LIBOR Transition FAQs – Single-Family Adjustable-Rate Mortgages

Single-Family Adjustable-Rate Mortgages (ARMs)

Q1. **Is there an impact to Uniform Mortgage-Backed Securities (UMBS)?**

No. UMBS are backed only by fixed-rate loans.

Q2. **Can lenders still sell LIBOR-indexed Single-Family ARMs to the GSEs?**

Yes, however, under FHFA guidance, the GSEs will no longer acquire LIBOR ARM loans by the end of 2020.

To be eligible for delivery to the GSEs, all LIBOR-indexed ARMs must have loan application dates on or before September 30, 2020. In addition, all LIBOR-indexed ARMs with application dates on or prior to September 30, 2020 must be purchased as whole loans on or before December 31, 2020, or in MBS pools with issue date on or before December 1, 2020.[1]

Q3. **What are the Single-Family SOFR ARM subtypes and prefixes?**

The Single-Family SOFR ARM prefixes were communicated in Fannie Mae Lender Letter LL-2020-01[2] and Freddie Mac Bulletin 2020-9. In addition, the Fannie Mae Prefix Glossary, the Fannie Mae ARM MBS Subtypes, and the Freddie Mac Prefix Library (for Freddie Mac 75-day prefixes) have been updated. Please see the subtypes and prefixes on p.19 of the SF Chapter in the Playbook (Playbook)

Q4. **What SOFR rate will be used and where is the rate available for Single-Family SOFR-indexed ARMs?**

The GSEs will use the 30-day compounded SOFR average which the New York Fed began publishing on March 2, 2020 on its website.

Q5. **Why are the reset periods pegged at six months instead of traditional one-year reset?**

With the shift to using a 30-day average of SOFR, the ARRC white paper discusses how a 6-month reset would help mitigate the potential mismatch between the loan rate set in advance based on historical averages of SOFR relative to future changes in market interest rates.

Historical data indicates that an average of the overnight rate with a 6-month adjustment period does much better at matching subsequent movements in interest rates than LIBOR with an annual adjustment period.

Q6. **Since the periodic reset period is six months, does this imply that there will be a 6-month term SOFR?**

For the new SOFR-indexed ARM product, the index is the 30-day compounded average of SOFR and the rate reset period is six months. The six-month rate reset period is unrelated to whether or not a Single-Family ARM product indexed to term SOFR will eventually be developed. See Enterprise FAQ #12.

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[1] For Fannie Mae these policies apply to all LIBOR ARM plans including plan number 2720 through 2729 and 2737

[2] Fannie Mae Lender Letter LL-2020-01 communicated both ARM subtypes and prefixes

Q7. **Why was the periodic adjustment cap changed to one percentage point?**

The change of the adjustment period from a 12-month periodic reset to a 6-month periodic reset created the need to lower the periodic adjustment cap. This safeguards against unexpected payment increases and remains consistent with current market practices. As a result, even in a period of rapidly rising interest rates, a borrower's payment would not change by more than two percentage points in a given year – which is the prevailing market convention.

Q8. **How do we determine the lifetime floor now that this is a field in the note that the Seller needs to populate?**

Fannie Mae's Selling Guide and Freddie Mac's Single-Family Seller/Servicer Guide each dictate that the lifetime floor must equal the initial margin, which must be populated into the applicable fields in the note. Once set at origination, the lifetime floor will not change over the life of the loan.

Q9. **What will the margin be for new SOFR-indexed ARM offerings?**

The new SOFR-indexed ARM products have a maximum margin of 3.00%. The ARRC recommends a margin between 2.75% and 3.00%.

Q10. **Where can consumers find more information on SOFR-indexed ARMs and program disclosures?**

The Consumer Financial Protection Bureau (CFPB) website contains up to date information on program disclosures as well as information on ARMs. It can be accessed here.

Q11. **Will the GSEs use a 45-day lookback period for SOFR-indexed hybrid ARMs to determine the 30-day Average SOFR rate?**

Yes, we will use a 45-day lookback period.

Q12. **Will the GSEs offer an assumability option for the SOFR-indexed ARM offerings?**

Yes. SOFR-indexed ARM Notes and Riders that provide for assumption during the adjustable rate period following the fixed rate period of the ARM are currently available.

Q13. **When will the GSEs' respective systems be updated to reflect SOFR-indexed ARMs?**

Please refer to the GSEs' April 1, 2020, bulletins for details. See Freddie Mac [Bulletin 2020-9] and Fannie Mae [Selling Guide Announcement SEL-2020-02].

Q14. **Do Lenders need to be ready to utilize the new DU® and LPA® Automated Underwriting Specifications prior to originating SOFR-indexed ARMs?**

Fannie Mae response	Freddie Mac response
No. Lenders can originate SOFR-indexed ARMs without making any system changes.	No. Freddie Mac will make SOFR-indexed ARMs available in Loan Product Advisor beginning Oct. 1, 2020 using the Loan Product Advisor v4.8.01. Loan Product Advisor v 5.0.06 is not required to start underwriting SOFR-indexed ARMs.

Q15. **Are the GSEs making additional changes under the Uniform Mortgage Data Program (UMDP)?**

Yes. The GSEs are making sure SOFR-indexed ARMs are accounted for in the applicable UMDP datasets. See the joint announcement (Fannie Mae: UMDP announcement) (Freddie Mac: UMDP announcement) where the changes to the UMDP datasets were communicated.

Q16. **Will SOFR-indexed ARMs be available for cash and guarantor execution?**

Yes. Sellers will be able to deliver SOFR-indexed ARMs through cash or guarantor executions. Bulk transactions will also be an available execution to sell SOFR-indexed ARMs.

Q17. **Why were the Single-Family LIBOR ARM Notes and Riders updated on February 5, 2020?**

The GSEs updated the Single-Family LIBOR ARM Notes and Riders to reflect the fallback language that the ARRC recommended in preparation for the potential cessation of LIBOR.

While current Single-Family ARM contract language allows the GSEs and other note-holders to replace the LIBOR index, it does not provide specific guidance on how to make such a replacement. The ARRC's recommended language is more robust because it clearly specifies what borrowers and investors should expect regarding when and how a replacement index will be chosen.

Q18. **Were only the LIBOR Single-Family ARM Notes and Riders updated in February 2020 to include the ARRC recommended fallback language?**

No. All GSE Single-Family ARM Notes and Riders were updated in February, not just LIBOR-indexed ARM Notes and Riders. In addition, on April 1, 2020, the GSEs published SOFR-indexed Single-Family ARM Notes and Riders that include the ARRC recommended fallback language.

Q19. **Have you chosen a replacement index for Single-Family legacy LIBOR-indexed ARMs? Could LIBOR-indexed ARMs become fixed rate?**

No, we have not chosen a replacement index for any of our legacy LIBOR-indexed ARMs.

Addressing what happens to legacy LIBOR-indexed ARMs is one of the largest remaining issues for the legislatures, regulators and the ARRC. The GSEs are working together at the guidance of our regulator to address these and other challenges. We also are working with the ARRC on the legacy transition away from LIBOR, which includes the ARRC's Consumer Products working group focus on transition of Single-

Family legacy LIBOR-indexed ARMs and other non-GSE consumer LIBOR-indexed products. We will provide guidance as work on these issues progresses.

When LIBOR is no longer available/published, the GSEs (as noteholders) have the obligation to choose a successor index based on comparable information. While we have not yet chosen a replacement index for legacy products (given that LIBOR remains available), a fixed rate is not something we view as being comparable to LIBOR.

Q20. **What does the legacy Single-Family ARM fallback language say?**

In many cases for loans owned by the GSEs, Fannie Mae's and Freddie Mac's legal documents allow for the applicable noteholder to choose a comparable alternative rate should the prevailing reference rate cease to exist. At the loan-level, the contract language determines the key decision-maker concerning the replacement index. Our uniform instrument (the Single-Family ARM note) contains a provision that, if an index becomes unavailable, we (as noteholder) have the authority and obligation to choose a successor index. The language is also described in the Fannie Mae Single-Family MBS Prospectus and Freddie Mac PC Offering Circular under ARM Indices.

The GSEs published updates to joint Fannie Mae/Freddie Mac uniform ARM notes and riders to incorporate the ARRC's recommended fallback language for newly-originated ARMs. In our respective April 1, 2020 announcements, the SOFR-indexed ARM uniform notes with the ARRC fallback language were made available.

Q21. **Will you create an ARM product indexed to term SOFR? When there is a term SOFR what will happen to this product?**

The GSEs were tasked with creating a SOFR-indexed product now. Accordingly, we designed the product using the existing 30-day Average of SOFR, as published by the New York Fed. This does not preclude other ARM products from being offered in the future.

Q22. **Why are you retiring the CMT ARM plans – it appears the CMT index will continue to be published?**

Under the guidance of FHFA, we will be retiring the CMT ARM products in 2021. Our regulator prefers that we only use robust, IOSCO-compliant rates.

Q23. **What are the options for individual borrowers with LIBOR ARMs?**

To date, nothing has changed for borrowers with existing ARM mortgages. As always, individual borrowers can choose to keep their LIBOR-indexed ARMs or seek to refinance into a fixed-rate or non- LIBOR based product. For borrowers who choose to keep their LIBOR-indexed ARMs, once LIBOR is no longer available, servicers of GSE owned loans will inform borrowers of the replacement index that is chosen by the GSEs in consultation with FHFA.

Q24**. Since there is not a specific mortgage margin associated with the SOFR ARM product, can loans with different mortgage margins be securitized in the same Fannie Mae MBS / Freddie Mac PC?**

Yes, loans with varying mortgage margins may be securitized in the same Fannie Mae MBS / Freddie Mac PC or delivered into whole loan commitments.

Q25. Can the initial fixed rate on a SOFR ARM be lower than the margin?

Yes, the stated floor, which must equal the margin, only applies during the adjustable rate period. However, the initial fixed rate cannot be lower than the margin minus the initial reset cap. For example, for a 5/6-Month SOFR-indexed ARM with a 3% margin and a 2% initial reset cap, the initial fixed rate cannot be lower than 1% (3% margin – 2% reset cap).