The End of LIBOR
Risk & Solutions for Residential Mortgages

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THE PROBLEM

Overview: The LIBOR is the most widely used index for adjustable rate mortgages (ARMs). At the end of 2021 it will cease to exist or become unreliable. While mortgage contracts give noteholders the authority to replace the index, it has not been done on such a scale, and the standard contract language is problematic. The Alternative Reference Rate Committee (ARRC)[1] has made recommendations for a new index and for the transition, but the ARRC's recommendations are only voluntary.

Risks for Homeowners with Legacy LIBOR ARMs

- The noteholder picks a new index that is too volatile or that trends at a higher rate than the LIBOR has.
- The noteholder fails to replace the LIBOR, leaving the loan stuck at the last LIBOR or the LIBOR becomes highly volatile.
- The loan servicer botches the mechanics of replacing the LIBOR, causing problems with payment calculations.
- HUD inattention to HECM (reverse mortgages) that use the LIBOR (suspected due to lack of communication or participation in ARRC).
- The consumer has no control over this event except to complain under RESPA or sue.

SOLUTIONS

Good communication with homeowners

- Most notes require the noteholder to give the consumer notice of any new index, and TILA Reg. Z, 12 C.F.R. § 1026.20(c)(2)(iii), specifically requires the creditor to provide information about the index when there is a rate change.
- ARRC and the Mortgage Bankers Association (MBA) have released consumer education materials that industry participants may use.
- The Consumer Financial Protection Bureau (CFPB) has consumer materials on its website

Existing regulation of mortgage loan indices

- AMTPA Reg. D, 12 C.F.R. § 1004.4(a)(2)(i) applies to non-home equity lines of credit (HELOCs)[2] and requires "(i) An index to which changes in the interest rate are tied that is readily available to and verifiable by the borrower and beyond the control of the creditor[.]" For HELOCs, Reg. Z, § 1026.40(f)(1), provides a similar rule.
- Reg. Z, § 1026.40(f)(3)(ii), says HELOC creditors may "Change the index and margin used under the plan if the original index is no longer available, the new index has an historical

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[1] The ARRC (Alternative Reference Rate Committee) is an industry group convened by the Federal Res. Board and NY Fed.
[2] A HELOC is a home equity line of credit and is otherwise known as home-secured open-end credit. Most mortgages are closed-end credit.

movement substantially similar to that of the original index, and the new index and margin would have resulted in an annual percentage rate substantially similar to the rate in effect at the time the original index became unavailable. " There is no equivalent rule for non-HELOCs.

IMPORTANT GAPS TO FILL

The ARRC's recommendations are nonbinding, so government action is needed to encourage compliance or ensure the safety of any alternative chosen by noteholders and servicers:

- Need clarity and uniformity on when to stop using LIBOR if publication continues after it becomes unreliable
- Need guidance on how to choose new index
- Need supervision of servicers and noteholders to ensure they are prepared for the transition

RECOMMENDATIONS FOR CONGRESSIONAL ACTION

Overview: Congress should pass these measures to ensure that all actors are thinking about the transition, give them strong guidance, and imply that failure to follow that guidance will expose them to regulatory and litigation risk.

- Direct HUD to report to Congress on the status of preparations for converting HECMs to a new index.
- Require all servicers and noteholders to produce a transition plan and provide it to their regulator or licensing authority. If the entity does not have a regulator or licensing authority, the plan should be provided to their homeowner/customers.
- Require the Federal Reserve to issue a formal statement when it believes the LIBOR should no longer be used.
- Require all federal and state financial and bank regulators to issue guidance on what is expected of the transition and to state a policy goal of minimizing value transfer and disruption.
- Pass a Sense of Congress resolution approving of the ARRC's recommendations.

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