Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, §§ 860D, 860G, 1001; 1.860G–2, 1.1001–3, 301.7701–2, 301.7701-3, 301.7701-4)

Rev. Proc. 2007–72

SECTION 1. PURPOSE

This revenue procedure describes the conditions under which changes to certain subprime mortgage loans will not cause the Internal Revenue Service to challenge the tax status of certain securitization vehicles holding the loans.

The purpose of this revenue procedure is to provide certainty in the current economic environment with respect to certain potential tax issues that may be implicated by fast track loan modifications, as described below. No inference should be drawn about whether similar consequences would obtain if a transaction falls outside the limited scope of this revenue procedure. Furthermore, there should be no inference that this revenue procedure is necessary to prevent transactions within its scope from impacting the tax status of securitization vehicles.

SECTION 2. BACKGROUND—THE ASF "FRAMEWORK"

.01 On December 6, 2007, the American Securitization Forum ("ASF") released a document entitled, "Statement of Principles, Recommendations and Guidelines for a Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans" (the "Framework"). An Executive Summary of the Framework (entitled "Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans") was released simultaneously and is attached as an Appendix to this revenue procedure.

.02 The Framework has been broadly supported as an appropriate step in addressing certain risks in the current economic environment.

.03 The Framework applies to first-lien subprime residential adjustable rate mortgage (ARM) loans that—

(1) Have an initial fixed rate period of 36 months or less (including "2/28s" and "3/27s");

(2) Were originated between January 1, 2005, and July 31, 2007;

(3) Are included in securitized pools; and

(4) Have an initial interest rate reset between January 1, 2008, and July 31, 2010.

This revenue procedure refers to these instruments as "Loans."

.04 The Framework provides a “fast track” procedure for modifying Loans and details the criteria for determining which Loans are eligible for the procedure. Modifications pursuant to the procedure are referred to as “fast track modifications.”

.05 In a fast track modification, a borrower is offered a Loan modification under which the interest rate on the affected Loan will be kept at the existing rate, generally for five years following the date on which the rate would have reset in the absence of the modification.

SECTION 3. BACKGROUND—REMICS

.01 Real Estate Mortgage Investment Conduits (REMICs) are widely used securitization vehicles for mortgages. REMICs are governed by sections 860A through 860G of the Internal Revenue Code.

.02 For an organization to qualify as a REMIC, all of the interests in the organization must consist of one or more classes of regular interests and a single class of residual interests, see section 860D(a), and those interests must be issued on the startup day, within the meaning of § 1.860G–2(k) of the Income Tax Regulations.

.03 A regular interest is one that is designated as a regular interest and whose terms are fixed on the startup day. Section 860G(a)(1). In addition, a regular interest must (1) unconditionally entitle the holder to receive a specified principal amount (or other similar amount), and (2) provide that interest payments, if any, at or before maturity are based on a fixed rate (or to the extent provided in regulations, at a variable rate).

.04 An interest issued after the startup day does not qualify as a REMIC regular interest.

.05 An entity qualifies as a REMIC only if, among other things, as of the close of the third month beginning after the startup day and at all times thereafter, substantially all of its assets constitute qualified mortgages and permitted investments. See section 860D(a)(4). An entity that initially qualifies as a REMIC may cease to qualify, if a sufficiently large portion of its qualified mortgages are significantly modified and the modified obligations are not qualified mortgages. See § 1.860G-2(b)(1). For this purpose, a qualified mortgage is generally treated as having been significantly modified if the change in terms would be treated as an exchange of obligations under section 1001 and the regulations thereunder. See § 1.860G-2(b)(2).

.06 Certain changes in the terms of an obligation, however, are not significant modifications for this purpose, regardless of whether they are significant modifications under section 1001 and § 1.1001-3. See § 1.860G-2(b)(3). In particular, changes in the terms of an obligation "occasioned by default or a reasonably foreseeable default" are not significant modifications for this purpose. See § 1.860G-2(b)(3)(i).

.07 Section 860F(a)(1) imposes a tax on REMICs equal to 100 percent of the net income derived from "prohibited transactions." The disposition of a qualified mortgage is a prohibited transaction unless the disposition is pursuant to (i) the substitution of a qualified replacement mortgage for a qualified mortgage; (ii) a disposition incident to the foreclosure, default, or imminent default of the mortgage; (iii) the bankruptcy or insolvency of the REMIC; or (iv) a qualified liquidation. Section 860F(a)(2)(A).

SECTION 4. BACKGROUND—TRUSTS

.01 Section 301.7701-2(a) of the Procedure and Administration Regulations defines a “business entity” as any entity recognized for federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under § 301.7701-3) that is not properly classified as a trust under § 301.7701-4 or otherwise subject to special treatment under the Code.

.02 Section 301.7701-4(a) provides that an arrangement is treated as a trust if the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

.03 Section 301.7701-4(c) provides that an “investment” trust is not classified as a trust if there is a power under the trust agreement to vary the investment of the certificate holders.

