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September 5, 2017

Office of Chief Counsel
Division of Investment Management
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: Redwood Trust, Inc.

On behalf of Redwood Trust, Inc. ("Redwood"), this is a request to the staff of the Division of Investment Management (the "Staff") regarding the Section 3(c)(5)(C) exclusion from the registration requirements of the Investment Company Act of 1940 (the "1940 Act"). Specifically, we request that the Staff advise that it will not recommend that the Securities and Exchange Commission take any enforcement action if subsidiaries of Redwood treat their investments in the notes or other instruments by which Fannie Mae and Freddie Mac (the "Enterprises") transfer credit risk to the private sector, as described more fully below, as "real-estate-type interests" for purposes of determining the applicability to such entities of the Section 3(c)(5)(C) exclusion.

Redwood is a residential mortgage-focused finance company. Redwood, established in 1994, is internally managed and is structured as a real estate investment trust ("REIT") for tax purposes, and conducts certain of its business and investment activities through wholly-owned subsidiaries ("Redwood Subsidiaries"). Redwood, through the Redwood Subsidiaries, acquires mortgages, mortgage-backed securities ("MBS") and other real-estate related assets. Among the assets Redwood acquires are securities (referred to as "credit risk transfer securities") that effectively transfer to institutional investors a portion of the credit risk of mortgage pools that are owned by Fannie Mae or Freddie Mac or that back MBS whose timely principal and interest payments are guaranteed by Fannie Mae or Freddie Mac.

Mortgages acquired by Redwood and its subsidiaries may be included in Redwood-sponsored mortgage-backed securitization transactions, sold to third parties such as banks or other financial institutions or investors, or held by Redwood or its subsidiaries as long-term investments. In addition to investing in securities through which the Enterprises transfer mortgage credit risk to the private sector, Redwood and its subsidiaries have also entered into bilateral transactions with the Enterprises in which such subsidiaries retain credit risk on mortgages sold to the Enterprises.

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Fannie Mae and Freddie Mac and the Federal Housing Finance Agency ("FHFA")

Fannie Mae and Freddie Mac are federally-chartered corporations that provide liquidity to the single- and multi-family residential mortgage markets by purchasing and guaranteeing mortgages originated by their lender-customers and issuing guaranteed mortgage-backed securities to global investors.

FHFA is a federal agency established in July 2008 by the Housing and Economic Recovery Act of 2008 and is responsible for the supervision, regulation, and housing mission oversight of the Enterprises. In response to a substantial deterioration in the housing markets that severely damaged the financial condition of the Enterprises, FHFA placed Fannie Mae and Freddie Mac into conservatorship in September 2008. FHFA continues to serve as conservator of the Enterprises.

Since establishing conservatorship in 2008, one of the key goals on which FHFA and the Enterprises have focused is mitigating Enterprise losses, which ultimately are borne by taxpayers.[1] In 2012, FHFA initiated a strategic plan to develop a program of credit risk transfer intended to reduce Fannie Mae's and Freddie Mac's overall exposure to mortgage credit risk. Credit risk transfer is now a regular part of the Enterprises' business. The Enterprises are currently transferring a significant amount of the credit risk on almost 90% of the loans that account for the vast majority of their exposure to underlying credit risk.[2]

Credit Risk Transfer Transactions

Both Fannie Mae and Freddie Mac transfer mortgage credit risk to the private sector, or otherwise share credit risk with the private sector, through a number of different arrangements, including through issuance of Fannie Mae's Connecticut Avenue Securities™ ("CAS") and Freddie Mac's Structured Agency Credit Risk ("STACR®") notes. These instruments share many characteristics. Each is an unsecured recourse obligation of the issuer (either Fannie Mae or Freddie Mac). Although not secured by or representing a direct ownership

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[1] FED. HOUS. FIN. AGENCY, A STRATEGIC PLAN FOR ENTERPRISE CONSERVATORSHIPS: THE NEXT CHAPTER IN A STORY THAT NEEDS AN ENDING 2 (2012), https://www.fhfa.gov/aboutus/reports/reportdocuments/20120221_strategicplanconservatorships_508.pdf.

[2] FED. HOUS. FIN. AGENCY, OVERVIEW OF FANNIE MAE AND FREDDIE MAC CREDIT RISK TRANSFER TRANSACTIONS 2 (2015), https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/CRT-Overview-8-21-2015.pdf.

