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Washington, DC 20224

Person to Contact:

Telephone Number:

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Date:

February 22, 1999

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This responds to your request of December 9, 1998, and subsequent correspondence submitted on behalf of New REMIC, that the Internal Revenue Service rule that a described funds-available cap will not prevent certain interests created in New REMIC from qualifying as regular interests under section 860G of the Internal Revenue Code.

FACTS

Sponsor is an investment bank organized as a corporation under the laws of State. It is engaged in the business of acquiring and financing real property and mortgages on real property. It regularly buys and sells, and in some instances makes a market in, mortgage-backed securities. Sponsor resecuritizes existing mortgage-backed securities in the ordinary course of its business.

Sponsor proposes to deposit certain existing regular interests issued by various real estate mortgage investment conduits ("existing REMICs") into a newly-created REMIC ("New REMIC"). The existing regular interests are of two general types: interest-only or "IO" REMIC regular interests, and principal-only or "PO" REMIC regular interests. The aggregate weighted average coupon of the loans underlying the PO existing regular interests is y percent and the corresponding rate with respect to the IO existing regular interests is w percent.

The PO existing regular interests are projected through the application of a prepayment assumption to have an initial principal balance of \$x. For the initial monthly accrual period, the IO existing regular interests are projected, through the application of a prepayment assumption, to have an aggregate distribution amount of \$y. Accordingly, the distributions on the IO existing regular interests are initially equivalent to a z percent annual interest rate when applied to the principal balance of the PO existing regular interests.

The regular interests in New REMIC ("new regular interests") will have a principal balance equal to the principal balance of the PO existing regular interests and will pay interest on that principal balance based on variable rates. One class of new regular interests, Class A, will bear interest at a rate equal to Index A plus \underline{r} percent, subject to a maximum rate, or cap, of \underline{s} percent and a minimum rate, or floor, of \underline{r} percent. The other class of regular interests, Class B, will bear interest at a rate equal to \underline{t} percent minus the product of thirteen times Index A, subject to a cap of \underline{t} percent and a floor of \underline{u} percent.

Distributions received by New REMIC on the IO existing regular interests, less a trustee fee, will be used first to pay interest on the new regular interests at the variable rate applicable during the related accrual period. Accordingly, the distributions on the IO existing regular interests available to pay interest on the new regular interests for the initial monthly accrual period will be the equivalent of an annual interest rate of $\underline{g}\%$ when applied to the initial principal balance of the new regular interests. All payments received by New REMIC with respect to the PO existing regular interests will be passed through as principal to the Class A and Class B regular interests on a pro rata basis, based on their principal amounts.

The Class A new regular interests will have an initial principal amount of $\$ \underline{p}$, representing approximately 92.857% of the aggregate initial principal balance of the new regular interests. The Class B new regular interests will have an initial principal amount of $\$ \underline{q}$, representing approximately 7.143% of the aggregate initial principal balance of the new regular interests. Distributions received by new REMIC on the IO existing regular interests in excess of the amount needed to pay the trustee fee and make interest distributions on the new regular interests will be used to make additional principal distributions on the new regular interests on the same basis as other principal distributions.

Viewed in the aggregate, the interest rate payable on the new regular interests will be equal to $\underline{n}\%$, a fixed rate, at any Index A value, notwithstanding that each regular interest individually accrues interest at a variable rate. Sponsor represents that Class A and Class B new regular interests will be issued to different purchasers and will be permitted to be traded separately in the secondary market. Sponsor further represents that no new regular interest will have an issue price in excess of 125 percent of its specified principal amount.

In the event that, contrary to Sponsor's reasonable expectations, payments received by New REMIC on the IO existing regular interests are not sufficient to distribute interest on the new regular interests at the applicable stated rate in any accrual period, distributions will be limited by a funds-available cap in that accrual period. Any such shortfall in interest due to the funds-available cap will be allocated first to the Class B new regular interests and then to the Class A new regular interests, and will be made up, if possible, in future accrual periods.

Sponsor represents that its expectation that the new regular interests will be paid in accordance with their terms, without regard to the funds-available cap, is reasonable based on the historic prepayment experience with respect to loans such as those underlying the regular interests. In support of this representation, Sponsor submits projections of payments on the new regular interest and the new residual interest to be issued by New REMIC under various prepayment assumptions. These projections reflect the payments each such interest will receive if the loans underlying the qualified mortgages held by New REMIC are prepaid at certain prepayment speeds. The projections indicate that at all the assumed prepayment speeds the principal and interest payments on the new regular interests will be made in accordance with their stated terms.

