3(c) of the 1940 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 publicly traded mortgage REITs, yet the Commission has not sought to regulate the amount of leverage such companies can employ. 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. In this regard, 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. We are also unaware of any empirical evidence that the amount of leverage used by publicly traded REITs like MFA has unduly put investors at risk.

Assuming for the sake of argument 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, depress vast amounts of existing shareholder value 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 and likely would be unable to satisfy the requirements imposed on it by the Administrative Procedure Act[45] and,

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[44] *See* the Release, 76 Fed. Reg. at 55,302.

[45] 5 U.S.C. §§ 551-559.

consequently, that any such attempted rule making likely would be vacated by the courts.[46]

Our leverage policies are overseen by our board of directors ("Board") and are set and adjusted from time to time with a view towards the best interests of our shareholders. Because we are internally managed and do not charge management fees, there is no incentive for our managers to increase the amount of leverage we use to increase their investment advisory fees. The amount of leverage we incur is 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 either no longer lend to us or may lend to us only on terms that are so onerous that incurring additional leverage would be uneconomical. In this regard, we note that, as of September 30, 2011, MFA's debt-to-equity ratio was approximately 3.5-to-1,[47] which was lower than other participants in the mortgage market and far lower than that employed by banks and other finance companies in general.[48] Even in interest rate environments where there was considerably less interest rate risk than in the current environment, our leverage was far lower than that employed by banks and other financial companies, which we believe have riskier businesses than ours.

In light of Congress' decision to exclude companies that 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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[46] *See, e.g., Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148-49 (D.C. Cir. 2011); *Chamber of Commerce v. SEC*, 412 F.3d 133, 139 (D.C. Cir. 2005); s*ee also Goldstein v. SEC*, 451 F.3d 873, 884 (D.C. Cir. 2006) (overturning a change to a long-standing provision of the Investment Advisers Act of 1940). In addition, Section 2(c) of the 1940 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).

[47] *See supra* note 4.

[48] *See supra* note 5.

For example, the Commission should ensure that mortgage REITs clearly and fully disclose their leverage policies and leverage usage and attendant sensitivity to changes in interests rates so that investors can be fully aware of the leverage risks associated with mortgage REITs and make informed investment decisions. We regularly disclose our leverage policies and the amount of leverage we incur to our shareholders. These disclosures are included in our prospectuses, shareholder reports and filings on Forms 10-Q and 10-K. Mortgage pools like MFA are acutely aware of the material impact that changes in interest rates can have on the performance of our stock.[49]

VII. Mortgage REITs like MFA protect investors by employing appropriate corporate governance standards

Regulation of mortgage REITs like MFA under the 1940 Act is unnecessary in light of the numerous investor protection safeguards that exist in our structure and operations. We are subject to extensive regulatory regimes that prevent us from engaging in many of the practices intended to be addressed by the 1940 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 1940 Act was designed to protect against. We also are not aware of any evidence that mortgage REITs present more of a regulatory risk than any other company excluded from registration as an investment company. 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. The regulation of mortgage REITs as 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

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[49] The 10-K includes extensive risk factors on interest rates ("An increase in our borrowing costs relative to the interest we receive on our MBS may adversely affect our profitability," MFA Financial, Inc., Annual Report (Form 10-K) at 13-14 (filed Feb. 14, 2011)), leverage ("Our business strategy involves a significant amount of leverage which may adversely affect our return on our investments and may reduce cash available for distribution to our stockholders as well as increase losses when economic conditions are unfavorable," *id.* at 9-10) and mortgage market conditions ("Risks Associated With Adverse Developments in the Mortgage Finance and Credit Markets," *id.* at 5-8).

than $30 billion of common stock issued by mortgage REITs[50] 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, we are subject to the requirements of various securities laws and applicable NYSE rules. Our operations are overseen by our Board. Currently, six of our eight directors are "independent directors" (as required by NYSE Rule 303A.01).[51] In addition to the NYSE independence requirements, our Board has adopted independence standards to assist it in assessing the independence of our directors.[52] We established the position of a lead independent director to further strengthen the presence and effectiveness of the independent and non-management directors on our Board.[53] Additionally, we have adopted a Code of Business Conduct and Ethics (the "Code of Ethics").[54] The Code of Ethics sets forth basic principles to guide all of our officers, directors and employees to ensure that our business is conducted in accordance with the highest legal and ethical standards. The Code of Ethics is intended to meet the standards for a code of ethics under Sarbanes-Oxley and NYSE listing standards and outlines, among other things, procedures for reporting suspected violations of the Code of Ethics, ensuring strict compliance with securities laws and handling of conflicts of interests.[55]

As discussed above, we have adopted several policies designed to protect our investors. Our compliance program, including our Code of Ethics, Related Party Transaction Policy and Corporate Governance Guidelines, ensures that our senior executives, directors and employees adhere to the highest legal and ethical standards when performing their duties. Our compliance program also promotes the

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

51 MFA Financial, Inc., Notice of Annual Meeting to Stockholders to be held on May 24, 2011 (Schedule DEF14A), at 16, *available at* http://www.mfa-reit.com (from home page, click "Investor Information," then "SEC Filings," then navigate to Form "DEF14A" listing with Apr. 13, 2011 filing date) (last visited Oct. 10, 2011) ("2011 Proxy Statement").