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interest in mortgages, principal payments on the CAS and STACR notes are determined by and are inextricably linked to the delinquency and principal payment experience on designated pools of mortgages underlying specified Fannie Mae- or Freddie Mac-guaranteed mortgage-backed securities.

The CAS and STACR note transactions are designed to provide credit risk protection to Fannie Mae or Freddie Mac with respect to mortgages in the designated reference pools that experience specified credit events. During the term of the CAS and STACR notes, the outstanding principal of the notes is reduced to reflect specified credit events with respect to the designated mortgages in the reference pools (e.g., 180-day delinquencies, short sales or deeds-in-lieu of foreclosure), and is written up to reflect certain other adjustments. Such reductions of the note balances are based on methodologies specified in connection with particular issuances.

The CAS and STACR notes transfer credit risk on mortgages that have already been purchased by the applicable Enterprise, and are referred to as "back end" credit risk transfer transactions. The Enterprises also enter into "front end" credit risk sharing transactions with lenders who retain, at the time of sale, a portion of the credit risk on mortgages sold to the Enterprises. The Enterprises also enter into both front end and back end arrangements to share mortgage credit risk with mortgage insurers.

The form of the instruments by which the Enterprises transfer credit risk to the private sector and the way in which the government provides its guarantee to support the market are likely to change as a result of the changes underway and further contemplated to the securities issuance programs of the Enterprises (including the "Single Security" and the "Common Securitization Platform"),[3] the various Congressional housing finance reform proposals that would reform or replace the Enterprises with other governmental agencies or otherwise change the way in which the federal government supports the housing markets,[4] and the focus of FHFA on the

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[3] *Single Security and the Common Securitization Platform (CSP),* FREDDIE MAC, http://www.freddiemac.com/mbs/html/single_security_csp.html (last visited Apr. 9, 2017).

[4] Such proposed legislation, which would wind down and phase out the Enterprises, replace the Enterprise guarantee structure with a Ginnie Mae guarantee program or with another federal guarantee program, or replace the Enterprises with a lender-owned cooperative or a new government regulator, etc., includes the following: Partnership to Strengthen Homeownership Act of 2015, H.R. 1491, 114th Cong. (2015)—Delaney/Carney/Himes; Housing Opportunities Move the Economy (HOME) Forward Act of 2014—Waters; Housing Finance Reform and Taxpayer Protection Act of 2013, S. 1217, 113th Cong. (2013)—Corker/Warner; Housing Finance Reform and Taxpayer Protection Act of 2014, S. 1217, 113th

development of additional credit risk transfer structures.[5] In May 2017, Fannie Mae and Freddie Mac announced proposed changes to the CAS and STACRs programs that are designed to expand the investor base for these securities, making the programs more attractive to REITs and other investors, and limiting investor exposure to the Enterprises. Under the proposed new structure, the CAS and STACR notes would be issued by trusts that qualify as REMICs. There is no assurance at this time as to whether the proposed changes will be adopted or as to the timing of implementation.

Redwood's request for advice includes the Fannie Mae CAS and Freddie Mac STACR notes as well as other investments in mortgage credit risk arising out of "back end" credit risk transfer transactions that have the following commonalities: (1) payment of the stated principal and interest on such securities is not guaranteed; (2) the performance of the securities is designed to simulate the delinquency and principal payment experience of a designated reference pool of mortgages that are owned by Fannie Mae or Freddie Mac or that back specified Fannie Mae- or Freddie Mac-guaranteed MBS; (3) their payments are not derived directly from mortgage cash flows; (4) the securities are not secured by and do not represent a direct ownership interest in mortgages; and (5) ownership does not empower investors to control the servicing of, or foreclose on, any of the pooled mortgages.

Legal analysis

Section 3(c)(5)(C) of the 1940 Act provides an exclusion from the definition of "investment company", and therefore from the registration requirements of the 1940 Act, for:

> [A]ny person who is not engaged in the business of issuing redeemable securities, face-amount certificates of the installment type or periodic payment plan certificates, and who is primarily engaged in one or more of the following businesses: . . . purchasing or otherwise acquiring mortgages and other liens on and interests in real estate.

Cong. (2014)—Johnson/Crapo; Protecting American Taxpayers and Homeowners (PATH) Act of 2013, H.R. 2767, 113th Cong. (2013)—Hensarling.

