

RESTRUCTURINGS OF SECURITIZED DEBT AND SECURITIZATION VEHICLES

INTRODUCTION

With U.S. corporate bankruptcies poised to hit a decade-long high as a result of the economic impact of COVID-19, we have prepared these materials that detail the key bankruptcy tax issues and guidance offered by Linda Swartz, the chair of Cadwalader's Tax Group, in old and new speeches and panels. We hope you find this presentation to be both useful and informative.

For additional information, contact [Linda Swartz](mailto:linda.swartz@cwt.com) (linda.swartz@cwt.com).

Upcoming speaking engagements:

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| October 14, 2020 | <ul style="list-style-type: none">• Linda Swartz will be presenting "Tax Strategies for Financially Troubled Businesses and Other Loss Companies" at PLI's Tax Strategies for Corporate Acquisitions, Dispositions, Spin-Offs, Joint Ventures, Financings, Reorganizations & Restructurings 2020 |
| November 5, 2020 | <ul style="list-style-type: none">• Linda Swartz will be presenting "A Cause for Distress? The Ways the Federal Income Tax Pushes Taxpayers into Bankruptcy" at The University of Chicago Tax Conference |
| January 25, 2021 | <ul style="list-style-type: none">• Linda Swartz will be presenting "Distressed Corporations: Creditor and Shareholder Issues" at the 2021 University of Southern California Federal Tax Institute |
| February 8, 2021 | <ul style="list-style-type: none">• Linda Swartz will be presenting "Workouts and Debt Restructurings" at PLI's 23rd Annual Real Estate Tax Forum |
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Linda Swartz, the longtime chair of Cadwalader's Tax Group and member of the Firm's Management Committee, focuses her practice on structuring complex restructurings, bankruptcies, mergers and acquisitions, spin-offs, joint ventures, and foreign tax planning strategies. She also regularly advises clients on fund structures, financings and derivative transactions.

Linda is consistently recognized as one of the leading tax lawyers in the country. She was recently named one of 14 "Influential Women In Tax Law" by *Law360*, noted for her role as "a key architect on billion-dollar transactions involving major multinational companies" with clients describing her tax structuring expertise as "so strong that we don't even go to the IRS to get a blessing from them. We go to Linda to get a blessing from her." She has been described by *Chambers USA* as "acclaimed for her vast reservoir of practical knowledge of the U.S. tax code" and "an expert on the law of today but cognizant of where the law might go in the future, allowing clients to make decisions which last for the next ten years." Clients quoted by *The Best Lawyers in America* have described Linda as "the foremost U.S. tax advisor on structured acquisition and divestiture deals" and "a professional force of nature" with "extraordinary technical ability, coupled with fiercest and most trenchant deal negotiation skills of any transactional tax lawyer." She was also recognized as "2017 Foreign Tax Planning Lawyer of the Year" by *Finance Monthly*, and *Dow Jones*, reporting on Procter & Gamble's Reverse Morris Trust transaction with Coty, noted that "it isn't often you see a tax adviser credited on a deal, but that's exactly what happened for Cadwalader, Wickersham & Taft in P&G's complicated \$12.5 billion unloading of its beauty business to Coty."

Linda is widely regarded as a thought leader in the industry and is a prolific speaker and writer on a wide range of transactional tax issues, with articles that include "Partnership Bankruptcy Tax issues," "Debt Exchanges," "Bankruptcy Tax Issues," and "Bankruptcy Tax 101." She also authors the chapters on Debt Exchanges in *Collier on Bankruptcy Taxation* (Matthew Bender) and Securities Lending Transactions in *Taxation of Financial Institutions* (Clark Boardman Callaghan). In addition to writing, she speaks on a broad range of topics, including each year on workout and bankruptcy tax issues at the corporate and real estate tax PLI conferences.

Linda is a member of the Executive Committee of the New York State Bar Association Tax Section and has chaired its Tax-Free Reorganizations; Corporations; Bankruptcy; Consolidated Returns; Real Property; and Tax Accounting and Basis Committees.

Linda received her J.D. from University of Pennsylvania Law School, and her B.A. from Bucknell University, where she graduated *magna cum laude* and was elected to Phi Beta Kappa.

EFFECTS OF EXCHANGES FOR SECURITIZATION VEHICLES

Practical difficulties may arise when securitization vehicles hold troubled loans.

