CAPSTEAD

November 7, 2011

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

Andrew F. Jacobs
President and Chief Executive Officer

Re: Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments, Release No. IC-29778, File No. S7-34-11: (**"Section 3(c)(5)(C) Concept Release" or "Concept Release"**)

Dear Ms. Murphy:

Capstead Mortgage Corporation ("Capstead" or the "Company") appreciates this opportunity to respond to the request of the Securities and Exchange Commission (the "Commission" or "SEC") for comments on the Section 3(c)(5)(C) Concept Release prepared by the staff of the Division of Investment Management (the "Staff"), including the Staff's interpretive guidance relating to Section 3(c)(5)(C) of the Investment Company Act of 1940, as amended ("Investment Company Act" or "40 Act"). Capstead is a member of the National Association of Real Estate Investment Trusts ("NAREIT") and participated in the drafting of comments on the Concept Release submitted by the Residential Committee of NAREIT's Mortgage REIT Council (the "NAREIT Residential Mortgage REIT Letter").

Capstead, a self-managed real estate investment trust or REIT, was formed in 1985 and is listed on the New York Stock Exchange ("NYSE"). Capstead invests primarily in a leveraged portfolio of residential adjustable-rate mortgage pass-through securities issued and guaranteed by government-sponsored entities, either Fannie Mae or Freddie Mac, or by an agency of the federal government, Ginnie Mae (collectively, "Agency Securities"). Since its inception Capstead has relied on the Section 3(c)(5)(C) exclusion from having to register as an investment company and over the years has closely followed the evolution of the Staff's interpretive guidance related to this exclusion.

Over its twenty-six year operating history, Capstead has provided its shareholders an average annual total return of 11.67%, compared to an average annual total return for the Standard and Poor's 500 Index and the Russell 2000 Index for the corresponding period of 9.79% and 6.93%, respectively. As illustrated in the NAREIT Residential Mortgage REIT Letter, other mortgage REITs investing primarily in Agency Securities have had similar success over their operating histories relative to benchmark returns. Throughout this period, in fact since enabling legislation for REITs was enacted in 1960, REITs have relied on Section 3(c)(5)(C) of the 40 Act to be excluded from having to register as an investment company. If, as the Concept Release might be read to suggest, the Section 3(c)(5)(C) exclusion were to be no longer available to companies investing in Agency Securities, Capstead and similar companies would be required to register as an investment companies. This would effectively eliminate these companies' ability to provide much needed capital to the residential mortgage markets to the detriment of their stockholders and the housing markets in general.

We strongly endorse the NAREIT Residential Mortgage REIT Letter, especially recommendations with respect to expanding and modernizing Section 3(c)(5)(C) interpretive guidance of what mortgage-related securities are deemed to be qualifying interests for purposes of qualifying for the exclusion. In particular, we endorse the recommended expansion and modernization of the Staff's interpretation to include so called partial pool mortgage-backed securities as qualifying interests. This evolution of the Staff's past interpretation is critical in light of the potential for

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significant changes in the government's future role in residential housing finance and in mortgage securitization practices that are expected to be mandated by federal regulators pursuant to bank reform legislation embodied in the Dodd-Frank Wall Street Reform and Consumer Protection Act, commonly referred to as "Dodd-Frank."

We also refer the Commission to, and strongly concur with, comments and materials included in the NAREIT Residential Mortgage REIT and the Securities Industry and Financial Markets Association ("SIFMA") comment letters regarding the well-regulated environment in which mortgage REITs currently operate. We believe that this environment fosters a culture within which investors are extremely well-protected. Finally, as the NAREIT Residential Mortgage REIT and SIFMA letters illustrate, and we firmly believe, mortgage REITs perform a vital and growing role in residential mortgage capital formation that could be drastically curtailed if the Commission pursues a more restrictive stance to Section 3(c)(5)(C) interpretive guidance.

The remainder of this letter provides the Commission with background information on the Section 3(c)(5)(C) exclusion that we believe supports our opinion on why this exclusion should only be interpreted in a broad fashion by the Staff.

I. LEGISLATIVE HISTORY OF THE INVESTMENT COMPANY ACT - INTENDED SCOPE OF THE SECTION 3(C)(5)(C) EXCLUSION

The statutory language of the Section 3(c)(5)(C) exclusion is broadly written and as noted in the Concept Release, Section 3(c)(5)(C) does not have an extensive legislative history. However, Congressional subcommittee testimony, including the April 1940 Senate Subcommittee hearings on Investment Trust and Investment Companies (held in connection with enacting the 40 Act), Mr. David Schenker, Chief Counsel of the SEC Investment Trust Study, discussed the substantive provisions of Section 3 of the bill, dealing with the Definition of Investment Company. On April 8, 1940 Mr. Schenker testified that (emphasis added):

> "... [i]n the popular mind an investment company is a company which is engaged in the business of investing, reinvesting, holding, and trading in the securities **of other corporations**."

