Structured Finance Industry Group

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United States Department of Treasury
1500 Pennsylvania Ave NW
Washington, DC, 20220

Ned Blanchard
Internal Revenue Service
1111 Constitution Ave, N.E.
Washington, DC 20044

Re: Transition from LIBOR to Alternative Rates

Dear Gentlemen:

The Structured Finance Industry Group ("**SFIG**") respectfully requests that the Treasury Department and the Internal Revenue Service remove a current source of market uncertainty by issuing guidance that will relieve the many issuers and holders of outstanding debt instruments, especially structured debt instruments, from the potentially severe tax consequences resulting from the anticipated replacement of interest rates based on LIBOR with interest rates based on alternative indices. In the case of structured debt, the tax consequences can include not only the recognition of income, but more importantly, the loss of the issuer's special tax status and the collapse of the transaction.

I. Replacement of LIBOR

For more than three decades LIBOR has been the basis for calculating the interest rate on trillions of dollars of indebtedness, including mortgage loans and mortgage-backed securities. The 2017 announcement by the U.K. Financial Conduct Authority (**"FCA"**) that it would no longer compel banks to submit quotes for LIBOR after 2021 has made it critical to determine the consequences, including the U.S. federal income tax consequences, of switching to replacement rates.

II. Potentially Harmful Tax Consequence Anticipated

In the case of ordinary indebtedness, the most immediate income tax question resulting from the likely transition of LIBOR-based financial contracts to those based on an alternative index is whether changing the interest rate on an outstanding debt instrument from one based on LIBOR to one based on an alternative index will be viewed as a "significant modification" of the LIBOR-based debt instrument, which can result in a taxable exchange of the LIBOR-based debt instrument for a new debt instrument under Section 1001 of the Internal Revenue Code (the "**Code**"). Not only can this debt-for-debt exchange trigger taxable gain to the holders of the debt instrument under Section 1001 of the Code and/or cancellation of indebtedness income to the issuer of the debt instrument under Section 61 of the Code, but under Treasury Regulation Section 1.1001-1(g), the "new" debt instrument can have a different issue price from the "old" debt instrument, which can change the timing and amount of the accrual of discount and the amortization of premium on the debt instrument. It can also cause a debt instrument that is otherwise grandfathered out of withholding under Sections 1471 through 1474 of the Code (commonly referred to as **"FATCA"**) to lose that status under Treasury Regulation Section 1.1471-2(b)(2)(iii) and (iv) or a bearer debt instrument that is otherwise grandfathered to lose its grandfathered status.

Structured financings often involve special purpose entities, which are not subject to entity-level income taxes, that hold pools of debt instruments as collateral and use the cash flows on the collateral to repay other debt instruments issued to investors. A transition from LIBOR that causes a deemed taxable exchange of either the debt instruments a special purpose entity holds or the debt instruments a special purpose entity issues to investors can adversely affect not only those debt instruments but, more significantly, can also jeopardize any special income tax status of the special purpose entity.

For example, if the debt instruments deemed to be exchanged are held by a fixed investment trust, the deemed exchange can be considered as a change in investment, which can cause the trust to lose its qualification as a "trust" under Treasury Regulation Section 301.7701-4(c) and be reclassified as a partnership or publicly traded partnership taxable as a corporation.

Alternatively, if a real estate mortgage investment conduit ("**REMIC**") is deemed to acquire new mortgage loans, the new mortgage loans may not be "qualified mortgages" under Section 860G(a)(3) of the Code, the REMIC may be reclassified as a taxable mortgage pool (under Section 7701(i) of the Code) taxable as a corporation, and holders of debt issued by the REMIC may be treated as shareholders in a corporation for income tax purposes. Further, if a REMIC is deemed to issue new interests to investors after its startup date, the new interests generally will not qualify as REMIC regular interests under Section 860G(a)(1) of the Code because they were issued after the startup date. Further, even if there was not a deemed exchange of REMIC regular interests under Section 1001 of the Code in connection with a transition from LIBOR (for example, where the "change in yield" safe harbor in Treasury Regulation Section 1.1001-3(e)(2) discussed below is satisfied), there is a potential concern that the REMIC regular interests might be considered not issued with "fixed terms" as required under Section 860G(a)(1) of the Code as a result of the transition from LIBOR.

