MORTGAGE BANKERS ASSOCIATION

August 4, 2020

The Honorable Kathy Kraninger
Director
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

RE: Facilitating the LIBOR Transition (Regulation Z)

Dear Director Kraninger:

The Mortgage Bankers Association (MBA)[1] appreciates the opportunity to provide observations and recommendations on the Consumer Financial Protection Bureau (Bureau) proposed rule to amend Regulation Z to facilitate the transition away from LIBOR.[2] Over the past several years, MBA has played an active role to help ensure that this transition does not cause disruptions in the single-family or commercial/multifamily mortgage markets. This work has entailed engagement with the Alternative Reference Rates Committee (ARRC) as well as the development of resources and informational materials for various mortgage market participants.

MBA also appreciates the efforts of the Bureau and the other ex officio and permanent members of the ARRC over the course of the transition process, particularly given the complex nature of the challenges in moving financial markets away from the use of LIBOR. A continued partnership between regulators and market participants will be necessary to produce a smooth implementation of alternative reference rates.

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, DC, 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 over 2,100 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, credit unions, thrifts, REITs, Wall Street conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

[2] Consumer Financial Protection Bureau, "Facilitating the LIBOR Transition (Regulation Z)," June 18, 2020, 85 FR 36938. Available at: https://www.federalregister.gov/documents/2020/06/18/2020-12239/facilitating-the-libor-transition-regulation-z.

When considering potential policy actions to facilitate the transition, MBA evaluates how such actions adhere to four core principles:

- Transition steps should minimize the potential for disruption to, or dislocation in, the processes for originating, servicing, and investing in adjustable-rate mortgage products;
- Transition steps should minimize the potential for value transfer between various parties;
- Transition steps should promote compliance certainty for market participants; and
- Transition steps should lead to long-run market conditions that are conducive to the broad availability of sustainable, adjustable-rate mortgage products.

MBA appreciates the Bureau issuing this proposed rule to clarify actions to be taken by creditors in a manner that is consistent with the core principles described above. The proposed rule would provide creditors with greater compliance certainty when replacing the index on adjustable-rate mortgage products that currently reference LIBOR. The comments below articulate these beneficial features of the proposed rule and suggest additional ways in which the proposed rule could enhance compliance certainty for creditors.

Closed-End Credit

To avoid disruption in the market for closed-end, adjustable-rate mortgages (ARMs), it is critical that replacement of the LIBOR index on existing ARMs not constitute a refinancing of these loans. If the index replacement is considered a refinancing, it would trigger numerous requirements and actions that would confuse borrowers, generate excessive costs for servicers, and harm the value of securities held by investors.

Regulation Z addresses this concern by allowing for an index replacement if the new index is deemed “comparable” to the prior index. In the context of the transition away from LIBOR, market participants need confidence regarding which replacement indices will be considered “comparable” to LIBOR and thus avoid triggering a refinancing of these loans.

MBA appreciates the Bureau’s identification of various spread-adjusted indices based on the Secured Overnight Financing Rate (SOFR) as “comparable” to the respective U.S. Dollar (USD) LIBOR indices of various tenors. Given the ARRC’s focus on developing liquid markets for SOFR-based products, many market participants will likely choose to transition their existing LIBOR-indexed ARMs to SOFR indices. The

proposed rule will provide greater certainty that such transitions do not constitute refinancings under Regulation Z.

While the proposed rule is not intended to list all indices that would be deemed “comparable” to LIBOR indices, it is not immediately clear why the prime rate is explicitly included as an acceptable alternative to LIBOR for open-end credit, but not for closed-end credit. While the standard for closed-end credit replacement indices (“comparable index”) is not the same as the standard for open-end credit replacement indices (“historical fluctuations that are substantially similar”), these standards are closely aligned. Said differently, it should be reasonable for creditors to determine that a replacement index that is suitable for open-end mortgage credit offerings, such as home equity lines of credit (HELOCs), is also suitable for ARMs – and vice versa.

The use of the prime rate as an illustrative example for HELOCs but not for ARMs also could unintentionally lead to confusion among market participants. While the proposed rule does not provide exhaustive lists of all acceptable replacement indices, one could view the decision to cite the prime rate only for open-end credit as an indication that the prime rate is not considered a comparable index to LIBOR for purposes of ARMs. Because of this potential for market confusion, the Bureau should explicitly include the prime rate among the illustrative examples of comparable indices to LIBOR for purposes of ARMs. Alternatively, if the Bureau does not consider the prime rate to be a comparable index to LIBOR, it should state this interpretation explicitly.