[5] "FHFA expects that the Enterprises will continue to advance their credit risk transfer programs by developing additional transaction structures, refining the structures already offered, and seeking to expand the investor base for credit risk transfer transactions." FED. HOUS. FIN. AGENCY, SINGLE-FAMILY CREDIT RISK TRANSFER REQUEST FOR INPUT 2 (2016), https://www.fhfa.gov/PolicyProgramsResearch/Policy/Documents/SF-CRT-RFI-6292016.pdf.

The Staff has taken the position that an issuer may rely on the exclusion provided by Section 3(c)(5)(C) if at least 55% of the issuer's assets consist of mortgages and other liens on and interests in real estate ("Qualifying Interests") and the remaining 45% of its assets consist primarily of real estate-type interests. As for such remaining assets, the Staff has stated that an issuer must "invest at least 25% of its total assets in real estate-type interests (subject to reduction to the extent that the issuer invests more than 55% of its total assets in qualifying interests) and may invest no more than 20% of its total assets in miscellaneous investments".[6]

The term "real estate-type interests" is not defined in the 1940 Act. However, the Staff has expressed the view that certain mortgage-related instruments that are not treated as Qualifying Interests may be treated as real estate-type interests, including, among other things, "agency partial pool certificates".[7]

Like the agency partial pool certificates described below, payments of principal, and therefore the return, on CAS and STACR notes and on other similar investments in mortgage credit risk described above, are tied directly to the credit and prepayment performance of a designated pool of residential mortgages which are guaranteed by Fannie Mae or Freddie Mac.[8] For this reason and for the reasons outlined below, it is our view that the CAS and STACR notes and such other similar investments should be treated as real estate-type interests as well.

Treatment of the CAS and STACR notes, and the other similar investments in mortgage credit risk described above, as "real estate-type interests" is further buttressed by the role that such investments play in financing housing. All of the credit risk transactions covered by this request are and will be essential parts of the financing of housing in the United States. When Freddie Mac was nearing completion of its first risk-sharing transaction in 2013, the then-Acting

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[6] Capital Trust, Inc., SEC Staff No-Action Letter (Feb. 3, 2009). *See also* Citytrust, SEC Staff No-Action Letter (Dec. 19, 1990).

[7] *See* Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments, Investment Company Act Release No. IC-29778, 76 Fed. Reg. 55,300, at 55,306 & n.54–55 (Sept. 7, 2011). References to "agency partial pool certificates" are to certificates issued by one of the Enterprises and that represent less than the entire ownership interest in a mortgage pool.

[8] Also, like agency partial pool certificates, such instruments through which credit risk is transferred do not empower investors to control servicing of the related mortgages or to foreclose on the related mortgages. We note, of course, that while the performance of the CAS and STACR notes is linked inextricably to the related pools of mortgages, such instruments do not represent a direct ownership interest in the mortgages in the same way that agency partial pool certificates represent a direct ownership interest in the pool of mortgages underlying such certificates.

Director of FHFA, Edward J. DeMarco, referred to the transaction as "a key step in the process of attracting private capital back to the U.S. housing finance market."[9]

CAS and STACR notes, and the other similar investments in mortgage credit risk described above, have similar characteristics and have the same economic substance as Enterprise-issued subordinate interests in pools of mortgages.[10] Such subordinate interests are agency partial pool certificates that do not benefit from an agency guarantee (i.e., that transfer mortgage credit risk to the private sector) and should be considered "real estate-type interests" for purposes of the Section 3(c)(5)(C) exclusion.

Even though the economic substance of CAS and STACR notes, and the other similar investments in mortgage credit risk described above, is the same as such agency partial pool certificates, the Enterprises have elected not to transfer residential mortgage credit risk to the private sector by issuing agency partial pool certificates because that structure would be highly problematic for the "To-Be-Announced" ("TBA") market, another essential part of the U.S. housing finance system. As counsel to the Enterprises have explained, "the terms of . . . multi-class securities with non-guaranteed subordinate tranches would vary widely from deal to deal and accordingly undermine the necessary market homogeneity and liquidity required for meeting TBA market eligibility."[11]

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[9] *Statement of FHFA Acting Director, Edward J. DeMarco, on Freddie Mac Risk-Sharing Transaction,* FED. HOUS. FIN. AGENCY (July 24, 2013), https://www.fhfa.gov/Media/PublicAffairs/Pages/Statement-of-FHFA-Acting-Director-Edward-J-DeMarco-on-Freddie-Mac-RiskSharing-Transaction.aspx.

