

# Clients & Friends Alert

## Legislation Affecting the REMIC Status of Existing Mortgage Securitization Transactions

**February 5, 2009** An amendment (the "Amendment") was introduced in the U.S. Senate yesterday to the American Recovery and Reinvestment Act of 2009 (the "Economic Stimulus Bill") that requires your immediate attention. The Amendment, if enacted into law, would have a significant impact on existing mortgage securitization transactions by denying tax-free REMIC status to a securitization if any document governing the activities of the servicer or trustee in that securitization restricts the ability of the servicer or trustee to reasonably modify or dispose of a mortgage loan in order to participate in any program established under TARP. A copy of the Amendment and sponsors' explanation are attached to this memorandum.

The Amendment is not currently law and we understand that legislative efforts are underway to have the Amendment withdrawn from the Economic Stimulus Bill. Even if removed, the elements of the Amendment may be introduced into legislation in another form. We therefore provide you with a description of the Amendment now in order to allow you an opportunity to analyze its content and to provide any desired input into the legislative process. We are in contact with the American Securitization Forum (ASF) and the Commercial Mortgage Securities Association (CMSA) to provide input and to stay abreast of developments.

Finally, while the drafters of the Amendment expressed concern for homeowners and the need to allow for broader modification of residential loans, the Amendment (as currently drafted) speaks to REMICs generally and would therefore be equally applicable to commercial mortgage loan securitizations.

### I. REMIC Status Preserved if Loans are Modified or Disposed of Pursuant to TARP

Many residential mortgage securitizations restrict or prevent the servicer or trustee from modifying or disposing of mortgage loans. In fact, consistent with a securitization vehicle's treatment as a REMIC, the servicer and trustee are generally prohibited from modifying any mortgage loan, unless default has occurred or is reasonably foreseeable. Section 1(a) of the Amendment provides that a securitization would not lose its REMIC status if the servicer or trustee modifies or disposes of a mortgage loan that is a "troubled asset" under TARP or under rules pertaining to a home mortgage relief program established under Section 2 of the Amendment (see below). Specifically, any such

modification or disposition would not subject the REMIC to a “prohibited transaction tax” nor would it cause any interest in the REMIC from failing to qualify as a regular interest, and any proceeds resulting from such modification or disposition would be treated as amounts received under “qualified mortgages” (which is what a REMIC must hold). Although perhaps it may be inferred, it would be helpful if the Amendment explicitly stated that any mortgage loan so amended would continue to be a “qualified mortgage.”

## **II. REMICs that Fail to Eliminate Restrictions on Loan Modifications Cease to Qualify as REMICs**

Section 1(b) of the Amendment states that a mortgage securitization will cease to qualify as a REMIC if the documents governing the conduct of the servicer or trustee of such REMIC:

- (1) prohibit or restrict (including restrictions on the type, number, percentage, or frequency of modification or dispositions) such servicers or trustees from reasonably modifying or disposing of any mortgage loan or foreclosure property in order to participate in a TARP program or any home mortgage relief program established under Section 2 of the Amendment,
- (2) give to a person other than the servicer or trustee the authority to prevent the reasonable modification or disposition of any mortgage loan or foreclosure property (this might include, for example, a particular investor class (such as a controlling holder), an insurer or rating agency),
- (3) require a servicer or trustee to purchase mortgage loans that are in default or as to which default is reasonably foreseeable for the purposes of reasonably modifying such mortgages or as a consequence of such reasonable modification, or
- (4) fail to provide that any duty a servicer or trustee owes when modifying or disposing of qualified mortgages or foreclosure property shall be to the trust in the aggregate and not to any individual or class of investors.

The effect of this section of the Amendment is to essentially mandate that all REMIC transaction documents be amended to remove any provision containing any of the above restrictions or requirements. Although many pooling and servicing agreements (“PSAs”) in fact permit the trustee to amend the PSA in order to preserve REMIC status, many do not. Trustees in these deals likely would need to seek the consent of each affected investor (or obtain an opinion of counsel that no class is adversely affected), as well as, in some cases, the consent of an insurer or rating agency, in order to remove any offending provision, a task that may prove difficult if not impossible. Even if the PSA is permitted to be amended by the trustee without investor consent, servicers are often restricted in their activities, particularly in commercial mortgage loan securitizations, by documents

outside the securitization (such as a participation or intercreditor agreement) entered into with parties who have little or no incentive to preserve a securitization's REMIC status.