SECTION 5. SCOPE

.01 This revenue procedure applies to the following transactions occurring on or before July 31, 2010—

(1) A fast track modification of a Loan pursuant to the Framework; and

(2) A second-lien holder’s action of subordinating its lien to any new lien that may arise under a Loan as the result of a fast track modification.

.02 If the Framework is materially modified after December 6, 2007, this revenue procedure does not necessarily apply to fast track modifications under the revised Framework or to second-lien subordinations to accommodate those modifications.

SECTION 6. APPLICATION

In the case of one or more transactions to which this revenue procedure applies—

.01 The Internal Revenue Service will not challenge a securitization vehicle's qualification as a REMIC on the grounds that the transactions are not among the exceptions listed in § 1.860G-2(b)(3);

.02 The Internal Revenue Service will not contend that the transactions are prohibited transactions under section 860F(a)(2) on the grounds that the transactions are not among the exceptions listed in section 860F(a)(2)(A)(i)–(iv);

.03 The Internal Revenue Service will not challenge a securitization vehicle's classification as a trust on the grounds that the transactions manifest a power to vary the investment of the certificate holders; and

.04 The Internal Revenue Service will not challenge a securitization vehicle's qualification as a REMIC on the grounds that the transactions resulted in a deemed reissuance of the REMIC regular interests.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective beginning December 6, 2007.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Diana Imholtz of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information, contact Ms. Imholtz on (202) 622–3930 (not a toll-free call).

American Securitization Forum

Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans

Executive Summary

December 6, 2007

Scope:

This streamlined framework applies to all first lien subprime residential adjustable rate mortgage (ARM) loans that have an initial fixed rate period of 36 months or less (including "2/28s" and "3/27s"), referred to below as "subprime ARM loans" that:

- were originated between January 1, 2005 and July 31, 2007;
- are included in securitized pools; and
- have an initial interest rate reset between January 1, 2008 and July 31, 2010.

This streamlined framework would be applied to subprime ARM loans in advance of an initial reset date. Typically, servicer/borrower communication should begin 120 days prior to the initial reset date.

Overarching Principles:

- The servicer will not take any action that is prohibited by the pooling and servicing agreement ("PSA") or other applicable securitization governing document, or that would violate applicable laws, regulations, or accounting standards. ASF's Statement of Principles, Recommendations and Guidelines for a Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans, published concurrently with this document, analyzes how the framework described in the Executive Summary is consistent with typical PSA provisions. The ASF urges readers of this Executive Summary to review the full Statement.

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- The ASF believes that this framework is consistent with the authority granted to a servicer to modify subprime mortgage loans in typical PSAs. The ASF expects that the procedures in this framework will constitute standard and customary servicing procedures for subprime loans.

- The servicer will expeditiously implement the ASF Investor Reporting Guidelines for the Modification of Subprime ARM Loans recommended by the ASF, which is simultaneously released with this framework.

- LTV and CLTV will be determined based on information at origination. If an origination LTV is below 97%, a servicer may obtain an updated home value by obtaining an AVM, BPO or other means.

- All servicers of second liens to subprime borrowers should cooperate fully with this framework by providing information needed by first lien servicers and by agreeing to subordinate the second lien to any new first lien resulting from a refinance (with no cash out) under this framework.

- All existing contractual obligations and remedies related to fraudulent mortgage origination activity should be strictly enforced.

- The streamlined framework outlined in this framework represents the consensus view of the membership of the ASF, acting through its Board of Directors, as to the parameters used to determine the segmentation of subprime ARM loans, including the numeric values included in those parameters. It is understood by the ASF's members that the numeric values included in the parameters are not based on historic data, but rather simply represent a consensus view as to appropriate numeric values for use within this framework for the purpose of supporting a streamlined approach to loan modifications that complies with typical securitization governing documents. The ASF, acting through its Board of Directors, may in the future change these numeric values or further refine these parameters as experience is gained and market conditions evolve.

Borrower Segmentation:

Under this framework, subprime ARM loans are divided into 3 segments.

Segment 1 includes current (as defined below) loans where the borrower is likely to be able to refinance into any available mortgage product, including FHA, FHA Secure or readily available mortgage industry products.

- Generally, the servicer will determine whether loans may be eligible for refinancing into readily available mortgage industry products based on ascertainable data not requiring direct communication with the borrower, such as LTV, loan amount, FICO and payment history. Servicers will generally not determine current income or DTI to determine initial eligibility for refinancing.

- If the borrower also has a second lien on the property, this framework contemplates that the borrower is able to refinance the first lien only, on a no cash out basis. In order for the loan to fall into this segment, the second lien does not have to be refinanced; however, any second lien holder will need to agree to subordinate their interest to the refinanced first lien.

