On June 4 the Consumer Financial Protection Bureau (CFPB) issued proposals to address issues arising from the required transition away from the London Interbank Offered Rate (LIBOR) scheduled for the end of 2021. LIBOR has been widely used as a benchmark in consumer financial products such as adjustable rate mortgage loans, home equity lines of credit (HELOCs), student loans and credit cards. The CFPB released a more than 200 page rulemaking proposal calling for changes to its truth-in-lending regulations relating to the LIBOR transition. The CFPB also simultaneously issued guidance in the form of Frequently Asked Questions (FAQ).

This blog will emphasize the proposal’s and the FAQ’s impact on adjustable rate mortgage loans and HELOCs.

Adjustable rate mortgage loans

Under Regulation Z as currently written, if the existing index used to calculate a mortgage loan’s interest rate is replaced and the new index is not a “comparable index,” the index change may constitute a refinancing. The proposed rule would provide an example of an index that is a “comparable index” to LIBOR – an index based on the Secured Overnight Financing Rate. This index has been endorsed by the Alternative Reference Rates Committee, a public-private LIBOR transition working group in the United States. It is worth noting that not everyone favors this index as a replacement for LIBOR, as some say it is subject to rate spikes that have not been historically present in LIBOR.
The CFPB is proposing a revamped Consumer Handbook on Adjustable Rate Mortgages, commonly known as the CHARM booklet. The proposed new CHARM booklet would remove all references to LIBOR and reduce the number of pages by half.

Per the FAQ, the proposed changes will affect ARM loan program origination disclosures for some loan programs, as the new index and formula used to calculate the interest rate will need to be identified, the explanation as to how the interest rate and payment will be determined will need to be modified, and rules relating to changes in the index or interest rate, such as an explanation of interest rate limitations, may need to be modified. The historical example and initial and maximum examples will also need to be modified. If the new index has not been in existence for fifteen years (the term of the historical example), then the proposal would require the historical example to cover the period in which the new index has been in existence.

The LIBOR transition is not expected to trigger ARM interest rate adjustment notices, because those notices are only required in connection with a monthly payment change. If the servicer chooses to notify the borrower of the pending index replacement when delivering an ARM interest rate adjustment notice, the servicer is prohibited from adding additional information to the notice, but may include a separate statement with the notice advising of the impending change in the index. The servicer may, however, add information to the monthly periodic statement delivered to the borrower, as long as the added information does not “overwhelm or obscure” the required disclosures.

The FAQ also advises that creditors offering adjustable rate mortgage loans must determine that the replacement index complies with the requirements of Regulation D, the rules for alternative mortgage transactions. Regulation D requires that if an index is used in connection with the calculation of the interest rate, the index used for closed-end mortgages must be readily available and verifiable by the borrower and beyond the control of the creditor. Hopefully the final amendment to Regulation Z will make clear that any index recommended as a replacement index in Regulation Z will satisfy the requirements of Regulation D.

HELOCs

The proposed rule would amend the open-end change-in-terms notice provisions to ensure that for the LIBOR transition, creditors are required to include in the change-in-terms notice the replacement index and any adjusted margin, regardless of whether the margin is being reduced or increased. The proposal would allow creditors to optionally comply with this provision between the issuance of the final rule and the provision effective date, October 1, 2021.

In order to change the index for HELOC accounts, the current rule requires that a) the original index be no longer available, and b) the replacement index meet certain requirements. The proposed rule would add a LIBOR-specific provision that would allow the LIBOR transition to occur on or after March 15, 2021 (instead of using the no longer available standard).

Additionally, the proposed LIBOR-specific provisions would retain similar
replacement index requirements to the current rule, including that the replacement index has historical fluctuations that are substantially similar and that the new rate selected is substantially similar. The proposed rule would identify December 31, 2020 as the date used for selecting the index values for the LIBOR index and the replacement index to compare the rates, rather than using the rates on the date that the original index becomes unavailable. The proposed rule identifies two example replacement indices for LIBOR that meet the proposed exception requirements – the prime rate published in The Wall Street Journal, and a spread-adjusted version of the Secured Overnight Financing Rate recommended by the Alternative Reference Rates Committee. While the prime rate is currently significantly higher than LIBOR, existing law requires the interest rate resulting from the use of a replacement index to have an annual percentage rate that is substantially similar to the APR with the old index, so replacing LIBOR with the prime rate could well result in the HELOC’s margin being substantially decreased.

Per the FAQ, the proposed changes will affect ARM loan program origination disclosures for some loan programs for HELOCs. Regulation Z generally requires that creditors provide certain disclosures about the plan at the time consumers are provided a HELOC application. Like other loan origination disclosures required by Regulation Z, the requirements include disclosures, as applicable, about the security interest, payment terms, variable rate information, fees and other key plan terms. Some of these disclosures may need to be revised. The disclosure is also required to include a historical example. Based on a $10,000 extension of credit, illustrating how the annual percentage rate and payments would have been affected by index value changes over the last fifteen years. This example will also need to be modified. If the new index has not been in existence for fifteen years (the term of the historical example), then the proposal would require the historical example to cover the period in which the new index has been in existence.

The CFPB will be accepting comments on the proposed rule through August 4.

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