The effective date of Section 1(b) is 3 months after the enactment of the Amendment unless the servicer seeks and obtains a waiver from the Secretary of the Treasury. This means that unless a waiver is obtained, governing documents would need to be amended within 3 months of the Amendment's enactment or the securitization risks being disqualified as a REMIC.

### **III. Treasury Authorized to Establish Residential Loan Relief Program**

Section 2 of the Amendment authorizes the Secretary of the Treasury to establish a program within 30 days of enactment to achieve broad scale modifications or dispositions of "troubled" home mortgage loans and broad-scale dispositions of foreclosure property.

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If you have any questions regarding the foregoing, please contact:

Charles M. Adelman	+1 212 504 6477	charles.adelman@cwt.com
Robert A. Davis	+1 202 862 2422	bob.davis@cwt.com
Gary T. Silverstein	+1 212 504 6858	gary.silverstein@cwt.com

or any of the following Capital Markets Department team:

#### **New York Office**

**One World Financial Center, New York, NY 10281-0006**

Michael S. Gambro	+1 212 504 6825	michael.gambro@cwt.com
Karen B. Gelernt	+1 212 504 6911	karen.gelernt@cwt.com
Anna H. Glick	+1 212 504 6309	anna.glick@cwt.com
Robert O. Link	+1 212 504 6172	robert.link@cwt.com
Lisa J. Pauquette	+1 212 504 6298	lisa.pauquette@cwt.com
Frank Poverino	+1 212 504 6820	frank.poverino@cwt.com
Patrick T. Quinn	+1 212 504 6067	pat.quinn@cwt.com
Y. Jeffrey Rotblat	+1 212 504 6401	jeffrey.rotblat@cwt.com
Jordan M. Schwartz	+1 212 504 6136	jordan.schwartz@cwt.com
Neil J. Weidner	+1 212 504 6065	neil.weidner@cwt.com

**North Carolina Office**  
**227 West Trade Street, Charlotte, NC 28202**

Stuart N. Goldstein	+1 704 348 5258	<a href="mailto:stuart.goldstein@cwt.com">stuart.goldstein@cwt.com</a>
Henry A. LaBrun	+1 704 348-5149	<a href="mailto:henry.labrun@cwt.com">henry.labrun@cwt.com</a>
Robert L. Ughetta	+1 704 348 5141	<a href="mailto:robert.ughetta@cwt.com">robert.ughetta@cwt.com</a>

**Washington Office**  
**1201 F Street N.W., Washington, DC 20004-1218**

Charles E. Bryan	+1 202 862 2212	<a href="mailto:charlie.bryan@cwt.com">charlie.bryan@cwt.com</a>
Gregg S. Jubin	+1 202 862 2485	<a href="mailto:gregg.jubin@cwt.com">gregg.jubin@cwt.com</a>

111<sup>TH</sup> CONGRESS  
1<sup>ST</sup> SESSION

**S.** \_\_\_\_\_

To provide rules for the modification or disposition of certain assets by real estate mortgage investment conduits pursuant to division A of the Emergency Economic Stabilization Act of 2008, and for other purposes.

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IN THE SENATE OF THE UNITED STATES

Mr. REED (for himself, Mr. DODD, Mr. KERRY, Mr. SCHUMER, and Ms. STABENOW) introduced the following bill; which was read twice and referred to the Committee on

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**A BILL**

To provide rules for the modification or disposition of certain assets by real estate mortgage investment conduits pursuant to division A of the Emergency Economic Stabilization Act of 2008, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Real Estate Mortgage  
5 Investment Conduit Improvement Act of 2009”.

1 **SEC. 2. SPECIAL RULES FOR MODIFICATION OR DISPOSI-**  
2 **TION OF QUALIFIED MORTGAGES OR FORE-**  
3 **CLOSURE PROPERTY BY REAL ESTATE MORT-**  
4 **GAGE INVESTMENT CONDUITS.**

5 (a) **IN GENERAL.**—If a REMIC (as defined in section  
6 860D(a) of the Internal Revenue Code of 1986) modifies  
7 or disposes of a troubled asset under the Troubled Asset  
8 Relief Program established by the Secretary of the Treas-  
9 ury under section 101(a) of the Emergency Economic Sta-  
10 bilization Act of 2008 or under rules established by the  
11 Secretary under section 3 of this Act—

12 (1) such modification or disposition shall not be  
13 treated as a prohibited transaction under section  
14 860F(a)(2) of such Code, and

15 (2) for purposes of part IV of subchapter M of  
16 chapter 1 of such Code—

17 (A) an interest in the REMIC shall not fail  
18 to be treated as a regular interest (as defined  
19 in section 860G(a)(1) of such Code) solely be-  
20 cause of such modification or disposition, and

21 (B) any proceeds resulting from such  
22 modification or disposition shall be treated as  
23 amounts received under qualified mortgages.