- Pooling and servicing agreements typically require servicer to maximize proceeds for investors, but limit timing and scope of servicer actions in workouts.
 - Generally not feasible to obtain certificate holders' consent to take additional actions.
 - Servicer actions after workout must also be strictly limited for new debt to be held by “qualified special purpose entity” and kept off balance sheet.
- Bankruptcies of underlying borrowers can have a larger impact on CLOs than other debt holders.
 - CLOs typically have small holdings of broadly syndicated loans, and CLO indentures contain restrictions on expending funds in a workout.
 - Because of this, CLOs are not well equipped to participate in restructurings, which can result in CLOs being forced to sell distressed loans at steep discount.
- Workouts can cause issues for securitization vehicles that must avoid engaging in a U.S. trade or business.
 - Managers of offshore CLOs typically follow “tax guidelines”, outlining permitted actions relating to loan originations, purchases and workouts, to avoid U.S. trade or business treatment.
 - Tax guidelines typically do not address additional advances to a borrower and must instead be reviewed by counsel on a case-by-case basis.

SATISFYING SECURITIZATION RULES

REMICs and grantor trusts cannot significantly modify a loan until it is “reasonably foreseeable” that it will be in default.

- Qualifying worked out loans will not be retested for equity characterization following deemed taxable exchange.
- Deemed exchange of a loan for which default is “reasonably foreseeable” is neither a potentially REMIC disqualifying prohibited transaction nor modification of a REMIC’s regular interests.
 - Similarly, a grantor trust’s modification of such a loan also will not be treated as a disqualifying power to vary the investment of certificate holders.
- Rev. Proc. 2020-26 permits REMICs and grantor trusts to grant COVID-19 related forbearances and make related modifications, regardless of whether default is “reasonably foreseeable”.
 - Forbearances under the CARES Act or similar forbearances are not prohibited transactions for REMICs nor a modification of regular interests.
 - Such forbearances made by grantor trusts do not manifest a power to vary the investment of certificate holders.

SATISFYING SECURITIZATION RULES (cont'd)

