Tuesday, October 12, 2021

LIBOR Mortis

Summary

Although the majority of FHA ARMs are now LIBOR-linked, HUD has been waiting for Congress, the Fed, or forces on high to help it set a new benchmark. Although deliverance may come, HUD has now taken the belated step of tentatively starting its own replacement-benchmark exercise. What it does how for whom will of course drive not just all FHA loans, but also the market as a whole.

Impact

In March of this year, HUD pulled LIBOR's plug for new loans, also publishing model fallback language for existing contracts based on the Fed's LIBOR-transition committee's guidance.

However, as with pretty much everything related to the LIBOR transition, just saying it's so is a long way from ensuring financial institutions and borrowers understand what's needed to make it so. As a result, HUD has now decided to issue what it describes as operational guidance, albeit none is to be found in this ANPR. All HUD seems to know now is that it wants two transitions: one for legacy loans and another specificizing approved SOFR adjusted benchmarks for new FHA-guaranteed forward and reverse mortgages. Although separate, these transitions would occur at the same time.

These "operational" transition issues are in fact that and much, much more. Handling legacy contracts is challenging enough for institutional contracts such as those in the derivatives market – see all the banking-agency guidance and remaining questions. But transitions for millions of retail consumers and then handling the complex coordination of how FHA's ARM rate compares to the GSEs' (a question not posed by HUD) will boggle the mind without fast-acting HUD standards ensuring at the least industry uniformity, if not also consensus.

HUD's ANPR is wide open, consisting largely of questions rather than a specific proposal. The questioning does not assume a SOFR-adjusted replacement benchmark even though the ANPR's text might lead one to assume this, focusing not only on what benchmark(s) mortgage lenders and servicers prefer, but also and extensively on how a transition will work. The questioning makes clear how strategic this transition will prove, but no guidance on these "operational" issues can be derived from even a close read.

Outlook

Comments on the ANPR are due December 6. Unless HUD puts the pedal down, it will be a long time after LIBOR's year-end expiration before anyone gets any legal certainty. Although LIBOR will still be published until June of 2023, the banking agencies want all new contracts written to SOFR or a SOFR-adjusted benchmark ASAP. If Congress fails to act on pending legislation to afford federal statutory

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certainty to the transition process, each bank will do what it wants within the boundaries of what its examiners will tolerate for ARMs outside the boundaries of the ISDA contractual provisions and certain other industry agreements aimed at least at bit of smooth sailing on these systemic seas. And, absent HUD standards, nonbanks are free to do as they like as long as investors and servicers allow.

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