Segment 2 includes current loans where the borrower is unlikely to be able to refinance into any readily available mortgage industry product.

- *Current*: For purposes of this framework "current" means the loan must be not more than 30 days delinquent, and must not have been more than 1 x 60 days delinquent in the last 12 months, both under the OTS method. Corresponding tests would apply under the MBA method if the servicer uses that standard.

- *LTV test*: All current loans with an LTV (based on the first lien only) greater than 97% are deemed not to be eligible for refinance into any available product, and thus are within Segment 2. (97% is the maximum LTV allowed under FHA Secure.)

- *Not FHA Secure eligible*: All current loans that otherwise do not satisfy FHA Secure requirements, including delinquency history, DTI at origination and loan amount standards for this program, are within Segment 2 unless the servicer can determine whether they may meet eligibility criteria for another product, by reviewing eligibility criteria without performing an underwriting analysis.

Segment 3 includes loans where the borrower is not current as defined above, demonstrating difficulty meeting the introductory rate.

Segment 1 – Refinance:

- It is expected that borrowers in this category should refinance their loans, if they are unable or unwilling to meet their reset payment. However, a servicer may evaluate each borrower in this category on a case by case basis or apply any framework consistent with the applicable servicing standard in the transaction documents for a loan modification or other loss mitigation outcome.

- The servicer will facilitate a refinance in a manner that avoids the imposition of prepayment penalties wherever feasible. This may be accomplished by timing the refinance to occur after the upcoming reset date.

- Servicers should take all reasonable steps permitted under the PSA and other governing documents to encourage or facilitate refinancing for borrowers in Segment 1, or to borrowers in Segment 2 who become eligible for a refinance, including, where permitted, providing borrowers with information about FHA, FHA Secure and other readily available mortgage industry products, even if that servicer is not able to provide those products through any affiliated originator.

Segment 2 – Loan Modification:

- The servicer will determine the following for each Segment 2 borrower: current owner occupancy status (based on information known to the servicer, including billing and property address), current FICO score and the FICO score at origination of the loan.

- FICO test:

    - If the current FICO score is less than 660 and is less than a score 10% higher than the FICO score at origination, the borrower is considered to have met the "FICO test." If the borrower meets the FICO test, the servicer will generally not determine the borrower's current income.

    - If either a) the current FICO score is 660 or higher, or b) the current FICO is at least 10% higher than the FICO score at origination, the borrower is considered to not meet the "FICO test." If the borrower does not meet the FICO test, the servicer will use an alternate analysis to determine if the borrower is eligible for a loan modification.

- Segment 2 loans will only be eligible for a fast track loan modification if:

    - The borrower currently occupies the property as his or her primary residence;

    - The borrower meets the FICO test; and

    - The servicer determines that, at the upcoming reset, the payment amount would go up by more than 10%.

- Borrowers in this segment and eligible for a fast track loan modification as described above may be offered a loan modification under which the interest rate will be kept at the existing rate, generally for 5 years following the upcoming reset.

- As to Segment 2 loans eligible for a fast track loan modification, the servicer may make the following presumptions:

- The borrower is able to pay under the loan modification based on his or her current payment history prior to the reset date.

- The borrower is willing to pay under the loan modification, as evidenced by a) an agreement to the modification after being contacted or b) in the event that the affirmative agreement of the borrower cannot be obtained, the borrower's payment of two payments under the loan as modified after receiving notice of the modified terms.

- The borrower is unable to pay (and default is reasonably foreseeable) after the upcoming reset under the original loan terms, based on the size of the payment increase that would otherwise apply.

- The modification maximizes the net present value of recoveries to the securitization trust and is in the best interests of investors in the aggregate, because refinancing opportunities are likely not available and the borrower is able and willing to pay under the modified terms.

- For borrowers that do not meet the FICO test, the servicer will use an alternate analysis to determine if the borrower is eligible for a loan modification, as well as the terms of the modification (which may vary). This may include a) conducting an individual review of current income and debt obligations, debt-to-income analysis, and considering a tailored modification for a borrower, or b) applying any other framework consistent with the applicable servicing standard in the transaction documents to determine if a borrower is eligible for a loan modification.

- For borrowers that are eligible for a fast track modification, the fast track option is non-exclusive and does not preclude a servicer from using an alternate analysis to determine if a borrower is eligible for a loan modification, as well as the terms of the modification.

Segment 3 – Loss Mitigation:

- For loans in this category, the servicer will determine the appropriate loss mitigation approach in a manner consistent with the applicable servicing standard in the transaction documents, but without employing the fast tracking procedures described under Segment 2. The approach chosen should maximize the net present value of the recoveries to the securitization trust. The available approaches may include loan modification (including rate reduction and/or principal forgiveness), forbearance, short sale, short payoff, or foreclosure.

- These borrowers will require a more intensive analysis, including where appropriate current debt and income analysis, to determine the appropriate loss mitigation approach.