To foster greater compliance certainty, the Bureau also should include the process for replacing the index on ARMs in the amendments to Regulation Z rather than solely relying on changes to the commentary. By addressing the ARM index replacement process in the regulation itself, the Bureau would minimize the opportunity for competing interpretations and better align its treatment of ARMs with its treatment of open-end credit.

More broadly, the Bureau could further enhance compliance certainty for creditors by providing factors or considerations that should be taken into account to determine whether a replacement index is comparable to LIBOR. Under such an approach, the Bureau would not need to provide an exhaustive list of acceptable replacement indices. Instead, it would include features of indices that creditors could evaluate to determine compliance. While the Bureau noted similarities in historical fluctuations in making its determination regarding comparable indices, this specific factor may not always be viable. A creditor considering a newly-established index, for example, would not be able to compare historical fluctuations. Reliance on historical fluctuations may also invite debate over the appropriate time period for comparison, as well as how similar the fluctuations must be to be considered “comparable.”

The Bureau should provide guidance in the commentary as to how a creditor should compare indices so that the ongoing concerns expressed by creditors in the LIBOR transition process do not pose problems for any future reference rate transitions. A creditor should be allowed to use any reasonable method to determine if a replacement index is comparable to the current index by taking into account the components of each index as they exist in either a dynamic or static manner, including the overnight risk-free rate, the expected change of the risk-free rate over the term, and a term credit component. Adopting such an approach in the commentary aligns with the work the ARRC has undertaken in making its determination that SOFR is a reasonable replacement for LIBOR, for example, by taking into account the desire for a term credit component and establishing a framework for a static credit spread adjustment as part of the plans to transition away from LIBOR. This approach would allow creditors to gain greater compliance certainty by analyzing factors specified by the Bureau, while also allowing sufficient flexibility for creditors to make determinations regarding alternative indices.

Open-End Credit

In the proposed rule, the Bureau notes that HELOC creditors would benefit substantially if they were permitted to transition existing products away from LIBOR prior to the point at which LIBOR “becomes unavailable” or “is no longer available.” MBA supports this approach, as it would allow creditors to undertake the transition on a timeline that is more manageable and less likely to cause disruption for both creditors and consumers.

The proposed rule contains a methodology by which creditors can compare the annual percentage rate (APR) of the HELOC under the LIBOR index (and prevailing margin) to the new APR generated by the replacement index and margin. Under the terms of the proposed rule, these APRs must be “substantially similar” when comparing the index values on December 31, 2020 and the margins associated with each index.

The benefits of using a single date for purposes of the index values in this comparison outweigh the costs. The use of a single date reduces complexity and allows for a simpler comparison. The Bureau is correct to note, however, that one or both indices could exhibit unusual behavior on the specified date, which could skew the results of the comparison. Further, the choice of December 31 as the prescribed date could introduce additional problems, as lighter trading volumes or “year-end effects” in the markets underlying certain indices could lead to unusual results.

The use of a single date is less worrisome for indices that are calculated using longer-term averages, such as those based on 30-day, 90-day, or 180-day averages

of SOFR. In these situations, the construction of the index reduces the likelihood that the value on any given day skews the results of the comparison with LIBOR.

For indices that are not calculated using longer-term averages, though, the Bureau should consider alternative comparison approaches. One option to reduce the likelihood of outlier results is to use the median value of the difference between the two indices over a slightly longer period of time. A creditor could, for example, observe the final fifteen dates on which values are published in 2020 for both LIBOR and the replacement index being considered, find the median value of the spread between the two indices, and use that date as the comparison date for purposes of the proposed rule.

To preserve flexibility and recognize that different indices will present different challenges with respect to evaluation on a single date, the Bureau should allow multiple types of comparisons for purposes of the proposed rule. The Bureau should maintain the approach in the proposed rule based on the index values on December 31, 2020, but also should include an option such as the approach described above, which would better address concerns around the use of a single date. Creditors would then be permitted to use a replacement index and margin if the APR that is produced is substantially similar to that of LIBOR and the prevailing margin under either approach.