[10] Freddie Mac has issued subordinate interests in its multi-family loan securitizations, referred to as "K-Deals". For a description of Freddie Mac K-Deals, see *A Closer Look: K-Deal Program Attracts Private Capital, Reduces Risk,* FREDDIE MAC (Apr. 2015), http://www.freddiemac.com/multifamily/pdf/mf_closer_look_k_deals.pdf. n

[11] Letter from Wells M. Engledow, Vice President & Deputy Gen. Counsel, Fed. Nat'l Mortg. Ass'n, and Melinda Reingold, Vice President & Deputy Gen. Counsel, Mortg. Sec., Fed. Home Loan Mort. Corp., to Elizabeth Sandoe, Sec. & Exch. Comm'n 5 (Dec. 21, 2015), https://www.sec.gov/comments/s7-38-11/s73811-57.pdf. According to a task force comprised of the staff of the Department of the Treasury, the Office of Federal Housing Enterprise Oversight, and the Securities and Exchange Commission:

> The TBA market functions on the premise that even though each pool that will be created is unique, all pools eligible for delivery on a given TBA trade are equivalent in their characteristics and expected performance. Therefore, any distinct characteristics of the underlying mortgage loans comprising a pool delivered in a trade are considered to blend together so that the [mortgage-backed securities] they back can be considered a generic security. As a result, TBA market participants consider [mortgage-backed securities] of

By contrast, the issuance of CAS and STACR notes to transfer credit risk to the private sector does not change the structure of the mortgage-backed securities issued by Fannie Mae and Freddie Mac and, accordingly, does not in any way interfere with smooth functioning of the TBA market. Maintaining the integrity of the TBA market is an essential component of liquidity for the Fannie Mae and Freddie Mac residential mortgage-backed securities markets.[12] Given the evolving role of the Enterprises and of the state of the housing finance market generally, we urge the Staff to take into account the economic substance of the CAS and STACR notes (and other similar investments in mortgage credit risk described above) in assessing whether such investments should be treated as real estate-type interests for purposes of evaluating the applicability of Section 3(c)(5)(C).

Public Policy Considerations

FHFA has continuously, for the last several years, directed the Enterprises to transfer more credit risk to the private sector in order to contract the dominant presence of the Enterprises in the marketplace and, as a result, to lower the risk to taxpayers.[13] FHFA has also directed the Enterprises to engage in multiple types of risk transfer structures.[14]

> Fannie Mae, Freddie Mac and Ginnie Mae that meet the Good Delivery Guidelines to be interchangeable or fungible with other such [mortgage-backed securities] issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae, respectively.

DEP'T OF TREASURY ET AL., STAFF REPORT: ENHANCING DISCLOSURE IN THE MORTGAGE-BACKED SECURITIES MARKETS 18 (2003), https://www.fhfa.gov/PolicyProgramsResearch/Research/PaperDocuments/20030203_RP_EnhancingDisclosureMBSMarkets_N508.pdf. The TBA market is not a relevant factor in the multi-family loan market.

[12] As explained by FHFA, "[t]he TBA market is an important contributor to a strong, vibrant, and highly liquid secondary mortgage market, which benefits lenders, investors, and borrowers." FED. HOUS. FIN. AGENCY, AN UPDATE ON IMPLEMENTATION OF THE SINGLE SECURITY AND THE COMMON SECURITIZATION PLATFORM 1 (2016), https://www.fhfa.gov/aboutus/reports/reportdocuments/implementation-of-the-ss-and-the-csp_772016.pdf.

[13] *See* FED. HOUS. FIN. AGENCY, FHFA STRATEGIC PLAN: FISCAL YEARS 2015-2019, at 15 (2014), https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/FHFA-Strategic-Plan-FY-2015-2019.pdf.

[14] FED. HOUS. FIN. AGENCY, THE 2014 STRATEGIC PLAN FOR THE CONSERVATORSHIPS OF FANNIE MAE AND FREDDIE MAC 12–13 (2014) [hereinafter 2014 Strategic Plan], https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2014StrategicPlan05132014Final.pdf. Thirty percent (30%) of FHFA's 2017 Scorecard for the Enterprises is based on the following objective: "Reduce taxpayer risk through increasing the role of private capital in the mortgage market." FED. HOUS. FIN.

