

Proposed TARP Legislation Addresses REMIC Loan Modifications/Dispositions and New Home Mortgage Loan Relief Program

Senator Jack Reed introduced on February 4, 2009 the Real Estate Mortgage Investment Conduit Improvement Bill of 2009 (the "REMIC Bill") as an amendment to the pending American Recovery and Reinvestment Bill of 2009 (the "Economic Stimulus Bill"). The REMIC Bill was subsequently withdrawn from the Economic Stimulus Bill and has been referred to the Senate Committee on Banking, Housing, and Urban Affairs. If enacted into law in its current form, the REMIC Bill would have a significant impact on existing and future commercial and residential mortgage-backed securitization transactions. The REMIC Bill proposes "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." Those rules would enable REMICs to dispose of loans under the auspices of the Troubled Asset Relief Program (the "TARP") without endangering their REMIC status. The REMIC Bill would also require existing REMICs to meet certain eligibility criteria related to loan modification limitations and procedures in order to retain their REMIC status, and would set a timeline for the establishment of a home mortgage loan relief program under the TARP.

REMIC Loan Modifications/ Dispositions

The first section of the REMIC Bill provides that if a REMIC modifies or disposes of a troubled asset under TARP or any home mortgage loan

relief program established by the REMIC Bill, (i) that action will not be treated as a prohibited transaction under section 860F(a)(2) of the Internal Revenue Code of 1986 (the "Code"); (ii) an interest in that REMIC will not fail to be treated as a REMIC regular interest under the Code solely as a result of that action; and (iii) any proceeds from the modification or disposition will be treated as amounts received under qualified mortgages.

The REMIC Bill also specifies that the continued inclusion of certain provisions in documents governing the conduct of servicers or trustees with respect to qualified mortgages would cause a securitization to no longer qualify as a REMIC. Qualification as a REMIC is often essential to a securitization structure to avoid taxation at the entity level; therefore, if the REMIC Bill becomes law in its current form, all pooling and servicing agreements ("PSAs") will need to be reviewed to determine whether their provisions are consistent with the requirements of the REMIC Bill. We expect that the great majority of such documents may need to be amended in order to comply with the new requirements.

Under the REMIC Bill, a securitization would cease to qualify as a REMIC if the related documents: (a) prohibit or restrict the servicer or trustee from completing reasonable modifications or dispositions of loans in order to participate in the TARP or any home mortgage loan relief program established by the REMIC Bill; (b) grant authority to prevent

modification or disposition of loans to anyone other than the servicer or trustee; (c) require the servicer or trustee to repurchase delinquent loans, in anticipation of, or as a result of, a modification; or (d) fail to provide that the duty of the servicer or trustee is to the trust in the aggregate and not to any individual or class of investors. These provisions would become effective three months after enactment of the REMIC Bill. The Treasury Secretary, however, could waive any provision if he determines that the entity is unable to comply with the requirements in a timely manner or that a waiver would further the purposes of the legislation.

Given the short three-month window to amend existing REMIC documentation to comply with the requirements of the REMIC Bill, swift action by issuers, servicers and trustees of mortgage-backed securities will be essential. Nonconforming governing documents for existing residential and commercial mortgage loan securitizations will need to be amended to comply with the REMIC Bill's requirement that any of the described restrictions on loan modifications be removed. Many (but not all) PSAs in mortgage-backed securitizations expressly permit amendments required to preserve REMIC status without the need for certificateholder consent. Amendments to certain PSAs, however, may require the consent of certain third parties such as the controlling class representative, any rating agency rating the deal or any bond insurer. In many CMBS transactions, certain parties (such as mezzanine lenders) may have approval rights with respect to loan modifications and may not be eager to relinquish those rights. If the REMIC Bill becomes law in its current form and those parties retain their consent rights, the REMIC could potentially lose its REMIC status, with potentially disastrous ramifications for the REMIC certificateholders, including entity level taxation as described herein. These ramifications are likely to negatively affect the pricing of REMIC bonds in the secondary market, which may cause investors in these products to oppose the REMIC Bill. In addition, it is important to consider that the increased level of activity by servicers and trustees in RMBS and CMBS transactions that is expressly permitted under the REMIC Bill will impact the true sale analysis of these transactions under FAS 140.