Separately, with respect to SOFR, it would be appropriate for the Bureau to clarify that the APR calculated using a spread-adjusted SOFR index is substantially similar to the APR calculated using a corresponding LIBOR index, provided the creditor uses the same margin in effect immediately prior to the transition. This clarification would further promote the use of spread-adjusted SOFR indices and provide another mechanism for compliance certainty for creditors. Given that the ARRC has recommended spread adjustments that would effectively equate LIBOR and SOFR, this calculation would be reasonable and appropriate for creditors.

Another area in which the Bureau could enhance compliance certainty relates to newly-established indices. The proposed rule requires replacement indices to exhibit historical fluctuations that are substantially similar to those of the prior index, unless the replacement index is “newly established.” This exception for newly-established indices is appropriate to encourage the development and use of new indices, particularly given increased activity in this field due to the expected discontinuation of LIBOR. The Bureau should provide greater detail to creditors regarding the factors or considerations that should be taken into account to determine that an index is “newly established.” Such factors or considerations could include the length of time in which an index has been published or made available, as well as the period of time since the index has gained broad acceptance or use in financial markets.

Lastly, the proposed rule requires HELOC creditors to inform consumers of the index that is replacing LIBOR and any adjustment to the margin, regardless of whether the margin is increasing or decreasing. This requirement is appropriate and should reduce confusion for consumers during the transition.

General Comments

MBA has also identified additional general recommendations that would supplement the ARM- and HELOC-specific recommendations described above.

As is done in the preamble to the proposed rule, the Bureau should make abundantly clear in the final rule that the examples of specific indices are illustrative rather than exhaustive. The use of illustrative examples is helpful for creditors as they transition away from LIBOR, but there should be no room for misinterpretation that the absence of a particular example means that index would not satisfy the conditions of the proposed rule.

The proposed rule also would better enhance compliance certainty for creditors by providing greater detail as to the process by which creditors must make various determinations regarding replacement indices. This enhancement should apply to the requirements that ARM replacement indices be “comparable” to LIBOR and that HELOC replacement indices produce an APR that is “substantially similar” to the APR produced by LIBOR indices. While the use of numerical thresholds or specific calculations likely would be too rigid, the Bureau should provide factors or considerations that creditors could take into account to comply with the proposed rule.

Similarly, while the Bureau need not determine when LIBOR (or another index) is unavailable for purposes of Regulation Z, it should provide further guidance to creditors to assist them in making this determination. The Bureau could, for example, cite triggers used in the ARRC’s recommended contractual fallback language, such as when an index administrator permanently or indefinitely stops providing the index to the general public, or when an index administrator or its regulator issues an official public statement that the index is no longer reliable or representative.

These enhancements to the proposed rule not only would assist creditors in undertaking the transition away from LIBOR, but also would provide the added benefit of aiding in the transition away from other benchmarks that will be phased out of use (such as the transition away from the 11th District Cost of Funds Index). Guidelines that are clear but also allow for flexibility in creditors’ analyses can serve as a valuable roadmap for future reference rate transitions.

Another potential enhancement to the proposed rule would entail the Bureau affirmatively stating that good-faith efforts to transition existing and new products away from the use of LIBOR do not constitute unfair, deceptive, or abusive acts or practices. Creditors should feel confident that their efforts to transition away from LIBOR – efforts they directly have been advised to undertake by regulators – will not subject them to undue compliance risks. Any lack of clarity on this front could deter creditors from taking actions that otherwise would be beneficial to consumers and the broader market.

Finally, the effective dates included in the proposed rule (March 15, 2021 and October 1, 2021) appear to be feasible and appropriate. These timelines should allow creditors sufficient opportunity for preparation and implementation, while also ensuring that necessary actions can be taken well in advance of any potential discontinuation of LIBOR.

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MBA appreciates the opportunity to provide comments on the proposed rule, as well as the continued engagement with the Bureau during the transition away from LIBOR. The proposed rule will benefit both creditors and consumers while lowering the likelihood of market disruptions due to this transition. Additional refinements to the proposed rule, as discussed above, would further enhance compliance certainty and promote stability.

Thank you in advance for your consideration of these comments. Should you have questions or wish to discuss further, please contact Dan Fichtler, Associate Vice President of Housing Finance Policy, at (202) 557-2780 and dfichtler@mba.org.

Sincerely,

Pete Mills
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Residential Policy and Member Engagement
Mortgage Bankers Association