American Bankers Association® | HPC Housing Policy Council | MBA Mortgage Bankers Association

December 6, 2021

Lopa P. Kolluri
Principal Deputy Assistant Secretary
Office of Housing – Federal Housing Administration
U.S. Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

Re: Adjustable Rate Mortgages: Transitioning From LIBOR to Alternate Indices

Dear Principal Deputy Assistant Secretary Kolluri:

The American Bankers Association (ABA),[1] the Housing Policy Council (HPC),[2] and the Mortgage Bankers Association (MBA)[3] (collectively, the Associations) thank the U.S. Department of Housing and Urban Development (HUD) for issuing an advance notice of proposed rulemaking[4] to accelerate the transition away from the use of LIBOR as an index for certain Federal Housing Administration (FHA)-insured loans.

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[1] The American Bankers Association is the voice of the nation's $23.3 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $19.2 trillion in deposits and extend nearly $11 trillion in loans.

[2] The Housing Policy Council is a trade association comprised of the leading national mortgage lenders and servicers, mortgage and title insurers, and technology and data companies. HPC advocates for the mortgage and housing marketplace interests of its members in legislative, regulatory, and judicial forums. Our interest is in the safety and soundness of the housing finance system, the equitable and consistent regulatory treatment of all market participants, and the promotion of lending practices that create sustainable homeownership opportunities in support of vibrant communities and long-term wealth-building for families. For more information, visit www.housingpolicycouncil.org.

[3] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 330,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of more than 1,900 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

[4] HUD, "Adjustable Rate Mortgages: Transitioning From LIBOR to Alternate Indices," 86 Fed. Reg. 54876, October 5, 2021. Available at: https://www.federalregister.gov/documents/2021/10/05/2021-21512/adjustable-rate-mortgages-transitioning-from-libor-to-alternate-indices.

HUD is considering a rule that would define a Secretary-approved replacement index for existing adjustable-rate mortgages (ARMs) and provide for a transition date consistent with the cessation of the LIBOR index. HUD proposes replacing the LIBOR index with the Secured Overnight Financing Rate (SOFR) interest rate index, along with a compatible spread adjustment to minimize any potential value transfer due to the replacement of LIBOR for legacy ARMs. HUD is seeking public comment on the appropriate means by which to facilitate the transition away from LIBOR for legacy loans and new originations.

The Associations and our collective members appreciate HUD's efforts to assist lenders and servicers as they implement the necessary transition to alternate indices for FHA-insured ARMs. The transition away from the use of LIBOR is the result of long-running changes to the interbank lending markets underpinning LIBOR and decisions by a wide range of private institutions and domestic and foreign regulators to seek more stable alternatives to LIBOR, which in turn have impacts throughout the financial markets.

The thorough work to advance this effort, undertaken by representatives from the public, private, and non-profit sectors over several years, has been guided by the twin pillars of facilitating a smooth transition and minimizing value transfer as a result of the transition. With respect to FHA-insured lending and servicing, a successful transition for all parties, including consumers, requires adherence to these principles, as well as clear guidance that promotes compliance certainty and equitable outcomes.

Servicing of Existing LIBOR-Indexed, FHA-Insured ARMs

Replacement of LIBOR as the index for existing FHA-insured ARMs will require servicers to adjust internal operations and systems, recalculate consumer payments, and notify affected consumers. This is not a simple process, but one that servicers can implement most efficiently if provided sufficient guidance by HUD. To promote a smooth transition, HUD therefore should issue a clear roadmap for servicers of FHA-insured ARMs, including specification of a replacement comparable index (or indices, if appropriate) for existing mortgages, as well as guidance on communications with borrowers.

The key element of this roadmap is the selection of a replacement comparable index or indices. HUD should specify a spread-adjusted alternate index (or indices, if appropriate) that:

- Are based on observable transactions from a robust underlying market;
- Are subject to established governance processes that protect the integrity of the index/indices and address potential conflicts of interest;
- Minimize expected differences in borrower payments between the use of LIBOR and the use of the replacement comparable index/indices; and
- Meet any other standards identified by key bodies such as the International Organization of Securities Commissions (IOSCO).

It is critical that servicers feel confident that by transitioning to a HUD-approved replacement comparable index, they are not breaching contractual terms and are not subject to increased litigation risk. To achieve this outcome, HUD should make clear that its approved replacement index or indices satisfy the condition that such an index/indices be based upon comparable information to LIBOR. This compliance certainty would parallel ongoing efforts to establish a legislative "safe harbor" at the federal and state levels for the transition of financial contracts indexed to LIBOR that meet certain conditions.[5]

While the precise timing of the transition depends on guidance issued by HUD, it is unlikely that servicers would change the index on existing FHA-insured ARMs prior to the expected cessation of the relevant LIBOR tenors on June 30, 2023 (again, absent explicit requirements to do so by HUD). Such a transition would not entail a single "change date" from the perspective of consumers, as each consumer's transition would occur at the first interest rate reset following the cessation of LIBOR. If a consumer has an annual interest rate reset on October 1 of each year, for example, his or her monthly payment would reflect the new index beginning on October 1, 2023 – despite LIBOR having ceased on June 30, 2023.

As noted earlier, servicers will need to implement various operational and systems changes to transition away from LIBOR. Servicers also will need to communicate with consumers well in advance of index changes on impacted ARMs. These realities of the transition demonstrate why HUD should issue any final rules or guidance significantly earlier than the expected June 30, 2023 cessation date for LIBOR. We recommend that HUD issue such rules or guidance no later than June 30, 2022 to provide servicers with the necessary time to make these changes. Given the detailed research and analysis that has been undertaken with respect to several potential alternate indices, we believe it is feasible for HUD to make its determination in this timeframe.