Several industry groups have issued proposals in recent months that address loan modifications and dispositions of foreclosure property held within a REMIC structure without threatening the REMIC's tax preferred status. In December 2008, the Real Estate Roundtable pushed for guidance from the Treasury and the Internal Revenue Service (the "IRS") that would allow commercial mortgage loans held by REMICs to be modified and

restructured without negative tax consequences to certificateholders. The Real Estate Roundtable proposed that Treasury and IRS guidelines for commercial mortgage loan modifications be based upon guidelines issued by the American Securitization Forum ("ASF") for residential mortgage loan modifications. The ASF guidelines permit a servicer to restructure residential mortgage loans if the servicer "reasonably believes that there is a significant risk of foreclosure of the original loan" based upon guidelines developed as part of a foreclosure prevention program. Also, in December of 2008, the American Special Servicers Association requested that the IRS take the position that REO property may be treated the same as the mortgage loans formerly secured by that property for REMIC purposes. This would permit REMIC structures to hold REO properties indefinitely rather than being forced to sell such properties (and risk severe loss to investors) in order to maintain their REMIC status. We expect that additional proposals and amendments to the REMIC rules will be introduced in the near future and will keep you apprised of such developments.

Home Mortgage Loan Relief Program

The second section of the REMIC Bill addresses the establishment of a home mortgage loan relief program under the TARP. It provides that a program "to achieve appropriate broad-scale modifications or dispositions of troubled home mortgage loans" and "broad-scale dispositions of foreclosure property" is to be implemented not later than thirty (30) days following enactment. In furtherance of this program, the Treasury Secretary is to promulgate rules governing the reasonable modification and disposition of any home mortgage loan or foreclosure property pursuant to the requirements of the REMIC Bill.

In developing those rules, the Treasury Secretary may consider debt-to-income ratios, loan-to-value ratios and payment histories of the mortgagors, and "any other factors consistent with the intent to streamline modifications of troubled home mortgage loans into sustainable home mortgage loans." The REMIC Bill would grant the Treasury Secretary broad authority to implement home mortgage loan relief, including the authority to make home mortgage loan purchases and guarantees, to make and fund commitments to purchase mortgage loans or mortgage-backed securities, to buy down interest rates and/or principal on mortgage loans, and to grant principal forbearance. The Treasury Secretary would also have the authority to develop standard

modification and disposition protocols for mortgage loans and to ratify the actions of servicers taken in anticipation of amendments of governing documents to make such documents consistent with the Treasury's standard modification and disposition protocols.

Dechert attorneys are working with several industry groups to assure that all ramifications of this proposed legislation are fully understood by lawmakers and to avoid any unintended consequences that might compound the significant issues currently facing the mortgage securitization market.

REMIC Bill's Home Mortgage Loan Relief Program (though each program is funded separately). A forthcoming issue of *DechertOnPoint* will address the Obama Housing Plan. Additional information on the Obama Housing Plan is available at:

www.treas.gov/initiatives/eesa/homeowner-affordability-plan/FactSheet.pdf.

The full text of the Real Estate Mortgage Investment Conduit Improvement Bill of 2009 is available at: www.govtrack.us/congress/billtext.xpd?bill=s111-376.

Homeowner Affordability and Stability Plan

On Wednesday, February 18, 2009, President Obama announced a new "Homeowner Affordability and Stability Plan" (the "Obama Housing Plan"), to be funded by the Housing and Economic Recovery Act. The Obama Housing Plan contains a number of initiatives regarding residential mortgage loan modifications, and its enactment may have a significant effect on the

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