24 (b) **TERMINATION OF REMIC.**—For purposes of the  
25 Internal Revenue Code of 1986, an entity which is a  
26 REMIC (as defined in section 860D(a) of the Internal

1 Revenue Code of 1986) shall cease to be a REMIC if the  
2 instruments governing the conduct of servicers or trustees  
3 with respect to qualified mortgages (as defined in section  
4 860G(a)(3) of such Code) or foreclosure property (as de-  
5 fined in section 860G(a)(8) of such Code)—

6 (1) prohibit or restrict (including restrictions on  
7 the type, number, percentage, or frequency of modi-  
8 fications or dispositions) such servicers or trustees  
9 from reasonably modifying or disposing of such  
10 qualified mortgages or such foreclosure property in  
11 order to participate in the Troubled Asset Relief  
12 Program established by the Secretary of the Treas-  
13 ury under section 101(a) of the Emergency Eco-  
14 nomic Stabilization Act of 2008 or under rules es-  
15 tablished by the Secretary under section 3 of this  
16 Act,

17 (2) commit to a person other than the servicer  
18 or trustee the authority to prevent the reasonable  
19 modification or disposition of any such qualified  
20 mortgage or foreclosure property,

21 (3) require a servicer or trustee to purchase  
22 qualified mortgages which are in default or as to  
23 which default is reasonably foreseeable for the pur-  
24 poses of reasonably modifying such mortgages or as  
25 a consequence of such reasonable modification, or

1           (4) fail to provide that any duty a servicer or  
2 trustee owes when modifying or disposing of quali-  
3 fied mortgages or foreclosure property shall be to  
4 the trust in the aggregate and not to any individual  
5 or class of investors.

6 (c) EFFECTIVE DATES.—

7           (1) SUBSECTION (a).—Subsection (a) shall  
8 apply to modification and dispositions after the date  
9 of the enactment of this Act, in taxable years ending  
10 on or after such date.

11           (2) SUBSECTION (b).—

12           (A) IN GENERAL.—Except as provided in  
13 subparagraph (B), subsection (b) shall take ef-  
14 fect on the date that is 3 months after the date  
15 of the enactment of this Act.

16           (B) EXCEPTION.—The Secretary of the  
17 Treasury may waive the application of sub-  
18 section (b) in whole or in part for any period  
19 of time with respect to any entity if—

20           (i) the Secretary determines that such  
21 entity is unable to comply with the require-  
22 ments of such subsection in a timely man-  
23 ner, or

1                   (ii) the Secretary determines that  
2                   such waiver would further the purposes of  
3                   this Act.

4 **SEC. 3. ESTABLISHMENT OF A HOME MORTGAGE LOAN RE-**  
5 **LIEF PROGRAM UNDER THE TROUBLED**  
6 **ASSET RELIEF PROGRAM AND RELATED AU-**  
7 **THORITIES.**

8           (a) ESTABLISHMENT.—Not later than 30 days after  
9 the date of enactment of this Act, the Secretary of the  
10 Treasury shall establish and implement a program under  
11 the Troubled Asset Relief Program and related authorities  
12 established under section 101(a) of the Emergency Eco-

13 nomic Stabilization Act of 2008 (12 U.S.C. 5211(a))—  
14           (1) to achieve appropriate broad-scale modifica-  
15           tions or dispositions of troubled home mortgage  
16           loans; and

17           (2) to achieve appropriate broad-scale disposi-  
18           tions of foreclosure property.

19           (b) RULES.—The Secretary of the Treasury shall  
20 promulgate rules governing the—

21           (1) reasonable modification of any home mort-  
22           gage loan pursuant to the requirements of this Act;  
23           and

1           (2) disposition of any such home mortgage loan  
2           or foreclosed property pursuant to the requirements  
3           of this Act.

4           (c) CONSIDERATIONS.—In developing the rules re-  
5           quired under subsection (b), the Secretary of the Treasury  
6           shall take into consideration—

7           (1) the debt-to-income ratio, loan-to-value ratio,  
8           or payment history of the mortgagors of such home  
9           mortgage loans; and

10          (2) any other factors consistent with the intent  
11          to streamline modifications of troubled home mort-  
12          gage loans into sustainable home mortgage loans.