On April 15, 1940 Mr. Schenker further testified that (emphasis added):

> "There shall also be excluded banks, common trusts **and any real estate company**..."

In enacting the 40 Act, Congress as well as the Commission clearly intended the regulation to apply only to companies investing in the stocks and bonds of corporate issuers and for the Section 3(c)(5)(C) exclusion to apply to real estate companies as broadly defined by the practices of the day. It is instructive to note that there were many types of real estate companies as well as mortgage instruments similar to today's mortgage-backed securities in existence in the 1920's and 1030's that played a dominant role in financing residential real estate (see subsection entitled, "Historical Support for Treating MBS as Qualifying Interests" included in the NAREIT Residential Mortgage REIT Letter). It is quite obvious from the record that despite the problems encountered by the housing markets and these companies in that era, Congress and the Commission intended to exclude this industry from the 40 Act regulatory regime that had been developed solely for conventional investment trusts.

Since the Investment Company Act was enacted in 1940, Congress has amended Section 3(c)(5)(C) only once, without any effort to restrict the use of the exclusion by real estate companies through narrowing the definition of constitutes being primarily engaged in investing in mortgages or real estate. Rather, the Investment Company Act Amendments of 1970 only prohibited companies issuing redeemable securities from relying on Section 3(c)(5)(C). The legislative history of the 1970 amendments state (emphasis added):

"**Although the companies enumerated** in Section 3(c)(6) [later to be renumbered as Section 3(c)(5)] **have portfolios of** securities in the form of notes, commercial paper, or **mortgages and other liens on and interests in real estate, they are excluded from the Act's coverage because they do not come within the generally understood concept of a conventional investment trust investing in stocks and bonds of corporate issuers**" (see H.R. Rep. No. 1382, 91st Cong., 2d Sess. 17 (1970), commonly referred to as the "1970 Report").

Since 1970 there have not been any other congressional efforts to amend the Section 3(c)(5)(C) exclusion, leading to the conclusion that after over 70 years, the original intent of Congress in the passage of the 40 Act still stands. Further, there is no indication that we are aware of that the exclusion was not intended to be broadly interpreted to exclude any real estate company, including mortgage REITs. It is clear that the 40 Act was and remains intended by Congress to focus on regulating conventional investment trusts investing in stocks and bonds of corporate issuers.

II. AGENCY SECURITIES – WHOLE POOL AND PARTIAL POOL CERTIFICATES

The Staff, in a series of no-action letters over the last 40 years, has interpreted the various provisions of Section 3(c)(5)(C) regarding what constitutes being "primarily engaged [in the business of] purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." The "primarily engaged" requirement of Section 3(c)(5) has been interpreted by the Staff to mean that at least 55% of a company's assets must be invested in mortgages, other liens on real estate, or interests in real estate (collectively "Qualifying Interests") and the remaining 45% of a company's assets must consist primarily of real estate-type investments.

The most prevalent form of Agency Security in the market today is structured as a "pass-through" certificate where the certificate holder owns an undivided beneficial interest in a distinct pool of mortgage loans and is entitled receive, almost immediately after receipt from the underlying borrowers, its pro rata portion of all payments of principal and interest, including prepayments. In instances where the certificate holder owns the entire ownership interest in a particular pool of mortgage loans (a "Whole Pool Certificate"), Staff no-action letters have held such securities to be Qualifying Interests. In instances where a certificate represents less than the entire ownership interest in the underlying mortgage pool (a "Partial Pool Certificate"), the Staff has held that such interests are not Qualifying Interests, but merely real estate-type securities. Partial Pool Certificates typically are structured as pass-through securities; however, through structured finance techniques, Partial Pool Certificates may also be structured as so called pay-through certificates, wherein each certificate may be entitled to a specific portion of the underlying cash flows from a pool of mortgages rather than a pro rata share those cash flows.