Permitted modifications prior to “reasonably foreseeable” default

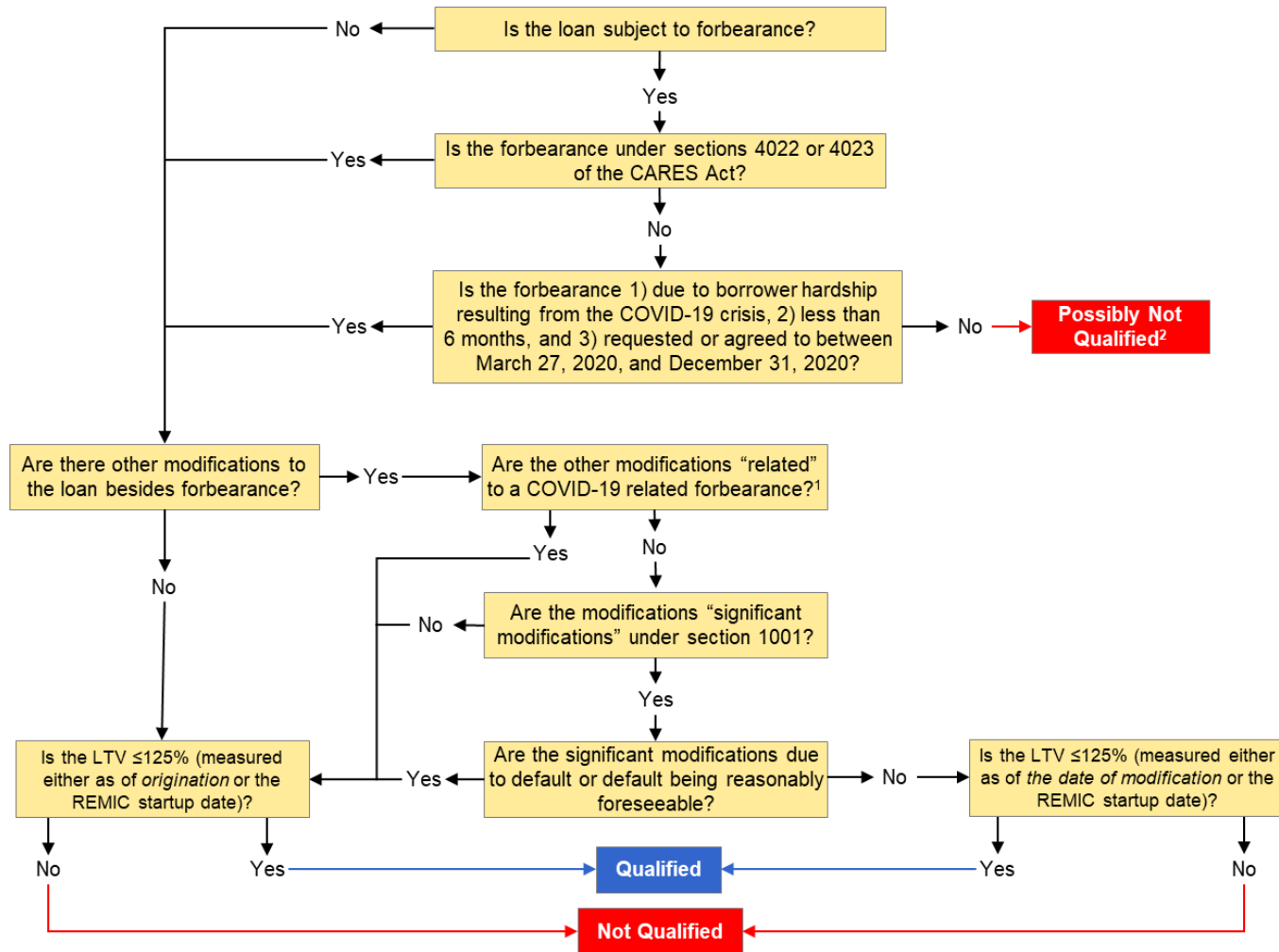
	REMIC	Grantor Trust
Change in yield	Permitted if less than (i) 25 basis points or (ii) 5% of the original annual yield of unmodified loan	Permitted if less than (i) 25 basis points or (ii) 5% of the original annual yield of unmodified loan
Releases of real property	Permitted if loan meets 125% LTV test after release or undergoes a qualified paydown	Permitted if (i) pursuant to terms of the loan, or (ii) not a substantial amount (generally 10%)
Deferral of scheduled payments, extensions	Permitted if less than (i) 5 years and (ii) 50% of the original term of the loan	Permitted if less than (i) 5 years and (ii) 50% of the original term of the loan
Change in lien priority	Permitted if does not result in a change in payment expectations	Permitted if does not result in a change in payment expectations
Prepayment premium waiver	Permitted if pro rata	Permitted if pro rata
Change from recourse to nonrecourse or vice versa	Permitted	Permitted if no change in collateral or payment expectations
Change in amount or use of reserves	Permitted	Permitted if not a substantial amount (generally 10%)
Changes to guarantee	Permitted	Permitted if not a substantial amount (generally 10%)

ACQUISITIONS OF DISTRESSED MORTGAGE LOANS

REMICs have restrictions on mortgage loans they may acquire

- To qualify for inclusion in a REMIC, a mortgage must have a loan-to-value ratio (LTV) less than 125% on either the origination date or the date the loan was contributed to the REMIC.
 - If the loan has been “significantly modified” prior to inclusion in a REMIC, the LTV must be tested as of the modification date.
- Real property acquired in foreclosure is not a good REMIC asset if, upon the date of contribution, the REMIC knew or had reason to know the loan would default.
 - If a workout is unsuccessful, REMIC will have to sell a foreclosure-imminent mortgage loan for which it had “improper knowledge” of anticipated default.
- REMICs issue classes of debt known as “regular interests”, the principal of which cannot be contingent.
 - If a loan subject to forbearance not covered under the COVID-19 safe harbor is contributed to a REMIC, the REMIC servicer will either need to make advances to cover missed borrower payments, or principal amounts on the regular interests must be reduced by anticipated shortfalls due to the forbearance.
- Rev. Proc. 2020-26 provides a safe harbor for REMICs acquiring loans subject to COVID-19 related forbearances and related modifications.
 - CARES Act and similar forbearances are not evidence of “improper knowledge”.
 - Such forbearances and related modifications do not reset the LTV determination date.
 - Delays and shortfalls due to COVID-19 related forbearances are not contingencies that would cause an interest in a REMIC to fail to qualify as a regular interest.

LOANS QUALIFYING FOR REMIC INCLUSION IN 2020



¹ Rev. Proc. 2020-26 does not define related modifications, but gives as examples (1) the capitalization of deferred interest and (2) the re-amortization of a loan to preserve its original maturity date. See our [Clients & Friends memo](#) for further details on the requirements of the Revenue Procedure.

² Facts not described in this table may permit a loan to be included in a REMIC, subject to further discussion and additional restrictions.