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24 CFR Parts 203 and 206

[Docket No. FR-6151-A-01]

RIN 2502-AJ51

Adjustable Rate Mortgages: Transitioning from LIBOR to Alternate Indices

AGENCY: Office of Housing, HUD.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: The majority of adjustable rate mortgages (ARMs) insured by the Federal Housing Administration (FHA) are based on the London Interbank Offered Rate (LIBOR), an interest rate index that is likely to become uncertain after December 31, 2021 and no longer be published after June 30, 2023. In reaction to this uncertainty, HUD has begun to transition away from LIBOR as an approved interest rate index. HUD has also approved the Secured Overnight Financing Rate (SOFR) index in some circumstances.

HUD recognizes there may be operational difficulties for mortgagees to implement the change to a new index. HUD is considering a rule that would address a Secretary-approved replacement index for existing loans and provide for a transition date consistent with the cessation of the LIBOR index. HUD is also considering replacing the LIBOR index with the SOFR interest rate index, with a compatible spread adjustment to minimize the impact of the replacement index for legacy ARMs.

DATES: Public comment due date: **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: Interested persons are invited to submit comments regarding this advanced notice of proposed rulemaking to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500. Communications must refer to the above docket number and title. There are two methods for submitting public comments. All submissions must refer to the above docket number and title.

1. Submission of Comments by Mail. Comments may be submitted by mail to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500.

2. Electronic Submission of Comments. Interested persons may submit comments electronically through the Federal eRulemaking Portal at www.regulations.gov. HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the www.regulations.gov website can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

Note: To receive consideration as public comments, comments must be submitted through one of the two methods specified above. Again, all submissions must refer to the docket number and title of the rule.

No Facsimile Comments. Facsimile (FAX) comments are not acceptable.

Public Inspection of Public Comments. All properly submitted comments and communications submitted to HUD will be available for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, an advance appointment to review the public comments must be scheduled by calling the Regulations Division at 202-402-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Information Relay Service, toll-free, at 800-877-8339. Copies of all comments submitted are available for inspection and downloading at www.regulations.gov.

FOR FURTHER INFORMATION CONTACT:

Joshua J. Miller, Senior Advisor to the Deputy Assistant Secretary for Single Family Housing, Office of Housing, Department of Housing and Urban Development, 451 7th Street, SW, Washington, DC 20410-8000; telephone number 202-402-5052 (this is not a toll-free number). Hearing- and speech-impaired persons may access this number through TTY by calling the Federal Relay Service at 800-877-8339 (this is a toll-free number).

SUPPLEMENTARY INFORMATION

I. Background

A. Statutory provisions

Section 251(a) of the National Housing Act (NHA) (12 U.S.C. 1715z–16(a)) authorizes HUD to insure ARMs, and provides that adjustments to the interest rate shall correspond to a specified interest rate index approved in regulations by the Secretary, which must be readily accessible to mortgagors from generally available published sources. For Home Equity Conversion Mortgages (HECM or reverse mortgages), Section 255(d) of the National Housing Act (12 USC 1715z-20(d)) authorizes FHA to insure variable rate HECMs and impose additional eligibility requirements on HECMs, which could include requirements for HECM ARMs.

B. Forward mortgages

HUD initially provided for mortgage insurance of ARMs for single family forward mortgages under part 203 and for part 234 condominium mortgages in 1984 (49 FR 23580, June 6, 1984). As provided in the statute at this time, such mortgages had to be adjusted annually, and there was a 1 percent cap on annual adjustments and an overall cap of 5 percent above the initial interest rate over the term of the mortgage. The index initially used was the Constant Maturity Treasury (CMT) rate. Subsequent to the statutory change allowing HUD to insure ARMs for mortgages that have fixed interest rates for 3 years or more and are not subject to interest rate caps if the interest rate remains fixed for more than 3 years, HUD, in 2004, issued a rule providing mortgage insurance for forward ARMs with rates first adjustable 1 year, 3 years, 5 years, 7 years, and 10 years from the date of the mortgagor’s first debt service payment (69 FR 11500, March 10, 2004, codified at 24 CFR 203.49(d)).

Under the 2004 rule, for 1-year, and 3-year, and 5-year ARMs, each adjustment provided for a cap in either direction of one percentage point from the interest rate in effect for the period immediately preceding the adjustment. For the life of the mortgage the overall 5 percent cap remained from the initial contract rate. For 7-year and 10-year ARMs, HUD raised the per-adjustment cap to 2 percent of the rate in effect for the immediately preceding period, and the life-of-mortgage cap to 6 percent from the initial contract rate. In all cases, changes of more than these amounts could not be carried over for inclusion in an adjustment for the subsequent year. In 2005, HUD revised the regulation to allow for annual adjustments of 2 percent for, and a life-of-mortgage cap of 6 percent for 5-year ARMs in 2005 (70 FR 16080, March 29, 2005), conforming 5-year ARMs to HUD's 7-year and 10-year ARM products.

In 2007, HUD added the LIBOR, along with the CMT, as acceptable indices for ARM adjustments for its ARM products. For forward mortgages, the applicability of these indices is codified at 24 CFR 203.49. The cap on 1-year and 3-year ARMs (no more than 1 percent in either direction per single adjustment, with a 5 percent from initial contract rate cap over the life of the loan) is codified at § 203.49(f)(1). The caps for 5-year, 7-year and 10-year ARMs (2 percent in either direction per adjustment, with a six percent from initial contract rate cap for the life of the mortgage) are located at § 203.49(f)(2). HUD also created model note documents for forward mortgages, which may have varied over the years. The 2015 model note contains provisions for the substitution of an index by the note holder based on "comparable information," should the index specified in the note become unavailable.

C. Reverse mortgages or HECMs

In 1989, the Home Equity Conversion Mortgage program rule provided for capped and uncapped ARMs (54 FR 24822, June 9, 1989). For capped HECM ARMs, the rule retained the 5 percentage point life-of-mortgage limit on interest rate increases and decreases in § 203.49, but increased the annual limit on rate increases and decreases from 1 percentage point to 2 percentage points (54 FR 24825). The rule also provided for an ARM that set a maximum interest rate that could be charged without a cap on monthly or annual increases or decreases. *Id*. In 2007, in the same rule in which LIBOR was added for forward mortgages, HUD added the LIBOR as an acceptable index for HECM ARM adjustments (72 FR 40048, July 20, 2007); these changes are codified in current §§ 206.3 (definitions) and 206.21 (interest rate). HUD's model HECM notes may have varied over the years, but the 2015 version contains provisions for the substitution of a Secretary-prescribed index, should the index specified in the note become unavailable.

For the capped option at § 206.21(b)(1), the interest rate cap structure is the same as provided in forward mortgages under § 203.49(a), (b), (d), and (f), except that under § 203.49(d), the reference to first debt service payment means the date of closing in the HECM context, and under § 203.49(f)(1), the cap on adjustments for 1-year and 3-year mortgages is 2 percentage points in the HECM context. Section 206.21(b)(1)(ii) applies the LIBOR and CMT index options in the same manner as forward mortgages at § 203.49(b) for both the capped and uncapped options. In addition, the uncapped option at § 206.21(b)(2) includes options to adjust based on the one-month CMT or one-month LIBOR index. Section 206.21(b)(1)(iii) also includes ARM interest rate adjustment options for HECMs in the same manner as forward mortgages at § 203.49(d).

On March 11, 2021, in Mortgagee Letter 2021-08, HUD removed LIBOR as an approved index for new HECM ARM originations and approved the SOFR index for new annually adjusted HECM ARM originations. (As explained in that Mortgagee Letter, the changes made by the Mortgagee Letter revised the existing HECM regulations pursuant to the authority granted in the Reverse Mortgage Stabilization Act of 2013 (Pub. L. 113-29; Section 255(h)(3) of the National Housing Act (12 U.S.C. 1715z-20(h)(3)). A mortgagee may set rates using CMT or SOFR for annually adjusted HECM ARMs and CMT only for monthly adjusted HECM ARMs. Also, among other changes to the ARM requirements in the Mortgagee Letter, HUD published revised model mortgage documents with "fallback" language intended to address future interest rate index transition events. This language was modeled after the Alternative Reference Rates Committee's (ARRC[1]) published fallback language for residential adjustable rate mortgages.[2]

D. Phase-out of LIBOR

The financial industry is seeking to transition from LIBOR given its increasing unreliability. The publication of US Dollar (USD) LIBOR tenors of one-month and one-year was recently extended to June 30, 2023. [3] However, the announcements included supervisory guidance encouraging banks to stop new USD LIBOR issuances by the end of 2021.[4]

As noted by the Financial Stability Oversight Council, the scarcity of underlying transactions makes LIBOR potentially unsustainable, as many banks have grown uncomfortable in providing submissions based on expert judgment and may eventually choose to stop submitting altogether. Two banks stopped submitting to USD LIBOR in 2016.[5] The relatively small number of transactions underpinning LIBOR has been driven by changing market structure, regulatory capital, and liquidity requirements as well as changes in bank risk appetite for short-term funding, creating uncertainty as to the integrity of the rate. In July of 2017, the U.K. Financial Conduct Authority (FCA), the financial regulator of LIBOR, announced that it will no longer persuade or compel contributing banks to submit rates used to calculate LIBOR

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[1] The Alternative Reference Rates Committee (ARRC) is a group of private-market participants convened by the Federal Reserve Board and the New York Fed to help ensure a successful transition from U.S. dollar (USD) LIBOR to a more robust reference rate, its recommended alternative, the Secured Overnight Financing Rate (SOFR). The ARRC is comprised of a diverse set of private-sector entities that have an important presence in markets affected by USD LIBOR and a wide array of official-sector entities, including banking and financial sector regulators, as ex-officio members. https://www.newyorkfed.org/arrc

[2] *ARRC Recommendations Regarding More Robust LIBOR Fallback Contract Language for New Closed-End, Residential Adjustable Rate Mortgages*, NEWYORKFED.ORG (Nov. 15, 2019), https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARM_Fallback_Language.pdf

[3] Statement on LIBOR Transition – November 30, 2020 - https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20201130a1.pdf

[4] *ARRC Applauds Major Milestone in Transition from U.S. Dollar LIBOR*, ALTERNATIVE REFERENCE RATES COMM. (Nov. 23, 2020), https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Press_Release_Applauds_Milestone_Transition_US_Dollar_LIBOR.pdf.

[5] *See Frequently Asked Questions*, Alternative Reference Rates Comm. (Jan. 31, 2019), https://www.sec.gov/spotlight/fixed-income-advisory-committee/arrc-faqs-041519.pdf.

after December 31, 2021, which will further heighten the uncertainty of LIBOR.[6] On November 30, 2020, the Federal Reserve Board announced that regulators had proposed clear end dates for the USD LIBOR immediately following the December 31, 2021 publication for the one week and two month USD LIBOR settings, and the June 30, 2023 publication for other USD LIBOR tenors to ease transition away from LIBOR.[7]

In December 2020, the ICE Benchmark Administration Limited (IBA) announced a consultation on its intention to cease publication of certain LIBOR tenors. On March 5, 2021, the IBA published the feedback to its consultation, announcing it will cease publication of the one month and one year USD LIBOR immediately following the LIBOR publication on June 30, 2023.[8]

With the uncertainty of LIBOR and upcoming phase-out, mortgagees must prepare to select a new replacement interest rate index for existing ARM contracts. The ARRC, a group of private market participants convened by the Federal Reserve Board and the Federal Reserve Bank of New York to ensure the transition from USD LIBOR to a reliable reference rate, has recommended selection of the SOFR for use in new USD contracts.[9] SOFR is published by the Federal Reserve Bank of New York in cooperation with the Office of Financial Research, an independent bureau with the U.S. Department of the Treasury, and ". . .is a broad measure of the cost of borrowing cash overnight collateralized by U.S. Treasury securities in the repurchase

[6] Andrew Bailey, *The Future of LIBOR*, FIN. CONDUCT AUTHORITY (July 27, 2017), https://www.fca.org.uk/news/speeches/the-future-of-libor.

[7] See *Federal Reserve Board Welcomes and Supports Release of Proposal and Supervisory Statements that Would Enable Clear End Date for U.S. Dollar (USD) LIBOR and Would Promote the Safety and Soundness of the Financial System*, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM (Nov. 30, 2020), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201130b.htm.

[8] *ICE LIBOR® Feedback Statement on Consultation on Potential Cessation*, ICE Benchmark Admin. (March 5, 2021), https://www.theice.com/publicdocs/ICE_LIBOR_feedback_statement_on_consultation_on_potential_cessation.pdf

[9] *About*, ALTERNATIVE REFERENCE RATES COMM., https://www.newyorkfed.org/arrc/about (last visited June 10, 2021).

agreement (repo) market."[10] It is anticipated that a spread-adjusted SOFR will be published to minimize the impact of the transition on legacy ARMs and other LIBOR-based contracts.

According to the ARRC, "SOFR is suitable to be used across a broad range of financial products, including but not limited to, derivatives (listed, cleared, and bilateral-OTC), and many variable rate cash products that have historically referenced LIBOR."[11]

II. This Advanced Notice of Proposed Rulemaking

HUD intends to issue a proposed rulemaking to remove LIBOR as an available interest rate index and provide a new available index for periodic adjustments for newly-insured forward and HECM ARMs, to recommend a replacement comparable index for existing forward mortgages, and to implement a Secretary-prescribed replacement index for existing HECMs. Upon the cessation of LIBOR, a mortgagee would be able to replace LIBOR with the spread adjusted index approved by HUD. HUD intends to propose two separate transitions: a transition to replace LIBOR for existing mortgages and a transition to remove LIBOR and approve a new index for new forward originations.

HUD recognizes that existing mortgages and new originations present different challenges. For existing mortgages, the contract (i.e., loan documents) for each loan governs the terms of the loan. As long as the LIBOR index is available, mortgagees may not have flexibility under their loan contracts to substitute a new index without a modification or a new contract, depending on which FHA model note form was used. Under some existing ARM contracts, a lender may only use a substitute index when the initial index "is no longer available." Once the publication of the one-month and 12-month LIBOR cease to be published, mortgagees will be able to use a replacement index and provide notice to the borrower of the replacement, in accordance with the terms of the loan documents. HUD's goal is to avoid disrupting existing

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[10] *Transition from LIBOR*, Alternative Reference Rates Comm., https://www.newyorkfed.org/arrc/sofr-transition (last visited June 10, 2021).

[11] *Frequently Asked Questions*, Alternative Reference Rates Comm (April 21, 2021), https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/ARRC-faq.pdf

loans or causing unnecessary confusion during the transition. HUD also seeks to transition to an index which will best serve the goals of HUD's forward and reverse mortgage programs. HUD intends that changes made to the existing forward mortgage program and reverse mortgage program occur simultaneously. While HUD has already made certain regulatory amendments to the HECM ARM origination requirements in Mortgagee Letter 2021-08 pursuant to the authority granted in the Reverse Mortgage Stabilization Act of 2013 (Pub. L. 113-29; NHA section 255(h)(3)(12 U.S.C. 1715z-20(h)(3)), HUD will codify those requirements in the rulemaking. Also, HUD did not address the LIBOR transition for legacy HECM contracts in Mortgagee Letter 2021-08.

HUD seeks public comment on the best method of making such a transition for legacy loans and new originations. For each of the questions asked below, and regarding any other issue, HUD is interested specifically in public comment on whether and how HUD should take a different course of action for HECM and forward mortgages. While the following lists are not exhaustive, HUD is particularly interested in comments on the following questions:

Questions Regarding Replacing LIBOR for Existing Loans

Question for Comment 1: What alternative index would be preferred and/or what alternative index would be considered "comparable" to LIBOR?