The Staff's interpretation, as established through the no-action letter process, has been that the holder of Agency Whole Pool Certificates generally has the same economic experience as the investor who purchases the underlying mortgages directly. This economic experience includes the receipt of principal and interest payments and the risk of prepayment on the underlying mortgage loans, notwithstanding the guarantees provided by the agencies. It is instructive to note that a credit guarantee simply represents a credit enhancement not unlike other credit enhancements commonly used in all forms of real estate lending such as overcollateralization, mortgage insurance, recourse to the borrower, or, in case of structured financings, subordinate certificates designed to absorb losses prior to senior certificates. Thus credit guarantees do not detract from the conclusion that Agency Securities give investors the same economic experience as direct ownership of the underlying loans. Rather, the guarantees simply serve to enhance investor protections associated with this particular form of real estate asset, and logically, increased investor protections should call for less regulation rather than more regulation. **Therefore, it is Capstead's opinion that Agency Whole Pool Certificates clearly should continue to be afforded Qualifying Interest treatment as has been the case for the last 40 years.**

Regarding Agency Partial Pool Certificates, the Staff has established an interpretation that these investments should be viewed as being more like an investment in the securities of an issuer (i.e., the agency that issued the security), rather than an investment in the underlying mortgages. This is in large part because a Partial Pool Certificate can be argued to provide greater diversification and perhaps a different prepayment risk than owning 100% of the underlying loans. With all due respect, the Staff's past interpretation seems to ignore the realities of what an investment in a mortgage-backed security represents: a participation, on a pro rata basis or otherwise, in the cash flows associated with a distinct pool of real estate loans underlying the security, without regard or claim (other than contractual credit enhancements such as a credit guarantee) to the assets of the issuer. Further, we would contend that the economic experience of owning a Partial Pool Certificate is essentially identical to that of owning a Whole Pool Certificate, including the receipt of principal and interest payments based on the prepayment performance of the underlying mortgage loans. **Therefore, in our opinion, Partial Pool Certificates, either in pass-through or pay-through form, should be considered "interests in real estate" falling within the Section 3(c)(5)(C) statutory exclusion and receiving Qualifying Interest treatment under the Staff's primarily engaged criteria.**

Qualifying Interest treatment for Partial Pool Certificates will become increasingly important to the expanding role in housing market capital formation being played by mortgage REITs as Congress addresses the future role of the federal government in the housing markets. Currently, GSE reform efforts center on how taxpayers can be protected from future credit losses while ensuring an ample, affordable and unwavering supply of capital to the housing markets. For example, a greater use of risk-sharing in the form of subordinated first-loss bonds sold to investors or retained by originators may become common place. This will likely entail, by definition, the issuance of pay-through Agency Partial Pool Certificates by Fannie Mae, Freddie Mac, or their successor(s). Similarly, credit risk retention will be mandated in some form for non-agency residential securitizations by federal regulators pursuant to the "skin in the game" provisions of Dodd-Frank. Without Qualifying Interest designation for both pass-through and pay-through Agency and non-agency Partial Pool Certificates, mortgage REIT participation in providing capital to the housing markets could be greatly diminished.

III. CONCLUSION

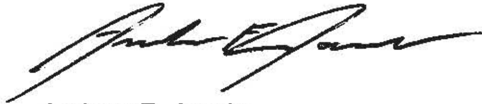
In our letter we have focused on why we believe the Commission should interpret the 40 Act's Section 3(c)(5)(C) exclusion in a broad fashion. We ask that the Commission affirm the Staff's past interpretations that mortgage REITs holding primarily Agency Whole Pool Certificates are appropriately excluded from regulation as investment companies. Further we ask that the Commission designate both pass-through and pay-through Partial Pool Certificates as Qualifying Interests, particularly given future changes that may occur as a result of GSE reform and implementing Dodd-Frank that potentially could significantly diminish the role of mortgage REITs in capital formation for the Country's ailing housing markets.

Finally, we strongly endorse the findings and comments made in the NAREIT Residential Mortgage REIT and SIFMA comment letters regarding (a) the well-regulated environment in which mortgage REITs currently operate that fosters a culture within which investors are well-protected and (b) the significant current and future role of mortgage REITs in support of our nation's housing markets through capital formation.

We appreciate the challenges faced by the Commission in today's economic and politically-charged regulatory environment and its efforts to ensure that investors are adequately protected. We hope that the information gathered in response to the Concept Release will convince the Commission that the mortgage REIT industry is an important part of the answer to the present and future capital formation needs of our nation's housing markets. Further, we hope the Commission will be convinced that past interpretations can be safely modernized to facilitate further capital formation by our industry.

We would be pleased to have the opportunity to discuss these matters further with members of the Commission and its Staff. Please feel free to contact me with any questions, concerns or comments.

Sincerely,



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