Servicers are committed to ensuring that communications with consumers regarding the transition away from LIBOR provide the necessary information in a digestible format. Industry efforts on this front have yielded templates for initial notices to consumers,[6] though further guidance from HUD specific to FHA-insured ARMs would be welcome. Such guidance could include standardized clauses that may be incorporated into disclosures, as well as the acceptable delivery mechanisms for these communications.

Finally, as is noted in the ANPR, HUD already permits the use of the Constant Maturity Treasury (CMT) index for FHA-insured ARMs. We believe no changes are necessary with respect to existing CMT-indexed, FHA-insured ARMs.

Origination of New FHA-Insured ARMs

Much like servicers of existing LIBOR-indexed, FHA-insured ARMs, lenders originating new FHA-insured ARMs will need to adjust their internal processes and systems in order to replace LIBOR with one or more alternate indices. And much like servicers, lenders can put these changes in place in a smooth manner if provided appropriate guidance and implementation time. The Alternative Reference Rates Committee (ARRC) has undertaken analysis to demonstrate

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[5] While HUD should provide servicers ample time to implement required index changes, the Associations urge that HUD also take into account any safe harbor available under federal or state legislation that ultimately is enacted to facilitate the transition away from LIBOR.

[6] MBA, "Letter Template for Communications with Existing LIBOR ARM Borrowers," April 26, 2021. Available at: https://www.mba.org/Documents/Policy/MBA_LIBOR_Transition_Template_Consumer_Letter-PR.pdf.

how indices based on SOFR can serve as alternate indices to LIBOR for mortgage products.[7] In recent months, several key regulators have issued statements noting their preference for the use of SOFR in new U.S. Dollar financial contracts, as well.[8] Fannie Mae and Freddie Mac also have transitioned to the use of SOFR for new ARMs eligible for purchase.[9] As such, we presume that HUD will adopt SOFR as a permissible alternate index. This is a reasonable and appropriate outcome based on the growing adoption of SOFR and its basis in observable transactions in a highly-liquid market. The use of 6-month term SOFR and, upon its endorsement by the ARRC, 1-year term SOFR should satisfy lender and consumer needs with respect to new originations.

While lenders would benefit from the choice of SOFR and CMT as permissible indices, we believe HUD should evaluate additional options for permissible indices, both as it develops a final rule in the coming months and on an ongoing basis. There are several potential alternatives to LIBOR that are in varying stages of development, some of which may meet HUD's criteria in the near future, even if they do not at the time a final rule is published.

We recommend, therefore, that after HUD determines whether any additional indices (beyond SOFR and CMT) are permissible for new originations in its final rule, it implement a system to evaluate alternate indices periodically. The final rule could specify either a timeline (*e.g.*, HUD will determine whether to add new permissible indices every two years) or a triggering event (*e.g.*, HUD will undertake an evaluation of an index if it is deemed compliant with the IOSCO principles).

We further recommend that HUD move quickly to authorize the use of one or more alternate indices. As noted above, many regulators have made clear their expectation that regulated institutions not originate new loans indexed to LIBOR beyond year-end 2021. Lenders that already have shifted their conventional ARM lending away from LIBOR at the urging of their primary federal or state regulator are highly unlikely to feel comfortable originating LIBOR-indexed, FHA-insured loans – even if HUD permits them to do so. To ensure lenders are able to continue offering consumers FHA-insured ARMs in a feasible manner, HUD should take swift action to clarify changes to its permissible indices for new originations.

Following this determination, HUD should provide a reasonable implementation period before prohibiting the use of LIBOR for new originations. While lenders will seek to transition away from the use of LIBOR as quickly as possible, different institutions will be able to complete this transition on different timelines. HUD should be cognizant of this fact when setting its timelines

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[7] ARRC, "Options for Using SOFR in Adjustable Rate Mortgages," July 2019. Available at: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARRC-SOFR-indexed-ARM-Whitepaper.pdf.

[8] Quarles, Randal K., "Goodbye to All That: The End of LIBOR," October 5, 2021, Available at: https://www.federalreserve.gov/newsevents/speech/quarles20211005a.htm. Wuerffel, Nathaniel, "Act Now, and Choose Wisely," October 27, 2021, Available at: https://www.newyorkfed.org/newsevents/speeches/2021/wue211027. Gensler, Gary, "Remarks Before the Alternative Reference Rates Committee's SOFR Symposium," September 20, 2021, Available at: https://www.sec.gov/news/speech/gensler-remarks-alternative-reference-rates-committee-sofr-symposium-092021.

[9] Fannie Mae, "Standard ARM Plan Matrix." Available at: https://singlefamily.fanniemae.com/media/6951/display. Freddie Mac, "SOFR-Indexed ARMs." Available at: https://sf.freddiemac.com/working-with-us/origination-underwriting/mortgage-products/sofr-indexed-arms.

for the phase-out of LIBOR.

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Thank you once again for your attention to this critically important transition for the mortgage market and the broader financial system. The Associations reiterate the importance of clear guidance from HUD that provides compliance certainty to lenders and servicers with respect to FHA-insured ARMs. Such guidance will promote a smooth transition away from LIBOR that benefits all parties, including consumers. We urge HUD to move quickly through the rulemaking process to identify one or more comparable substitute indices for existing ARMs and one or more alternate indices for new ARMs.

Should you have questions or wish to discuss these comments, please contact Hu Benton at hbenton@aba.com, Matt Douglas at matt.douglas@housingpolicycouncil.org, or Dan Fichtler at dfichtler@mba.org.

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