

# Operators of Mortgage REITs Exempted from Requirements for Commodity Pool Operators

The Commodity Futures Trading Commission's ("CFTC") Division of Swap Dealer and Intermediary Oversight has issued a no-action letter that exempts an operator of a mortgage REIT ("mREIT") that satisfies certain specified criteria from the requirements applicable to "commodity pool operators". As a result, the operators of qualifying mREITs will not need to register as "commodity pool operators". However, this exemption is not self-executing and the mREIT must file a claim for relief.

## Background

Under the CEA, a "commodity pool" is defined as any investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity interests. Commodity pool operators ("CPOs") are subject to regulation by the CFTC. Historically, "commodity interests" were largely limited to futures and options contracts. However, as a result of changes mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd Frank Act") the definition of "commodity interest" was expanded to include swaps (although physically settled foreign exchange swaps or forwards are not swaps or commodity interests for these purposes.) For any investment trust considered to be a commodity pool, the entity acting as its operator will be required to register with the CFTC as the CPO for that investment trust.

As a result of these changes, REITs that enter into swaps or other commodity interests could fall within the CFTC's broad interpretation of the definition of commodity pool and therefore potentially subject their managers, sponsors or directors to regulation and registration as a CPO. In a letter dated October 11, 2012, the CFTC staff exempted equity REITs that meet certain criteria from the definition of "commodity pool". (See Clifford Chance Client Memorandum available [here](#)).

## Mortgage REITs

On December 7, 2012, the CFTC staff issued a letter (the "Staff Letter", available [here](#)) that states that the Division will not take action against the operator of an mREIT if the mREIT meets the following criteria:

1. The mREIT must limit initial margin and premiums for commodity interests (swaps and exchange-traded derivatives) to no more than 5% of the fair market value of the mREIT's total assets;
2. The mREIT must limit net income derived annually from commodity interests that are not "qualifying hedging transactions" to less than 5% of gross income ("qualifying hedging transactions" appear to be qualified REIT hedging transactions as described in Section 856 of the Internal Revenue Code);

3. Interests in the mREIT must not be marketed to the public as a commodity pool or other vehicle for trading in commodity interests; and
4. The mREIT must identify itself as a mortgage REIT in item G of its income tax return on Form 1120-REIT (or, if no income return has yet been filed on Form 1120-REIT, the mREIT must disclose to shareholders that it will so identify itself.)

The operator of an mREIT meeting the above criteria will not be subject to regulation as a CPO if it files the claim described below.

### The Relief is Not Self-Executing

The Staff Letter states that the relief provided is not self-executing. In order to obtain relief, the mREIT must file a claim to obtain relief. Such a claim would be effective upon filing, as long as it is complete.

The only requirements for the claim that are specified in the Staff Letter are that the claim (i) must identify the mREIT; (ii) be signed by a person authorized by the mREIT and (iii) must be filed with the CFTC by email prior to December 31, 2012 or, for an mREIT that begins to operate after December 1, 2012, within 30 days after it begins to operate as an mREIT.

## Contacts

### Jay Bernstein

T: +1 212 878 8527  
E: jay.bernstein@cliffordchance.com

### Per Chilstrom

T: +1 212 878 3079  
E: per.chilstrom@cliffordchance.com

### Lewis Cohen

T: +1 212 878 3144  
E: lewis.cohen@cliffordchance.com

### Andrew Epstein

T: +1 212 878 8332  
E: andrew.epstein@cliffordchance.com

### David Felsenthal

T: +1 212 878 3452  
E: david.felsenthal@cliffordchance.com

### Larry Medvinsky

T: +1 212 878 8149  
E: larry.medvinsky@cliffordchance.com

### Jason Myers

T: +1 212 878 8324  
E: jason.myers@cliffordchance.com

### Gareth Old

T: +1 212 878 8539  
E: gareth.old@cliffordchance.com

### Kathleen Werner

T: +1 212 878 8526  
E: kathleen.werner@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA  
© Clifford Chance US LLP 2012  
Clifford Chance US LLP

[www.cliffordchance.com](http://www.cliffordchance.com)

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Kyiv ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh\* ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

\*Clifford Chance has a co-operation agreement with Al-Jadaan & Partners Law Firm in Riyadh.