13          (d) USE OF BROAD AUTHORITY.—The Secretary of  
14          the Treasury shall use all available authorities to imple-  
15          ment the home mortgage loan relief program established  
16          under this section, including, as appropriate—

17                 (1) home mortgage loan purchases;

18                 (2) home mortgage loan guarantees;

19                 (3) making and funding commitments to pur-  
20                 chase home mortgage loans or mortgage-backed se-  
21                 curities;

22                 (4) buying down interest rates and principal on  
23                 home mortgage loans;

24                 (5) principal forbearance; and

1           (6) developing standard home mortgage loan  
2           modification and disposition protocols, which shall  
3           include ratifying that servicer action taken in antici-  
4           pation of any necessary changes to the instruments  
5           governing the conduct of servicers or trustees with  
6           respect to qualified mortgages or foreclosure prop-  
7           erty are consistent with the Secretary of the Treas-  
8           ury's standard home mortgage loan modification and  
9           disposition protocols.

10          (e) PAYMENTS AUTHORIZED.—The Secretary of the  
11          Treasury is authorized to pay servicers for home mortgage  
12          loan modifications or other dispositions consistent with  
13          any rules established under subsection (b).

14          (f) RULE OF CONSTRUCTION.—Any standard home  
15          mortgage loan modification and disposition protocols de-  
16          veloped by the Secretary of the Treasury under this sec-  
17          tion shall be construed to constitute standard industry  
18          practice.

**\*\*AS IF GIVEN LIVE\*\*\*\***

**REAL ESTATE MORTGAGE INVESTMENT CONDUIT IMPROVEMENT ACT OF 2009**

Mr. REED: Mr. President, today I introduce, along with Senators Dodd, Kerry, Schumer, and Stabenow, the Real Estate Mortgage Investment Conduit (REMIC) Improvement Act. This legislation could provide one of the keys to solving our national foreclosure crisis by unlocking mortgage securitization trusts so that more homeowners can stay in their homes.

In my own state of Rhode Island, 7.30% of all outstanding home loans are delinquent and 5.33% of all home loans are in the foreclosure process. This is the 10<sup>th</sup> highest foreclosure rate in the nation, and the highest in New England. I have heard story after story of how difficult it is to get a loan modified or restructured if it is part of a mortgage securitization pool. As we have learned, part of the reason we are in the worst housing crisis since the Depression is that Wall Street firms packaged mortgages into pools and then sold different tranches of these pools to investors from all over the world. This diverse and convoluted ownership structure has made it difficult to get investor approval to modify or restructure them. Unlike in the movie "It's a Wonderful Life," most families can no longer walk into their local bank to talk to George Bailey about modifying or restructuring their loan.

The Emergency Economic Stabilization Act of 2008 required the Treasury Department to use its new authorities to incentivize servicers toward more loan restructurings. However, it has become clear that additional legislation is needed to free servicers of these loan pools from conflicting requirements regarding modifications and provide them with the ability to sell mortgages to Treasury for foreclosure avoidance.

Many servicers, managing pools of loans for investors, are constrained by the trust agreements from modifying loans to a level that families can afford to pay or from selling the underlying mortgage loans. In other cases, servicers must obtain the approval of a significant

number of the trust's beneficiaries or third parties in order to make changes to how loans within the pool are handled. However, the trust agreements also provide that servicers must amend the agreements if doing so would be helpful or necessary to stay in compliance with tax rules under the REMIC statute; REMIC status frees these securitization trusts from taxation at the entity level and therefore provides important benefits to its investors.

Under the REMIC Improvement Act, in order to keep their preferred tax status under the REMIC provisions of the Internal Revenue Code, servicers would need to modify their trust agreements to remove artificial restrictions that keep them from modifying loans that provide a greater return to investors as a whole than foreclosing would, and keep families in their homes to prevent entirely unnecessary foreclosures at the same time. This is a practical way for servicers to modify loans without undue fear of legal sanctions. This also would allow servicers to sell loans to Treasury for restructuring without having to obtain an affirmative response by a significant number of the beneficiaries of the trust if it was for the good of the overall trust. Participation in any Treasury program would be voluntary, but some of the key legal impediments to participation would be removed.

Additionally, the Treasury Department has not put in place a loan modification program, even after Congress gave it the authority to do so in the Emergency Economic Stabilization Act. Many experts believe such a program would be helpful in helping resolve the current housing crisis. The REMIC Improvement Act will ensure that Treasury uses its authority to set up a program to achieve broad-scale modifications and, where necessary, dispositions of foreclosed property.

Mr. President, I ask unanimous consent that the text of REMIC Improvement Act of 2009 be printed in the record.