

## CFTC Staff Provides Mortgage REITs With No-Action Relief From Commodity Pool Operator Registration

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On December 7, 2012, the Commodity Futures Trading Commission (CFTC) Division of Swap Dealer and Intermediary Oversight (**Division**) issued no-action relief from commodity pool operator (CPO) registration to mortgage REITs that use CFTC-regulated products (**commodity interests**) and that satisfy certain enumerated criteria.<sup>1</sup> **In order to claim this no-action relief, an eligible mortgage REIT must submit a notice to the Division.**

### Mortgage REIT No-Action Relief

Consistent with previous no-action letters that were issued to three different publicly traded mortgage REITs in 2000 by the Division's predecessor (the Division of Trading and Markets),<sup>2</sup> the Division states in the no-action letter that mortgage REITs "are properly considered commodity pools," but concludes that CPO registration is unnecessary based on mortgage REITs' limited use of commodity interests and on the applicability of other laws and regulations.<sup>3</sup> The no-action letter acknowledges that mortgage REITs' primarily invest in mortgage loans, mortgage-backed securities and other real estate-related assets, and that their commodity interest activities generally are limited to hedging or mitigating the risks (normally changes in interest rates or fluctuations in currency) of those primary investments. The no-action letter further recognizes that a mortgage REIT's use of commodity interests is restricted by the provisions of the Internal Revenue Code of 1986, as amended. Specifically, the tax code requires that in order to qualify annually as a REIT, a mortgage REIT must satisfy two income tests — a 75 percent test and a 95 percent test — the latter of which places a cap on the amount of income that a mortgage REIT can receive in a year from commodity interest transactions that are not "qualified hedging transactions."<sup>4</sup> The no-action letter also notes that any mortgage REIT relying on the exclusion under Section 3(c)(5)(C) of the Investment Company Act of 1940 must have at least 55 percent of its assets in qualifying real estate interests.

Pursuant to the no-action letter, the Division will not recommend that the CFTC take enforcement action against a mortgage REIT if its operator fails to register as a CPO, provided that the mortgage REIT (1) submits a claim to take advantage of the relief and (2) the mortgage REIT:

- (a) Limits the initial margin and premiums required to establish its commodity interest positions to no greater than 5 percent of the fair market value of the mortgage REIT's total assets;

1 The no-action letter was issued in response to numerous requests submitted by Skadden on behalf of its clients (as well as to other requests submitted by four separate law firms). See CFTC Staff Letter No. 12-44, available [here](#).

2 CFTC Staff Letter No. 00-49, Comm. Fut. L. Rept. (CCH) ¶28,100 (March 24, 2000); CFTC Staff Letter No. 00-50, Comm. Fut. L. Rept. (CCH) ¶28,101 (March 24, 2000); CFTC Staff Letter No. 00-53, Comm. Fut. L. Rept. (CCH) ¶28,115 (March 24, 2000).

3 The no-action letter also states that the Division remains "open to discussions with mortgage REITs to consider the facts and circumstances of their ... structures with a view to determining whether or not they might not be properly considered a commodity pool."

4 See 26 U.S.C. §§ 856(c)(3), 856(c)(5)(G) and 1221(b)(2).

- (b) Limits the net income derived annually from its commodity interest positions, excluding the income from commodity interest positions that are “qualifying hedging transactions,” to less than 5 percent of its annual gross income;
- (c) Does not market interests in the mortgage REIT to the public as interests in a commodity pool or otherwise in a vehicle for trading in the commodity futures, commodity options or swaps markets; and
- (d) Either:
  - (i) Identified itself as a “mortgage REIT” in Item G of its last U.S. income tax return on Form 1120-REIT; or
  - (ii) If it has not yet filed its first U.S. income tax return on Form 1120-REIT, it discloses to its shareholders that it intends to identify itself as a “mortgage REIT” in its first U.S. income tax return on Form 1120-REIT.

### **Procedure to Claim No-Action Relief**

The relief provided in the no-action letter is not self-executing. Eligible mortgage REITs are required to file a claim with the Division via email. Such claim, as long as it is materially complete, will become effective upon filing. The claim must:

- (a) State the name, main business address and main business telephone number of the mortgage REIT with respect to which the relief is being claimed;
- (b) Be electronically signed by a person authorized to bind the mortgage REIT; and
- (c) Be filed with the Division via email at [dsionoaction@cftc.gov](mailto:dsionoaction@cftc.gov) with the subject line “mREIT” prior to December 31, 2012, for a mortgage REIT in operation as of December 1, 2012, or, for a mortgage REIT that begins to operate after December 1, 2012, within 30 days after it begins to operate as a mortgage REIT.

The Division noted in the no-action letter that the relief will not excuse the affected mortgage REIT from compliance with any other applicable requirements set forth in the Commodity Exchange Act or in CFTC regulations (such as the antifraud provisions).