52 Director Independence Standards, MFA Financial, Inc., *available at* http://www.mfa-reit.com/getpage.php?pgid=104 (last visited Oct. 8, 2011).

53 *See* 2011 Proxy Statement, *supra* note 53, at 15.

54 Code of Business Conduct and Ethics, MFA Financial, Inc., *available at* http://www.mfa-reit.com/getpage.php?pgid=101 (last visited Oct. 8, 2011).

55 *Id.*

highest duty of loyalty among our senior executives director, and employees to MFA. In addition, as part of our policy to prevent misappropriation of and to safeguard our assets, we have retained several independent third parties to act as our custodians pursuant to various custody agreements. These policies and procedures all operate to protect our investors.

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 our financial statements in accordance with GAAP. As part of this process, as noted above, we have retained an independent registered public accounting firm responsible for auditing our financial statements.

These practices, which are required by the regulatory regimes of the federal securities laws, achieve one of the principal goals of the 1940 Act: 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 for the mortgage industry, and elimination would harm the mortgage market

Regulation by the Commission of mortgage REITs like MFA 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. Almost 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.[56] However, since the onset of the 2008 financial crisis, federally chartered corporations and U.S. Government agencies like the Federal Housing Administration have become responsible for an ever-increasing

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[56] *See* The 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 originally created, then the foundation is in place for the private sector to assume a more significant market role.").

share of mortgage-related credit.[57] 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.[58] With the continuing decline of investment in Agency MBS by foreign central banks,[59] private market participants like MFA are one of the only potential buyers of Agency MBS left and, as the U.S. Government revisits its role in the mortgage market, mortgage REITs like MFA are best situated to replace the U.S. Government's participation in the domestic residential mortgage market.

Another historically important source for MBS demand has been commercial banks, but they face an uncertain regulatory environment, potentially facing higher capital charges. If capital requirements increase, commercial banks may need to sell their portfolios of Agency MBS in order to comply with the new regulatory environment. In the event commercial banks begin selling their Agency MBS holdings in high quantities, mortgage REITs will be one of the few market participants able to absorb that supply.

In fact, given the current economic climate, we believe that private participation in the U.S. residential mortgage market is critical to the resumption of large scale lending (and securitization of those loans) and the future health and stabilization of the domestic housing market. The Exclusion, along with the tax status of REITs, puts the residential mortgage REIT industry in an ideal position to assist the U.S. Government as it aims to wean the residential mortgage market from the GSEs. The residential mortgage REIT industry can also assist in the creation of new loans through actively purchasing MBS and/or originating new loans, thus reducing the need for GSEs and decreasing the U.S. Government's financial exposure. Further restriction of the Exclusion's availability to residential mortgage REITs like MFA, however, would harm the potential for residential mortgage REITs to buoy the domestic residential mortgage market as the economy continues to sputter and as the U.S. Government reexamines its role in the residential mortgage

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[57] *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).

[58] *See id.*

[59] *See* Henry Sender and Michael McKenzie, *Fannie and Freddie Debt Fuels Anxiety*, Fin. Times (Oct. 9, 2011), *available at* http://www.ft.com/cms/s/0/1de57e0e-f22d-11e0-b439-00144feab49a.html (stating "[s]ince its peak in mid 2008, foreign central banks holdings of GSE debt have fallen 26.4 per cent to $724 [billion]").

market. Such harm would likely damage the residential 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 1940 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. Our structure and operations contain numerous safeguards that protect our investors and that address the concerns the 1940 Act was intended to prevent. We adhere to the highest standards of fiduciary duty to our shareholders. 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 financial companies that are excluded from registration as investment companies under the 1940 Act. Our leverage usage is 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 for the 1940 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. Accordingly, treating agency whole pool certificates as Qualifying Interests is consistent with the congressional intent and the purposes and policies of the 1940 Act.

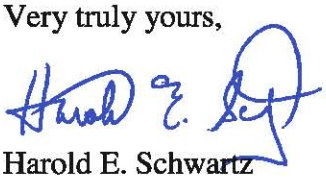
The Staff, through its long history of no-action letters, has confirmed that agency whole pool certificates are Qualifying Interests. We respectfully submit that the Commission should affirm the Staff's historical position regarding these real

estate assets. We also respectfully submit that the Commission should state that agency and non-agency partial pool certificates are Qualifying Interests.

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.

My colleagues and I would be happy to discuss the issues addressed in this comment letter with members of the Commission and the Staff. In that regard, please do not hesitate to contact me at (212) 207-6400 with any questions or comments relating to this letter.

Very truly yours,



Harold E. Schwartz
Senior Vice President and
General Counsel

cc: Mary L. Schapiro, Esq., Chairman
Elisse B. Walter, Esq., Commissioner
Luis A. Aguilar, Esq., Commissioner
Troy A. Paredes, Esq., Commissioner
Daniel M. Gallagher, Esq., Commissioner
Ms. Eileen Rominger, Director, Division of Investment Management
Rochelle Kauffman Plesset, Esq., Senior Counsel
Nadya Roytblat, Esq., Assistant Chief Counsel