In addition, FHFA Deputy Director, Division of Conservatorship, Wanda DeLeo, in a statement before the U.S. Senate Committee on Banking, Housing and Urban Affairs, identified the reduction of systemic risk as another benefit of credit risk sharing transactions.

> [The Enterprises' credit risk sharing transactions spread] risk across many investors with varying degrees of leverage, and with varying degrees of risk concentration in mortgages. Less risk concentration and less leverage has the potential to reduce systemic risk relative to past and current practices that channel the bulk of the risk into a very small number of highly leveraged institutions, such as the Enterprises.[15]

Redwood, like other mortgage REITs, has limited balance sheet room for CAS and STACR notes if such notes are not treated as "real estate-type interests" for purposes of Staff interpretations of the Section 3(c)(5)(C) exclusion. At the same time, the market for CAS and STACR deals continues to grow,[16] FHFA intends for the Enterprises to continue to develop and expand their credit risk transfer programs,[17] and increased liquidity from current and additional investors will be required for these programs to be economically feasible.

Liquidity is currently inadequate. FHFA is concerned that "the long-term prospects of a robust investor base are yet to be tested".[18] Redwood and other residential-focused mortgage finance companies, including mortgage REITs, fit the ideal profile of long-term credit risk transfer

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AGENCY, 2017 SCORECARD FOR FANNIE MAE, FREDDIE MAC, AND COMMON SECURITIZATION SOLUTIONS 5 (2016), https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2017-Scorecard-for-Fannie-Mae-Freddie-Mac-and-CSS.pdf.

[15] Wanda DeLeo, Deputy Dir., Fed. Hous. Fin. Agency Div. of Conservatorship, Statement Before the U.S. Senate Committee on Banking, Housing and Urban Affairs: Housing Finance Reform: Fundamentals of Transferring Credit Risk in a Future Housing Finance System (Dec. 10, 2013).

[16] CAS and STACRs note issuances, in the aggregate, have increased from $1.8 billion in 2013, to $10.8 billion in 2014 and $12.6 billion in 2015. *See* FED. HOUS. FIN. AGENCY, SINGLE-FAMILY CREDIT RISK TRANSFER PROGRESS REPORT 6 tbl.2 (2016), https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/CRT-Progress-Report-6292016.pdf.

[17] FHFA has stated that "[g]oing forward, [it] will continue to encourage the Enterprises to engage in large volumes of meaningful credit risk transfer through specific goals in the annual conservatorship scorecard and by working closely with Enterprise staff to develop and evaluate credit risk transfer structures." FED. HOUS. FIN. AGENCY, *supra* note 2, at 2.

[18] 2014 Strategic Plan, *supra* note 14, at 13.

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investors. A broader field of market participants will increase liquidity and improve pricing to the Enterprises when issuing these securities.

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The treatment of CAS and STACR notes and similar risk transfer investments as "real estate-type interests" for purposes of the Section 3(c)(5)(C) exclusion would be consistent with the language, as well as the legislative history, of Section 3(c)(5)(C), and also with the public policy objectives described above. Accordingly, we believe that a Redwood subsidiary may hold up to 45% of its assets in these credit risk transfer securities and be able to rely on the Section 3(c)(5)(C) exclusion provided that at least 55% of its assets are qualifying interests and that the other conditions of the exclusion are satisfied.

On the basis of the foregoing, we respectfully request that the Staff advise that it will not recommend that the Securities and Exchange Commission take any enforcement action if Redwood's subsidiaries treat their investments in instruments by which Fannie Mae and Freddie Mac transfer credit risk to the private sector as "real-estate-type interests" for purposes of determining the applicability to such entities of the Section 3(c)(5)(C) exclusion from the registration requirements of the 1940 Act.

If for any reason the Staff is not disposed to grant the requested no-action position, we request an opportunity to discuss this matter with the Staff prior to the issuance of any formal letter.

We thank you for your attention to this matter. If further clarification is required, please contact Andrew Stone, General Counsel of Redwood (andy.stone@redwoodtrust.com; (415) 389-7373), or Howard Altarescu of Orrick, Herrington & Sutcliffe LLP (haltarescu@orrick.com; (212) 506-5000).

Very truly yours,

Howard Altarescu