Because modifications of assets and liabilities in structured finance transactions generally require legal opinions confirming that a trust or a REMIC will continue to qualify as such, and possibly that there will be no taxable exchange or other material adverse tax consequences for investors, the lack of certainty on the foregoing issues may cause significant delays or even failures to effect the modifications needed for an orderly transition from LIBOR.

III. Relief Sought

Debt instruments issued before the FCA's announcement did not anticipate a permanent discontinuance of LIBOR. Either the debt instruments were silent on the issue or they provided imperfect substitute rates such as ones based on the "Prime Rate", a long-term (as opposed to a short-term) rate, or ones intended to address temporary unavailability only (for example, based on the last LIBOR setting, a short-term fixed (as opposed to floating) rate). Some debt instruments issued after the FCA announcement have mechanisms to establish substitute rates more approximate to LIBOR, but these fallback provisions could not anticipate fully the substitutes for LIBOR that the regulators and markets will ultimately establish. For certain new financial contracts, the Alternative Reference Rates Committee, a group of private-market participants convened by the Federal Reserve Board and Federal Reserve Bank of New York, have identified the secured overnight financing rate (**"SOFR"**) as the rate that "represents best practice," but different alternatives may emerge.

Regardless of how this question is resolved, for the majority of debt instruments already outstanding, if the parties to a LIBOR-based debt instrument want to preserve their economic arrangement after LIBOR is no longer published, they will have to negotiate a new interest rate based on standards that were not contemplated when the instrument was issued. There can be no assurance that changing to such a new rate will not trigger a taxable exchange under Section 1001 of the Code: the difference between the LIBOR-based rate and the new rate may fail to satisfy the "change in yield" safe harbor in Treasury Regulation Section 1.1001-3(e)(2) and any negotiations required may prevent the change from being considered as occurring by operation of the terms of the debt instrument under Treasury Regulation Section 1.1001-3(c)(1). Consequently, the potentially adverse tax consequences of transitioning from the LIBOR benchmark could be imposed on parties that are seeking to preserve the economic terms of their original arrangement and not trying to significantly modify its terms.

As you are aware, the rate change on LIBOR-based debt instruments generally will be unavoidable if LIBOR is no longer published. Further, because the parties (lenders and borrowers) will, in most cases, be dealing at arm's length, the potential for abuse from a LIBOR rate substitution (that is, as a way to change rather than preserve the economic terms of a debt instrument) seems minimal. As such, and to prevent the concerns related above, especially the effects a taxable LIBOR transition can have on multiple elements of a structured financing, we request that the Treasury Department and the Internal Revenue Service grant broad relief. Such relief could be in the form of a notice (rather than a regulation or other more formal pronouncement), stating that a change from a LIBOR index to an alternative index would not be treated as a taxable exchange under Section 1001 of the Code or cause a REMIC regular interest to be treated as not having fixed terms on the REMIC's startup day.

The members of the SFIG Tax Policy Committee who prepared this request[1] would welcome an opportunity to work with you on addressing these issues, including the scope and form of any helpful guidance.

[1] Robert Kreitman, Gary Silverstein, Andrea Mandell, Russell Nance, Ryan Zucchetto, Jason Schwartz, Steve Jackson and Marshall Feiring are the principal authors of this request and they were helped by many others. Although some of the members of the Committee who participated in preparing this request have clients that may be affected by the substitution of interest rates based on LIBOR with interest rates based on alternative indices and have advised clients on the potential consequences, none of these members (or the firms or organizations to which these members belong) have been engaged by a client to prepare this request.

SFIG appreciates your consideration of these concerns and welcomes the opportunity to discuss them further. If you have any questions about this matter, please contact Sairah Burki, Head of ABS Policy, at (202) 524-6302 or sairah.burki@sfindustry.org.

Yours Sincerely,

Sairah Burki
Senior Director, Head of ABS Policy
Structured Finance Industry Group