LAW AND ANALYSIS

Section 860D(a)(2) of the Code defines a REMIC, in pertinent part, as an entity all of the interests in which are regular interests or residual interests. Section 860G(a)(1) defines a regular interest; section 860G(a)(1)(B) (i) requires interest payments on a regular interest to be payable based on a fixed rate (or to the extent provided in regulations, at a variable rate).

Section 1.860G-1(a)(3) of the regulations describes a variable rate of interest for purposes of section 860G(a)(1)(B) (i). Under paragraphs (a)(3)(i), (iii), and (iv) of section 1.860G-1(a)(3), a rate is a variable rate of interest if it is based on a fixed multiple (which may be positive or negative) of a qualified floating rate (as defined in section 1.1275-5(b)(1)) that may be limited by a cap or floor.

Section 1.860G-1(a)(3)(v)(A) of the regulations states that a rate is a variable rate if it is a rate that would be described in section 1.860G-1(a)(3)(i) through (iv) except that it is subject to a funds-available cap. A funds-available cap is a limit on the amount of interest to be paid on an instrument in any accrual or payment period that is based on the total amount available for the distribution, including both principal and interest received by an issuing entity on some or all of its qualified mortgages as well as amounts held in a reserve fund. The term does not include, however, any cap or limit on interest payments used as a device to avoid the standards of section 1.860G-1(a)(3)(i) through (iv).

Section 1.860G-1(a)(3)(v)(B) of the regulations states that, in determining whether a cap or limit on interest payments is a funds-available cap within the meaning of the regulation, and not a device used to avoid the standards of the regulation, all the facts and circumstances must be considered. Facts and circumstances that must be taken into consideration are (1) whether the rate of the interest payable to the regular interest holders is below the rate payable on the REMIC's qualified mortgages on the start-up day; and (2) whether, historically, the rate of interest payable to the regular

interest holders has been consistently below that payable on the qualified mortgages.

Section 1.860G-1(a)(3)(v)(C) of the regulations provides examples of the application of the standards of the regulation to particular facts and circumstances. The examples and accompanying text illustrate the primary purpose of the funds-available cap rule: The rule permits a REMIC to allocate to regular interest holders the risk of nonpayment of interest that results from a mismatch between the rates of interest on REMIC assets and the rates of interest payable on REMIC interests ("basis risk").

Although the regulation under discussion speaks primarily to the allocation of basis risk, it need not be read as limited to that circumstance. A funds-available cap is defined by the regulation as "a limit on the amount of interest to be paid...that is based on the total amount available for distribution...". Just as the rate of interest payable on qualified mortgages constitutes a limit on the amount of interest to be paid that is based on the total amount available for distribution, the prepayment speed of the qualified mortgages (in this case, the existing IO interests) underlying the REMIC interests also constitutes such a limit. Economic factors governing the movement of interest rates are similar to those economic factors dictating the speed of prepayments of qualified mortgages. A funds-available cap premised upon the speed at which qualified mortgages prepay therefore may be a funds-available cap within the scope of this regulation.

In the case of a funds-available cap premised upon prepayment speed, the comparisons of start-up day levels and historical performance of the underlying assets required by section 1.860G-1(a)(3)(v)(B)(1) and (2) of the regulations should be undertaken by performing economically similar comparisons. In performing the comparison required by section 1.860G-1(a)(3)(v)(B)(1), which calls for a determination whether the rate of the interest payable to the regular interest holders is below the rate payable on the REMIC's qualified mortgages on the start-up day, reference should be made to the rate of interest payable to the new regular interest holders in comparison with the projected rate of payment on the existing regular interests (the qualified mortgages), based on commercially reasonable prepayment assumptions. In performing the comparison required by section 1.860G-1(a)(3)(v)(B)(2), which looks to whether the rate of interest payable to the regular interest holders historically has been consistently below that payable on the qualified mortgages, reference should be made to the rate of interest payable to the new regular interest holders as against the projected cash flows on the existing regular interests (the qualified mortgages), taking into account historic prepayment experience.

HOLDING

The described funds-available cap will not prevent Class A and Class B interests created in New REMIC from qualifying as regular interests under section 860G and section 1.860G-1(a)(2)(v) of the regulations.

Except as specifically ruled upon above, no opinion is expressed or implied regarding the federal tax consequences of the described transaction. No opinion is expressed as to whether REMIC otherwise qualifies as a REMIC under sections 860A through 860G of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter should be attached to the federal income tax return of New REMIC for the start-up year.

Sincerely yours,

Assistant Chief Counsel
(Financial Institutions and Products)

By Marshall D. Feiring
Marshall D. Feiring
Senior Technician Reviewer, Branch 2
I.D. No. 50-02262

Enclosure: 6110 copy

cc: