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24 CFR Parts 203 and 206

[Docket No. FR-6151-F-03]

RIN 2502-AJ51

Adjustable Rate Mortgages: Transitioning from LIBOR to Alternate Indices

AGENCY: Office of Housing, U.S. Department of Housing and Urban Development (HUD).

ACTION: Final rule.

SUMMARY: HUD is removing the London Interbank Offered Rate (LIBOR) as an approved index for adjustable interest rate mortgages (ARMs), and replacing LIBOR with the Secured Overnight Financing Rate (SOFR) as a Secretary-approved index for newly originated forward ARMs. HUD is also codifying its removal of LIBOR and approval of SOFR as an index for newly-originated Home Equity Conversion Mortgage (HECM or reverse mortgage) ARMs. In addition, HUD is establishing a spread-adjusted SOFR index as the Secretary-approved replacement index to transition existing forward and HECM ARMs off LIBOR. HUD is also making clarifying changes to its HECM Monthly ARM regulation and establishing a lifetime adjustment cap for monthly adjustable rate HECMs. This final rule adopts HUD's October 19, 2022, proposed rule with minor changes.

DATES: Effective date: **[Insert date 30 days after date of publication in the FEDERAL REGISTER].**

FOR FURTHER INFORMATION CONTACT: Lisa Saunders, Office of Housing, Department of Housing and Urban Development, 451 7th Street, SW, Washington, DC 20410-8000; telephone number 202-402-2378 (this is not a toll-free number); email address sffeedback@hud.gov. HUD welcomes and is prepared to receive calls from individuals who are deaf or hard of hearing, as well as individuals with speech or communication disabilities. To learn more about how to make an accessible telephone call, please visit: https://www.fcc.gov/consumers/guides/telecommunications-relay-service-trs.

SUPPLEMENTARY INFORMATION:

I. Background

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, information on which must be readily accessible to mortgagors from generally available published sources. For HECMs, section 255(d) of the NHA (12 U.S.C. 1715z- 20(d)) authorizes the Federal Housing Administration (FHA) to insure variable rate HECMs and imposes additional eligibility requirements on HECMs, which include requirements for HECM ARMs.

Forward ARMs

HUD initially provided mortgage insurance of ARMs for single family forward mortgages under 24 CFR part 203 and for part 234 condominium mortgages in 1984.[1] As provided in the statute at that time, the interest rate on ARMs had to be adjusted annually, and there was a one percent cap on annual adjustments and an overall cap of five percent above the initial interest rate over the term of the mortgage. The index originally used by HUD was the U.S. Constant Maturity Treasury (CMT). In 2001 and 2003, statutory changes to section 251 of the NHA, 12 U.S.C. 1715z–16 allowed HUD to insure ARMs 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.[2] In 2004, HUD issued a rule ("the 2004 rule") implementing these statutory changes and providing mortgage insurance for forward ARMs with interest rates first adjustable in 1 year, 3 years, 5 years, 7 years, and 10 years.[3]

Under the 2004 rule, 1, 3, and 5-year ARMs were capped, for each adjustment, in either direction at one percentage point from the interest rate in effect for the period immediately

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[1] 49 FR 23580, June 6, 1984.
[2] Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 2002 (Pub. L. 107–73, approved November 26, 2001); HOPE VI Program Reauthorization and Small Community Main Street Rejuvenation and Housing Act of 2003 (Pub. L. 108-186, 117 Stat. 2685, approved December 16, 2003).
[3] 69 FR 11500, March 10, 2004.

preceding the adjustment. For the life of the mortgage, the overall five percentage point cap in either direction remained. For 7 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. In all cases, changes that exceeded 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 a 2 percent change in either direction, and a life-of-mortgage cap of 6 percent in either direction for 5-year ARMs in 2005, conforming 5-year ARMs to HUD's 7 and 10-year ARM products.[4]

In 2007, HUD added LIBOR, along with the CMT, as an acceptable index for ARM adjustments for its ARM products ("the 2007 rule").[5] For forward mortgages, the applicability of these indices is codified at 24 CFR 203.49. The cap on 1 and 3-year ARMs (no more than 1 percent in either direction per single adjustment, with a five percentage points from initial contract rate cap over the life of the loan) is codified at § 203.49(f)(1). The caps for the 5, 7 and 10-year ARMs (2 percent in either direction per adjustment, with a 6 percent from initial contract rate cap for the life of the mortgage) are codified at § 203.49(f)(2). HUD also created model note and mortgage documents for forward ARMs and revised those model documents over the years. The 2015 Model ARM Note[6] contains a provision for the substitution of an index by the note holder based on "comparable information," should the index specified in the note become unavailable.

Reverse mortgages or HECMs

In 1989, the Home Equity Conversion Mortgage program rule (the HECM rule) provided for ARMs with both capped and uncapped interest rate adjustments.[7] For capped HECM ARMs, the HECM rule retained the five percentage point life-of-mortgage limit on interest rate increases

[4] 70 FR 16080, March 29, 2005.
[5] 72 FR 40047, July 20, 2007.
[6] The 2015 Model ARM Note is available on HUD's website at: https://www.hud.gov/program_offices/housing/sfh/model_documents.
[7] 54 FR 24822, June 9, 1989.

and decreases in § 203.49, but increased the annual limit on rate increases and decreases from 1 percentage point to 2 percentage points. The HECM rule also provided for a HECM ARM that sets a maximum interest rate that could be charged without a cap on monthly or annual increases or decreases.

In the 2007 rule, in which LIBOR was added for forward mortgages, HUD also added LIBOR as an acceptable index for HECM ARM adjustments in current §§ 206.3 (definitions) and 206.21 (interest rate).[8] HUD's model HECM ARM note and mortgage documents have been revised 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.[9]

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 closing in the HECM ARM context, and under § 203.49(f)(1), the cap on adjustments for one- and three-year mortgages is 2 percentage points in the HECM ARM context. Section 206.21(b)(1)(ii) applies the LIBOR and CMT index options in the same manner as forward ARMs 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 and approved the SOFR index for annually adjustable HECM ARMs closed on or after May 3, 2021.[10] A mortgagee may set rates using CMT or SOFR for annually adjustable HECM ARMs and CMT only for monthly adjustable HECM ARMs. Also, among other changes to the

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[8] 72 FR 40048, July 20, 2007.

[9] The 2015 Model ARM Note is available on HUD's website at: https://www.hud.gov/program_offices/housing/sfh/model_documents.

[10] As explained in Mortgagee Letter 2021-08, 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)).

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)[11] published fallback language for residential ARMs.[12]

Phase-out of LIBOR

The financial industry is transitioning from use of the LIBOR index given its increasing unreliability and speculative nature. 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.[13] 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, thereby creating uncertainty as to the integrity of the index.

In July of 2017, the U.K. Financial Conduct Authority (FCA), the financial regulator of LIBOR, announced that it would no longer persuade or compel contributing banks to submit rates used to calculate LIBOR after December 31, 2021, further heightening the uncertainty of LIBOR.[14] 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 immediately following

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[11] The ARRC is a group of private-market participants convened by the Federal Reserve Board and the Federal Reserve Bank of New York 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.

[12] 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.

[13] *See* Second Report, The Alternative Reference Rates Committee, p.6 (March 2018), https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-Second-report.

[14] Andrew Bailey, The Future of LIBOR, Fin. Conduct Authority (July 27, 2017), https://www.fca.org.uk/news/speeches/the-future-of-libor.

the June 30, 2023 publication for other USD LIBOR tenors.[15] On March 5, 2021, the ICE Benchmark Administration Limited (IBA) published the feedback it received to a December, 2020, consultation, and announced it would cease publication of the one month and one year USD LIBOR immediately following the LIBOR publication on June 30, 2023.[16]

With the uncertainty and upcoming phase-out of LIBOR, mortgagees have been working to transition to 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, recommended the selection of SOFR for use in new USD contracts.[17] 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 agreement (repo) market."[18] HUD anticipates 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."[19]

As part of the Consolidated Appropriations Act, 2022,[20] Congress passed the Adjustable Interest Rate (LIBOR) Act of 2021 (LIBOR Act)[21] to, in part, create a clear and uniform process,

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[15] 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.

[16] 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.

[17] About, Alternative Reference Rates Comm., https://www.newyorkfed.org/arrc/about (last visited June 10, 2021).

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

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

20 Consolidated Appropriations Act, 2022, Pub. L. 117-103.

21 *Id.* at Division U.

on a nationwide basis, for replacing LIBOR in existing contracts where the terms do not provide for the use of a clearly defined or practicable replacement benchmark rate, without affecting the ability of parties to use any appropriate benchmark rate in a new contract.[22] Generally, for LIBOR-based ARMs without language providing for a specific replacement index, the default replacement index will be a spread-adjusted SOFR as provided for under the LIBOR Act.

The LIBOR Act establishes that this spread-adjusted replacement index will replace LIBOR for existing contracts on the Replacement Date, specified in the LIBOR Act as the first London banking day after June 30, 2023, unless the Federal Reserve Board specifies another date (the "Replacement Date").[23] The LIBOR Act also established a one-year linear basis to transition the tenor spread adjustment from LIBOR to the SOFR spread-adjusted index.[24] For FHA-insured LIBOR-based ARMs, the LIBOR Act authorizes HUD to approve the spread-adjusted SOFR index, or another benchmark replacement index selected by HUD, as a replacement to LIBOR for existing ARMs starting on the Replacement Date.[25]

Advanced Notice of Proposed Rulemaking

On October 5, 2021, HUD published an advanced notice of proposed rulemaking (ANPR) to seek input from the public on the transition away from LIBOR.[26] HUD sought comment on how to address a Secretary-approved replacement index for existing loans and provide for a transition date consistent with the cessation of the LIBOR index. HUD also sought comment on replacing the LIBOR index with the SOFR interest rate index, with a compatible spread adjustment to minimize the impact of the replacement index for existing ARMs. The comment period closed on December 6, 2021. HUD received nine comments on the ANPR, which were considered when drafting the proposed rule.

II. The Proposed Rule

22 *Id.* at Division U, section 102(b)(1).
[23] *Id.* at Division U, section 103(6), (17), (19) and section 104(a)(3).
[24] *Id.* at Division U, section 104(e)(2).
[25] Id. at Division U, section 103(10) and section 104(c).
[26] 86 FR 54876.

On October 19, 2022, HUD published for public comment a proposed rule to amend 24 CFR parts 203 and 206 ("the proposed rule").[27] HUD proposed three changes. First, HUD proposed to transition from LIBOR to a spread-adjusted SOFR index for existing forward and HECM ARMs, update the HECM ARM regulation consistent with changes already made through Mortgagee Letter 2021-08 regarding new originations, and replace LIBOR with SOFR as a Secretary-approved index for new forward ARMs. HUD also proposed that the Secretary will publish through notice any additional requirements for transition of existing LIBOR-based ARMs to address technical aspects of the transition process, newly published SOFR tenors, and any developments arising from the transition.

Second, HUD proposed to clarify its regulations regarding the Monthly Adjustable Interest Rate HECMs at § 206.21(b)(2) to clarify the requirements applicable to monthly adjustments to align with those provided for annual adjustments.

Third, HUD proposed to establish a five percentage point lifetime cap on the adjustment of the HECM monthly ARM interest rate to align with similar ARM interest rate caps that are currently used for annual interest rate HECMs and forward ARMs in the mortgage industry.

III. This Final Rule

In response to public comments as discussed further below, and in further consideration of issues addressed at the proposed rule stage, HUD is publishing this final rule with the following changes from the proposed rule.

<u>Lifetime Adjustment Cap for Monthly Adjustable Interest Rate HECMs at § 206.21(b)(2)(iii)</u>

HUD proposed to establish a five percentage point cap for monthly HECM ARMs. After consideration of comments, HUD is revising § 206.21(b)(2)(iii) to state that the maximum lifetime adjustment cap for monthly HECM mortgages will be set at no more than ten percentage points in either direction from the initial mortgage interest rate, and that HUD may revise this cap through notice.

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[27] 87 FR 63458.

Constant Maturity of the SOFR tenor at §§ 203.49(b)(1) and 206.21(b)(1)(ii)

In response to comments stating that the language regarding constant maturity is unique to the U.S. Treasury and does not apply to SOFR, HUD is removing the clause "adjusted to a constant maturity" from application to SOFR at §§ 203.49(b)(1) and 206.21(b)(1)(ii).

Reorganization of § 206.21(b)

To make clear that the paragraph regarding application of the replacement index to existing mortgages applies to both annual and monthly HECM mortgages, HUD is moving the proposed § 206.21(b)(1)(ii)(B) to a new paragraph at § 206.21(b)(3).

Index rate dropping below zero at § 206.21(b)(1)(ii) and (b)(2)(i)

In response to a comment suggesting that it is the index, not the mortgage rate, which should be prohibited from going below zero, HUD has revised § 206.21(b)(1)(ii) and (b)(2)(i) to replace "mortgage rate" with "index figure".

HUD is also making two other clarifying changes to these paragraphs. First, HUD is revising the word "change" to "periodic adjustment" in both § 206.21(b)(1)(ii) and (b)(2)(i). Second, HUD is changing "Note rate" to "mortgage interest rate" in § 206.21(b)(2)(i) to align with § 206.21(b)(1)(ii).

IV. Public Comments

The public comment period for the proposed rule closed on November 18, 2022. HUD received 4 comments relating to the rule.

Support for the proposed rule

Commenters supported the proposed rule. Commenters stated that SOFR rates are more accurate rates based off historical trends, more stable, less risky, and less prone to manipulation. A commenter stated that without a transition from LIBOR, forward mortgage borrowers could see their monthly payments become unaffordable and HECM borrowers could see their equity eroded. A commenter noted that SOFR is calculated from billions of dollars of actual daily transactions compared to LIBOR, which is calculated based on fewer transactions and often uses estimates or even simply expert judgment. A commenter stated that lenders have manipulated the LIBOR interest rate system and suggested that this manipulation contributed to the real estate crash of 2008. This commenter stated that LIBOR allowed lenders to manipulate interest rates over 3, 6, and 12 month periods. This commenter stated that these advantages of SOFR will lead to lower borrowing cost for companies, which should help improve the US economy. A commenter noted that SOFR is publicly available for free and maintained by an independent, quasi-governmental entity, compared to LIBOR, which is controlled by a private benchmark administrator that restricts access to those who pay for it.

A commenter noted that Fannie Mae and Freddie Mac have already replaced LIBOR with SOFR in their uniform instruments, giving substantial weight to the use of this index in the mortgage market. This commenter also noted that Ginnie Mae has already stopped purchasing loans that use LIBOR, and better alternatives (e.g., the 30-day SOFR) are now available, so it is appropriate for HUD to formally prevent the issuance of any more LIBOR loans.

A commenter, in support of the proposed rule, emphasized that without a good transition off LIBOR, forward mortgage borrowers could see their monthly payments become unaffordable or more volatile, driving them into default and foreclosure, and HECM borrowers could see their equity be eroded at an unsustainable pace. This commenter also noted the Mutual Mortgage Insurance Fund (MMIF) would bear the financial cost of any mismanagement in the LIBOR transition. This commenter further noted that borrowers have no control over what happens in this process and mortgage contracts provide them with no say in the noteholder's decision, and so borrowers' only form of recourse would be to complain or initiate litigation.

This commenter also specifically supported HUD's proposal to require noteholders to follow the Alternative Reference Rates Committee's (ARRC) recommendation to replace LIBOR with the spread-adjusted SOFR in existing mortgages. This commenter asserted that the spread-adjusted SOFR accurately accounted for SOFR's slightly lower historical trend compared to LIBOR, and was therefore the best replacement index available.

HUD Response: HUD appreciates the support for its proposal to remove the LIBOR index and add SOFR as a Secretary-approved index for newly originated ARMs and to approve a spread-adjusted SOFR index as the replacement index for existing forward and HECM ARMs that will transition from LIBOR. HUD believes that following the ARRC recommendations to replace LIBOR with SOFR is a crucial step for aligning with the GSEs and is also in the best interest of borrowers and mortgagees. Using a spread-adjusted SOFR as the Secretary-approved replacement index should facilitate a smooth transition for existing mortgages. HUD will publish a Mortgagee Letter to implement the requirements in this final rule.

<u>Opposition to a five percent lifetime rate cap</u>

Commenters opposed HUD's proposal to cap HECM ARMs at five percentage points. A commenter disagreed with HUD's assertion that, currently, HECM ARMs may be uncapped. The commenter stated that lenders must set a maximum interest rate to comply with section 1204 of the Competitive Equality Banking Act of 1987 ("CEBA"). This commenter stated that CEBA does not specify what the rate cap might be, but in the commenter's experience, lenders set their rate caps between five and ten percentage points over the initial interest rate. The commenter objected to HUD's statement that setting a five percentage point rate cap would reduce risk to borrowers and the MMIF, stating that HUD offers no evidence to support the assertion. The commenter also objected that the statement ignores that lenders have been voluntarily offering monthly ARMs with a five percentage point rate cap. The commenter noted that if HUD required a five percentage point rate cap, lenders might increase the initial rate by increasing the margin, and suggested that lenders have indicated that the ability to set the rate cap at ten percentage points allows lenders to offer lower margins which could be more beneficial to borrowers and the MMIF than the proposed rate cap. This commenter also noted that taking away the lower rate option by mandating a specific rate cap would increase risk for GNMA and HMBS issuers, where in an increasing rate environment, participations subject to lower rate caps can trade below par. This commenter concluded by requesting that FHA recognize that monthly adjustable

HECM ARMs per current law cannot be "uncapped," recognize existing lender practice, and allow lenders to continue to set their own cap.

Another commenter referred to the ten percentage point cap as being "tried and true." This commenter warned that the five percentage point cap would appear to, but would not actually, benefit senior borrowers. The commenter explained that the five percentage point cap would have a much more conservative limit to growth in situations where the borrower chooses not to access their line of credit immediately, and instead lets it grow over time. The commenter noted the importance to senior couples or surviving spouses of the ability to use this additional growth. This commenter also noted that the five percentage point cap would reduce lender participation in the current volatile interest rate environment where many of the recent loans in the pool are already pushing the limits of the five percentage point caps.

HUD Response: HUD recognizes that the reverse mortgage industry has a "self-imposed" ten percent maximum interest rate cap, and more recently, some mortgagees have used a maximum interest rate of five percent on a monthly ARM. HUD notes that CEBA does not mandate a specific cap and the current industry standard may change or may not be universally followed. HUD recognizes that there may be situations where a ten percent cap is beneficial both to the borrower and mortgagee. However, HUD also notes that HUD's responsibility for managing and mitigating risks to the MMIF, is challenged when house price appreciation slows, the housing market is volatile, or inflation is increasing. Therefore, after considering comments, HUD has determined it will establish a maximum interest rate cap of up to ten percent beyond the initial mortgage interest rate for monthly mortgages, but may adjust this cap in the future through notice.

Overall, setting a cap will reduce risk to the borrower and the MMIF by reducing potential loan balance growth and slow the rate at which the outstanding principal limit balance reaches 98% of the maximum claim amount while reserving the property's equity in a declining market. Borrowers would also be protected from the risk of entering into a financial product where the maximum interest rate could exceed the ten percent limit during a period of higher interest rates. This change will also permit mortgagees to continue to offer monthly ARMs that align with current mortgagee practices and supports the borrower's ability to negotiate with the mortgagee for best interest rate terms.

HUD initially intends to set the cap at up to ten percent above the initial mortgage interest rate. If HUD determines it is necessary to change the maximum mortgage interest rate range, HUD will examine a variety of market factors. These factors may include the FHA portfolio analysis of default and claim rates of HECMs with similar attributes, analysis of HECMs across geographical areas segmented by the maximum mortgage interest rate, and any other relevant factors.

Constant maturity of the SOFR tenor

A commenter noted that HUD proposed to use the 30-day average SOFR tenor "adjusted to a constant maturity of one year," but the concept of adjustments to a constant maturity is a U.S. treasury concept and does not apply to SOFR. This commenter therefore suggested that HUD issue either in the final rule or in a concurrent mortgagee letter, that for the replacement index for existing ARMs indexed to LIBOR, that HUD approved SOFR tenors are the spread-adjusted SOFR rates published by Refinitiv for the one-, three-, six-, and twelve-month indices.

HUD Response: HUD appreciates the feedback and has adopted the change suggested by commenters to remove "adjusted to a constant maturity of one year" from §§ 203.49(b)(1) and 206.21(b)(1)(ii) since this reference is not applicable to the 30-day average SOFR tenor. HUD also recognizes the index selected must be appropriate and from a publicly available source such as the one suggested. HUD will take this suggestion into consideration when it publishes the notice establishing approved indices.

Applicability of § 206.21(b)(1)(ii)(B) to monthly adjustable HECMs

A commenter noted that the proposed rule established the replacement index for mortgages with an existing adjustable interest rate indexed to LIBOR in § 206.21(b)(1)(ii)(B), but the commenter noted that § 206.21(b)(1) addresses annually adjustable HECM ARMs, whereas monthly adjustable HECMs are primarily addressed in § 206.21(b)(2). This commenter requested that HUD make clear that the entirety of § 206.21(b)(1)(ii)(B) applies to monthly adjustable HECMs. This commenter also requested that HUD clarify that for any monthly adjustable HECM ARMs, the remainder of the contract provisions of the HECM loan notes will remain unchanged, which the commenter said was clearly required under § 206.21(b)(1)(ii)(B), but did not clearly also apply to § 206.21(b)(2).

HUD Response: HUD appreciates the concerns raised by this commenter and has restructured § 206.21(b) by creating a new paragraph (b)(3) to avoid confusion and ensure the requirements for transitioning existing HECMs from LIBOR to the Secretary-approved spread-adjusted SOFR replacement index is applicable to annual and monthly HECM ARMs.

<u>Calculating a new interest rate</u>

A commenter noted that the proposed § 206.21(b)(2)(ii) differed from language included in section 5(C) of the Model Note for HECMs as updated in March of 2021 and suggested that HUD revise § 206.21(b)(2)(ii) to align with the Model Note.

This commenter also requested that HUD clarify that the index only needs to be rounded 3 digits to the right of the decimal point.

HUD Response: HUD appreciates the feedback provided; however, HUD believes the changes made to § 206.21(b)(2) accomplishes its intent to clarify the requirements applicable to monthly ARMs in a similar manner that is currently provided for annual ARMs. HUD will revise and publish a Model Note that corresponds to the requirements in this final rule.

Currently, the mortgage interest rate that is entered into HUD’s systems must be rounded to 3 digits to the right of the decimal point. HUD does not anticipate making changes to this requirement.

Index rate dropping below zero

A commenter noted HUD proposed that the downward change in the index "will not result in a mortgage interest rate that is less than zero" and suggested changing "mortgage interest rate" to "index", consistent with HUD's Model HECM ARM Note.

HUD Response: HUD appreciates the feedback provided and has adopted the suggested language to replace "mortgage interest rate" with "index figure".

Effective dates of specific SOFR rates

A commenter requested that HUD issue guidance that SOFR rates "established on Mondays and going into effect on Tuesday and are good until the following week's index is established." This commenter noted that this would be consistent with the method used for LIBOR rates under Mortgagee Letter 2007-13.

HUD Response: HUD will consider this comment when issuing guidance to implement the requirements in this final rule.

Unsecured Debt

A commenter suggested the HECM program should align with the forward mortgage program and allow borrowers to immediately qualify by paying off unsecured debt. The commenter stated that not allowing a client to participate in the HECM program due to not being able to restructure debt in a better way had no justification.

HUD Response: HUD appreciates this comment, but this recommendation is outside the scope of this rulemaking.

V. Findings and Certifications

Regulatory Review—Executive Orders 12866 and 13563

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 indices 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 prevent HUD's rules on ARMs from becoming obsolete as well as to avoid the risk of financial harm for all ARM lenders and borrowers, and the larger ARM market, and the MMIF.

HUD does not expect the rule to have an economic impact as a result of the transition to the alternative rate. For newly endorsed forward ARMs, SOFR will become an available index in addition to the one-year CMT index. HUD has already removed LIBOR and approved SOFR for new annually adjustable HECM ARM originations. As of the Effective Date or prior to the cessation of LIBOR, existing LIBOR indexed FHA-insured ARMs may transition to a spread-adjusted SOFR to make it a comparable rate for existing LIBOR-based ARMs. Transition to the spread-adjusted SOFR will align FHA-insured ARMs with other LIBOR contracts covered by the LIBOR Act.

For existing mortgages that transition to spread-adjusted SOFR, we do not anticipate a significant economic impact. For all existing FHA-insured ARMs, the per-adjustment and lifetime caps on total adjustments will continue to apply, minimizing the impact to borrowers or mortgagees as a result of the transition to SOFR.

This rule was not subject to OMB review. This rule is not a "significant regulatory action" as defined in section 3(f) of Executive Order 12866, and is not an economically significant regulatory action.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (Pub. L. 104–4; approved March 22, 1995) (UMRA) establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments, and on the private sector. This rule does not impose any Federal mandates on any State, local, or tribal governments, or on the private sector, within the meaning of the UMRA.

Environmental Review

This rule consists of statutorily required and/or discretionary establishment and review of interest rates 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 rule is categorically excluded from environmental review under the National Environmental Policy Act of 1969 (42 U.S.C. 4321).

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 et seq.) generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. This rule provides for the removal of LIBOR as an allowable index rate for adjustments for new FHA-insured forward ARMs and establish SOFR as a new index along with the CMT for new forward ARMs, aligning it with the available indices for annually adjustable HECM ARMs. There will be a Secretary-approved spread-adjusted SOFR for existing FHA-insured ARMs transitioning from LIBOR.

The rule requires mortgagees to, where appropriate, utilize a new approved index. Mortgagees are already required to substitute an index under the terms of their existing loan documents when the index used becomes unavailable. Additionally, this rule establishes a new index for origination of new forward ARMs, which mortgagees regularly provide when originating a loan. Therefore, the changes in this rule should not have a significant economic impact on mortgagees. If there is an economic effect on mortgagees, it would fall equally on all mortgagees who originate or service ARMs. Further, HUD anticipates that allowing an additional index for newly originated ARMs will have a net positive economic impact on borrowers and mortgagees by providing additional market opportunities, decreasing the cost of credit associated with these ARMs.

Therefore, the undersigned certifies that the rule will not have a significant economic impact on a substantial number of small entities.

Executive Order 13132, Federalism (64 FR 43255; August 10, 1999)

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either: (1) imposes substantial direct compliance costs on State and local governments and is not required by statute, or (2) preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. This rule does not have federalism implications and does not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive order.

Paperwork Reduction Act

The information collection requirements contained in this rule are currently approved by OMB and have been given OMB Control Number 2502-0322 and OMB Control Number 2502-0524 and 2502-0611. In accordance with the Paperwork Reduction Act, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

List of Subjects

24 CFR Part 203

Hawaiian Natives, Home improvement, Indians—lands, Loans programs—housing and community development, Mortgage insurance, Reporting and recordkeeping requirements, Solar energy.

24 CFR Part 206

Aged, Condominiums, Loan programs—housing and community development, Mortgage insurance, Reporting and recordkeeping requirements.

For the reasons discussed in the preamble, HUD amends 24 CFR parts 203 and 206 as follows:

PART 203—SINGLE FAMILY HOUSING MORTGAGE INSURANCE

1. The authority citation for part 203 continues to read as follows:

Authority: 12 U.S.C. 1707, 1709, 1710, 1715b, 1715z-16, 1715u, and 1715z-21; 15 U.S.C. 1639c; 42 U.S.C. 3535(d).

2. Amend § 203.49 by revising paragraph (b) to read as follows:

§ 203.49 Eligibility of adjustable rate mortgages.

* * * * *

(b) *Interest-rate index*—(1) *CMT and SOFR indices*. Changes in the interest rate charged on an adjustable rate mortgage must correspond either to changes in the weekly average yield on U.S. Treasury securities, adjusted to a constant maturity of one year (CMT); to the 30-day average Secured Overnight Financing Rate (SOFR) published by the Federal Reserve Bank of New York (or a successor administrator); or to an alternative SOFR tenor approved by the Secretary. The Secretary may publish approved SOFR tenors as alternatives to the 30-day average SOFR tenor through notice.

(2) *Transition for existing mortgages indexed to LIBOR*. Mortgages with an existing adjustable interest rate indexed to the London Interbank Offered Rate (LIBOR) must be transitioned to the spread-adjusted SOFR replacement index approved by the Secretary by the next interest rate adjustment date for the mortgage on or after the Replacement Date, which means the first London banking day after June 30, 2023, unless the Board of Governors of the Federal Reserve System determines that any LIBOR tenor will cease to be published or cease to be representative on a different date. In such case, Replacement Date means the first business day following the date announced by the Board of Governors of the Federal Reserve System. Notice of the transition to the SOFR replacement index must be sent to the borrower in accordance with the mortgage documents. The Secretary will publish through Mortgagee Letter any additional requirements for the transition of existing mortgages.

(3) *Changes in the mortgage interest rate*. Except as otherwise provided in this section, each change in the mortgage interest rate must correspond to the upward and downward change in the index.

*   *   *   *   *

PART 206—HOME EQUITY CONVERSION MORTGAGE INSURANCE

3. The authority citation for part 206 continues to read as follows:

Authority: 2 U.S.C. 1715b, 1715z-20; 42 U.S.C. 3535(d)

4. Amend § 206.3 by revising the definition of “Expected average mortgage interest rate” and adding, in alphabetical order, definitions for “Margin”, “Replacement Date”, and “SOFR” to read as follows:

§ 206.3 Definitions.

*   *   *   *   *

Expected average mortgage interest rate means the interest rate used to calculate the principal limit established at closing.

(1) For fixed interest rate HECMs, the expected average mortgage interest rate is the same as the fixed mortgage (Note) interest rate and is set simultaneously with the fixed interest (Note) rate.

(2) For adjustable interest rate HECMs, the expected average mortgage interest rate is the sum of the mortgagee's margin plus the weekly average yield for U.S. Treasury securities (CMT) adjusted to a constant maturity of 10 years or an additional SOFR index as approved by the Secretary. Commingling the index type used to calculate the expected average mortgage interest rate and the index type used to calculate the adjustable mortgage interest (Note) rate and adjustments is only permissible as provided for by the Secretary.

(3) Mortgagees, with the agreement of the borrower, may simultaneously lock in the expected average mortgage interest rate and the mortgagee's margin prior to the date of mortgage closing or simultaneously establish the expected average mortgage interest rate and the mortgagee's margin on the date of mortgage closing.

*　　*　　*　　*　　*

Margin means the amount added to the index value to compute the expected average mortgage interest rate and the initial mortgage interest (Note) rate and periodic adjustments to the mortgage interest (Note) rate.

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Replacement Date means the first London banking day after June 30, 2023, unless the Board of Governors of the Federal Reserve System determines that any LIBOR tenor will cease to be published or cease to be representative on a different date. In such case, Replacement Date means the first business day following the date announced by the Board of Governors of the Federal Reserve System.

SOFR means the Secured Overnight Financing Rate published by the Federal Reserve Bank of New York (or a successor administrator).

5. Amend § 206.21 by revising paragraphs (b)(1)(ii) and (b)(2) and adding paragraph (b)(3) to read as follows:

§ 206.21 Interest rate.

* * * * *

(b) * * *

(1) * * *

(ii) *Interest rate index*. Changes in the mortgage interest rate charged on an adjustable interest rate mortgage must correspond to changes in the weekly average yield on U.S. Treasury securities (CMT) adjusted to a constant maturity of one year; to the 30-day average Secured Overnight Financing Rate (SOFR); or to an alternative SOFR tenor approved by the Secretary. The Secretary may publish approved SOFR tenors as alternatives to the 30-day average SOFR tenor through notice. The index type used to calculate the initial mortgage interest rate must be the same index type used to calculate the mortgage interest rate adjustments, except as provided in paragraph (b)(3) of this section. Commingling of index types for the mortgage interest rate and adjustments is not otherwise allowed, unless approved by the Secretary. Unless otherwise provided in this section, each periodic adjustment in the mortgage interest rate must correspond to the upward and downward change in the index, except that downward changes in the index will not result in an index figure that is less than zero.

* * * * *

(2) *Monthly adjustable interest rate HECMs.* If a mortgage meeting the requirements of paragraph (b)(1) of this section is offered, the mortgagee may also offer a mortgage which provides for monthly adjustments to the interest rate subject to the following requirements:

(i) *Interest rate index.* Changes in the interest rate charged on an adjustable interest rate mortgage shall correspond to changes in the weekly average yield on U.S. Treasury securities (CMT) adjusted to a constant maturity of one year, to the weekly average yield on CMT adjusted to one-month, or to an alternative SOFR index approved by the Secretary. The index type used to calculate the initial mortgage interest rate must be the same index type used to calculate the mortgage interest rate adjustments, except as provided in paragraph (b)(3) of this section. Commingling of index types for the mortgage interest rate and adjustments is not otherwise allowed, unless approved by the Secretary. Unless otherwise provided in this section, each periodic adjustment in the mortgage interest rate must correspond to the upward and downward change in the index, except that downward changes in the index will not result in an index figure that is less than zero.

(ii) *Frequency of interest rate changes.* (A) The interest rate adjustments must occur monthly, calculated from the date of the closing, except that the first adjustment shall be no sooner than 30 days (28 days for February, as applicable) or later than three months from the date of the closing.

(B) To set the new interest rate, the mortgagee will determine the change between the initial (*i.e.,* base) index figure and the current index figure, or will add a specific margin to the current index figure. The initial index figure shall be the most recent figure available before the date of mortgage loan origination. The current index figure shall be the most recent index figure available 30 days (28 days for February, as applicable) before the date of each interest rate adjustment.

(iii) *Magnitude of changes.* The initial mortgage interest rate shall be agreed upon by the mortgagee and the borrower. Adjustments in the effective rate of interest over the entire term of the mortgage (the lifetime adjustment cap) may result in a change in either direction of no more than ten percentage points from the initial contract interest rate. The Secretary may change this lifetime adjustment cap through notice.

(3) *Transition for existing mortgages indexed to LIBOR*. Mortgages with an existing adjustable interest rate indexed to the London Interbank Offered Rate (LIBOR) must be transitioned to the spread-adjusted SOFR replacement index approved by the Secretary by the next interest rate adjustment date for the mortgage on or after the Replacement Date. Notice of the transition to the SOFR replacement index must be sent to the borrower in accordance with the mortgage documents. The Secretary will publish through Mortgagee Letter any additional requirements for the transition of existing mortgages.

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Assistant Secretary for Housing - FHA
Commissioner

[Billing code: 4210-67]

[FR Doc. 2023-03952 Filed: 2/28/2023 8:45 am; Publication Date: 3/1/2023]