Question for Comment 2: Will servicing mortgagees seek to replace the interest rate index from LIBOR prior to the last one-month and twelve-month USD LIBOR publication on June 30, 2023?

Question for Comment 3: What documentation would servicing mortgagees need to modify in moving to an alternative index? Would this documentation need to be modified before or after the Transition date, or both?

Question for Comment 4: How long would servicing mortgagees need to transition technology to an alternative index?

Question for Comment 5: How long would servicing mortgagees need to transition operations to an alternative index?

Question for Comment 6: What communication plan is being considered from servicing mortgagees to borrowers and how should borrower protections be addressed for this population?

Question for Comment 7: Do servicing mortgagees have any alternate proposals to negotiating new agreements?

Question for Comment 8: If servicing mortgagees intend to replace the index for existing ARMs prior to LIBOR ceasing to be published, how long would servicing mortgagees need to negotiate new agreements with borrowers to incorporate a new interest rate including providing a revised annual total cost of the loan?

Question for Comment 9: Do industry partners anticipate any concerns over a single interest rate change date for all existing mortgages?

Question for Comment 10: What methods of communication would servicing mortgagees expect to be most beneficial in communicating with borrowers on this index change?

Question for Comment 11: What issues do servicing mortgagees anticipate regarding HECM principal limit growth resulting from an index change?

Questions Regarding removal of LIBOR and establishing a new index for New Originations

Question for Comment 12: What alternative index would be preferred?

Question for Comment 13: What tenure rate(s) would be preferred for the alternative index?

Question for Comment 14: How many tenure rate(s) would be needed for the alternative index?

III. Findings and Certifications

<u>Regulatory Review—Executive Orders 12866 and 13563</u>

Under Executive Order 12866 (Regulatory Planning and Review), a determination must be made whether a regulatory action is significant and, therefore, subject to review by the Office of Management and Budget (OMB) in accordance with the requirements of the order. Executive

Order 13563 (Improving Regulations and Regulatory Review) directs executive agencies to analyze regulations that are "outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned." Executive Order 13563 also directs that, where relevant, feasible, and consistent with regulatory objectives, and to the extent permitted by law, agencies are to, "identify and consider regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public."

The current rules providing for the use of LIBOR as an index for interest rate adjustments for ARMs in HUD's forward and reverse mortgage insurance programs are becoming obsolete as LIBOR is in the process of being phased out. HUD is required by statute to approve by regulation interest rate indexes for its forward ARM products. HUD must also amend by regulation its permitted interest rate indices for HECM ARM products and permit lenders to transition from LIBOR to a replacement index for existing HECM ARMs. Therefore, this rule is necessary to avoid HUD's rules on ARMs from becoming obsolete as well as to avoid the risk of financial harm for ARM lenders, borrowers, and the larger ARM market.

This advanced notice of proposed rulemaking has been reviewed by OMB. As a result of this review, OMB determined that this advanced notice of proposed rulemaking is not significant under Executive Order 12866 and Executive Order 13563.

Environmental Review

This advanced notice of proposed rulemaking consists of "[s]tatutorily required and/or discretionary establishment and review of interest rates, loan limits, building cost limits, prototype costs, fair market rent schedules, HUD-determined prevailing wage rates, income limits and exclusions with regard to eligibility for or calculation of HUD housing assistance or rental assistance, and similar rate and cost determinations and related external administrative or fiscal requirements or procedures which do not constitute a development decision that affects the physical condition of specific project areas or building sites." Accordingly, under 24 CFR

50.19(c)(6), this advanced notice of proposed rulemaking is categorically excluded from environmental review under the National Environmental Policy Act of 1969 (42 U.S.C. 4321).

Lopa P. Kolluri
Principal Deputy Assistant Secretary,
Office of Housing – Federal Housing
Administration

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