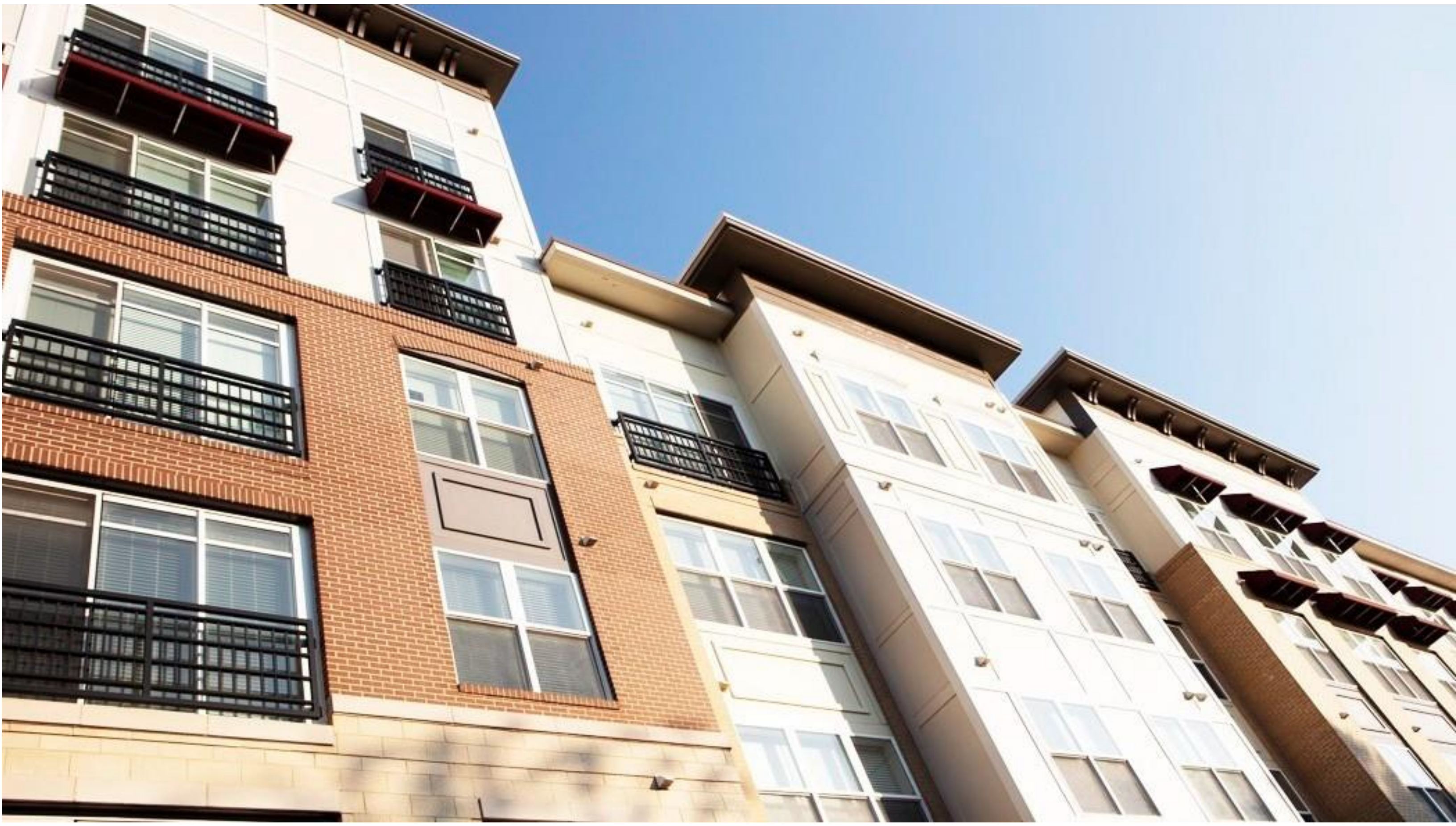


# LIBOR Transition Playbook

# Collateralized Mortgage Obligations

**August 2020**

# 4 Collateralized Mortgage Obligations ("CMOs")

## 4.1 Introduction

The ARRC endorsed SOFR as its recommended alternative rate to LIBOR in anticipation of the potential cessation of LIBOR as early as 2022.

To prepare for a potential cessation of LIBOR, the GSEs recently adopted a slightly modified version of the ARRC securitization waterfall for new-issue LIBOR-indexed CMOs. This waterfall language generally provides for the use of Term SOFR as the first alternative rate. If Term SOFR is not available, the next alternative rate is 30-day Average SOFR.

The GSEs started offering SOFR-indexed CMOs for settlement in July 2020. Additionally, under the guidance of FHFA, Freddie Mac and Fannie Mae will cease offering new LIBOR-indexed CMOs for issuance starting October 2020. The GSEs will continue to issue new resecuritizations of LIBOR-indexed CMOs (also known as "ReREMICs"), provided that such resecuritizations do not increase the total unpaid principal balance of the LIBOR- indexed CMOs outstanding.

## 4.2 Overview

There are a variety of ways to implement a SOFR CMO rate structure. The feasibility of these options depends on events that have not yet occurred or other variables (potential emergence/publication of Term SOFR rates, operational capabilities at both GSEs, the NY Fed, and Common Securitization Solutions, etc.).

The GSEs have structured new-issue Delay and Non-Delay SOFR-indexed CMOs so that they:

- Initially use 30-day Average SOFR published by the NY Fed as the reference rate, with a Determination Date of 2 Business Days (2BD) prior to the beginning of the accrual period for 45-day, 55-day, and 75-day Delay and Non-Delay securities (same as current LIBOR-indexed CMOs)
  - The CMO program will transition to a Term SOFR rate at the GSEs' discretion at a later date if the appropriate regulatory authority approves such a rate (for this purpose, "appropriate regulatory authority" generally refers to the Federal Reserve, the NY Fed or applicable official committee (e.g., the ARRC))
  - The transition would be made as soon as the Term SOFR rate can be operationalized and is administratively feasible, and the transition would make use of the same Determination Date conventions mentioned for 30-day Average SOFR above
  - This transition could occur prior to the time LIBOR ceases or is declared to be non-representative
- Utilize at-issuance disclosure and operative documents that provide that the CMO securities accrue interest in accordance with the bullets above

Once a Term SOFR rate is operationalized and administratively feasible, the GSEs would cease any further new issuance using 30-day Average SOFR and would utilize solely the Term SOFR rate.

### 4.3 Eligible collateral

For new-issue SOFR-indexed CMOs, the GSEs will accept all collateral that is currently acceptable for LIBOR-indexed structures at each respective entity. For more information on how collateral may be affected by the transition, refer to "Securitization of SOFR ARMs" in section 2.4 Preparation for SF SOFR ARMs.

### 4.4 Issuance

#### ❖ Delay and Non-Delay (30-day Average SOFR)

**Key updates**

The Determination Date for 45-day, 55-day, and 75-day Delay and Non-Delay securities based on 30-day Average SOFR is 2BD prior to the beginning of the accrual period. This is the same as the current practice for LIBOR-indexed securities.

If the GSEs transition the Delay and Non-Delay securities from 30-day Average SOFR to Term SOFR, there will be no change to the Determination Date. The Determination Date will continue to be 2BD prior to the beginning of the accrual period.

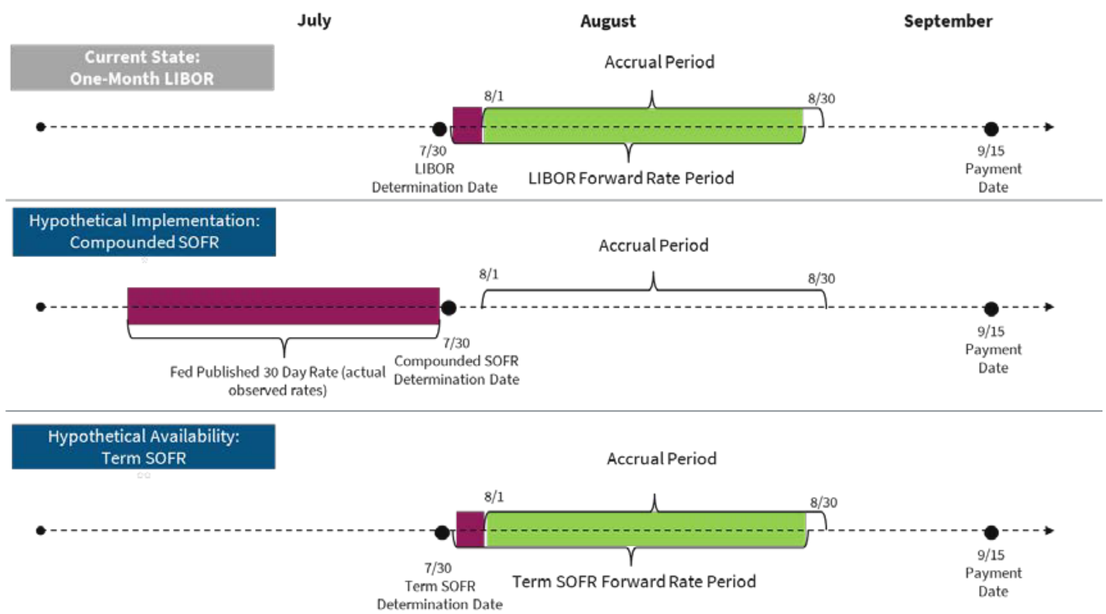
### 4.5 Administration

#### ❖ Delay

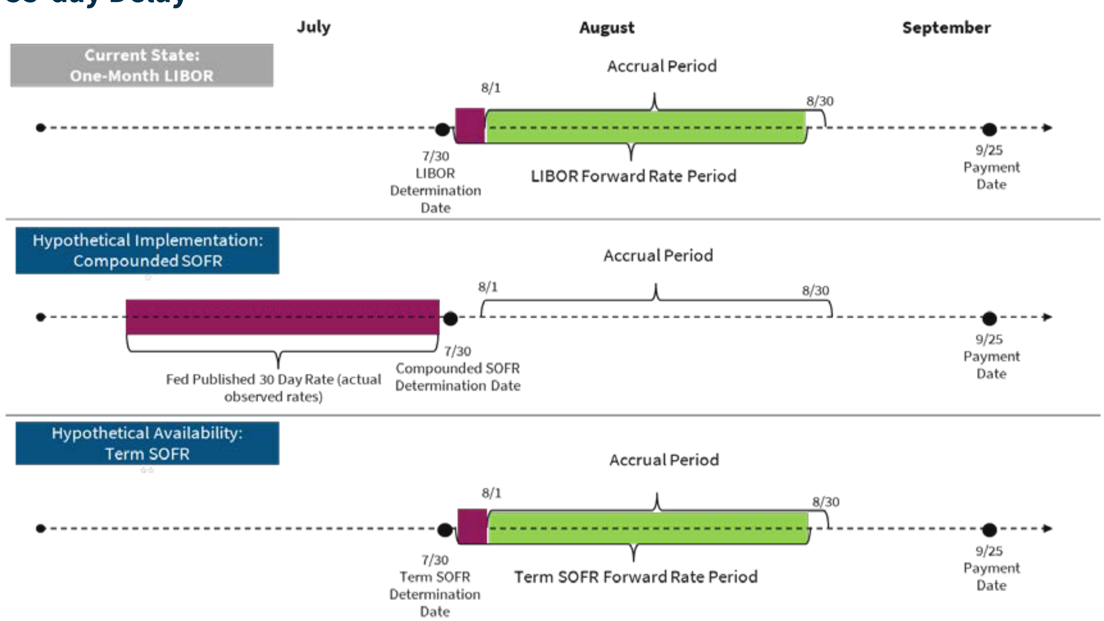
**Key updates: 45-day, 55-day and 75-day Delay CMOs**

For 45-day, 55-day and 75-day Delay CMOs based on 30-day Average SOFR (or "Compounded SOFR" per the subsequent timelines), the Determination Date will be 2BD prior to the beginning of the accrual period. This is the same as for LIBOR-indexed CMOs, which also have a Determination Date of 2BD prior to the accrual period (prior month). The graphics on the subsequent pages display the timing:

## 45-day Delay[1]




## 55-day Delay[1]

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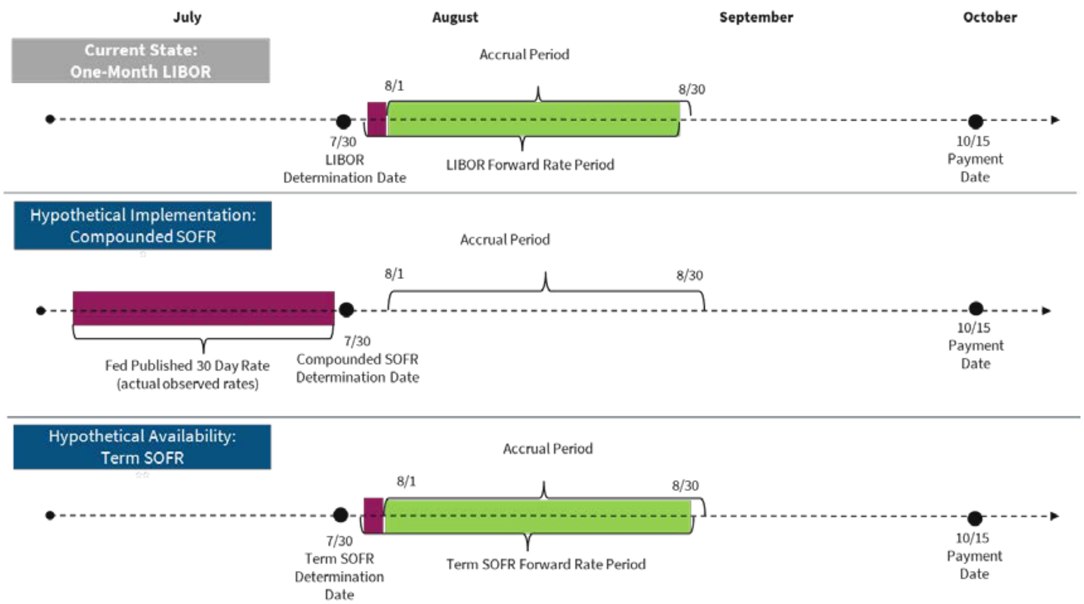
1 **Legend**

= Rate Aligns with Accrual Period

= Rate Does Not Align with Accrual Period

### 75-day Delay[1]




## ❖ Non-Delay

### Key updates: 45-day, 55-day and 75-day Non-Delay CMOs

For 45-day, 55-day and 75-day Non-Delay CMOs based on 30-day Average SOFR, the Determination Date will be 2BD prior to the beginning of the accrual period. This is the same as for LIBOR-indexed CMOs, which have a Determination Date of 2BD prior to their respective accrual periods (the 13th for 45-day, or the 23rd for 55-day) of the month preceding payment, or the 13th (75-day) of the second month preceding payment. The graphics on the subsequent pages display the timing:

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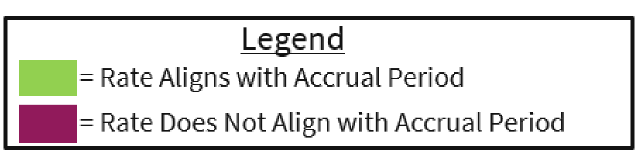
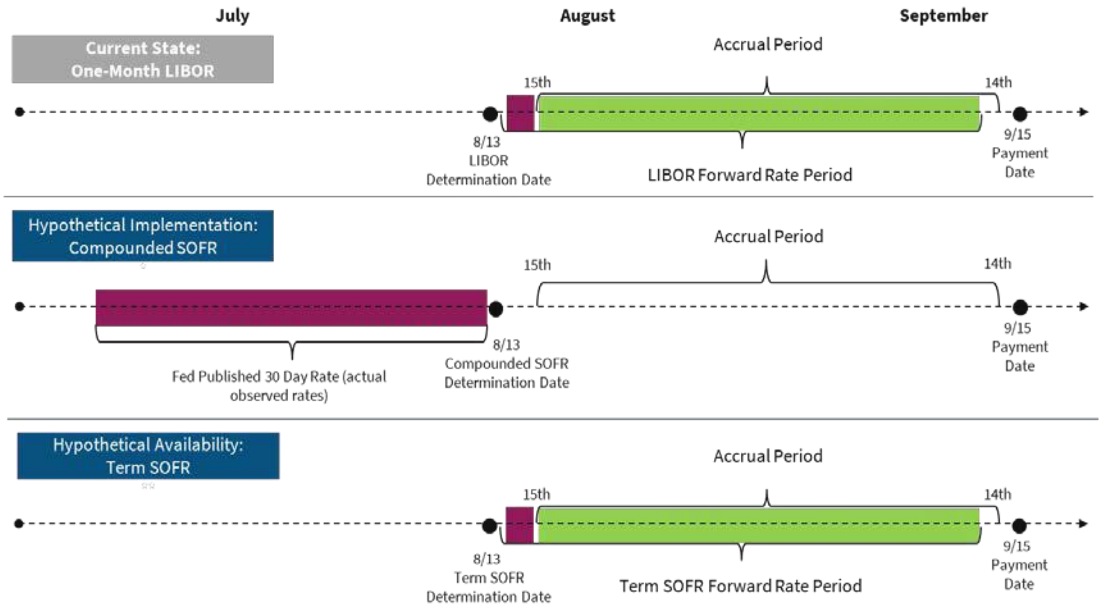
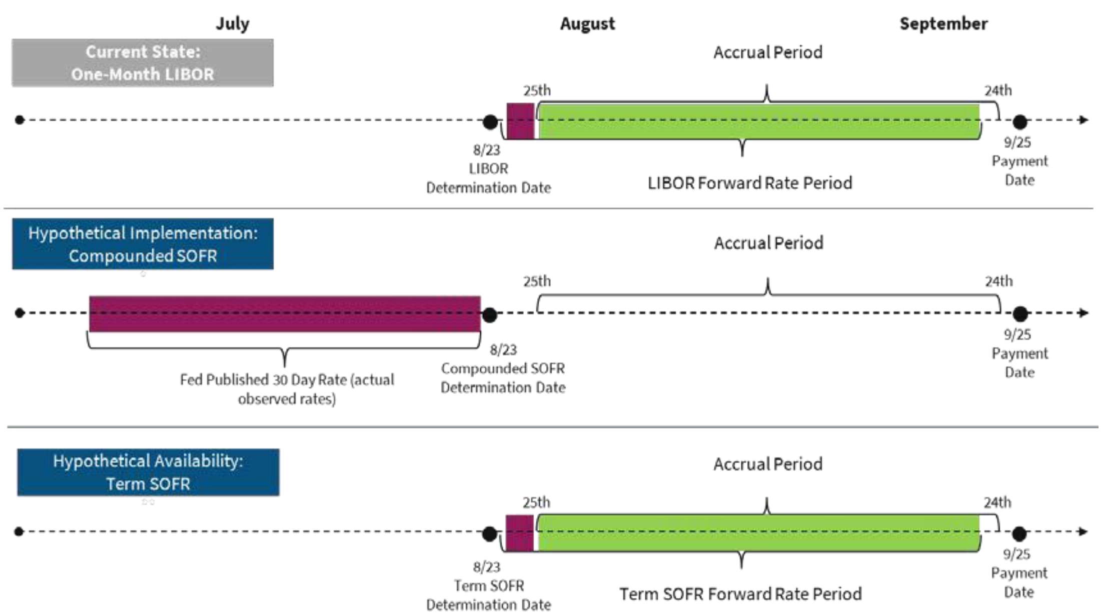
1 

## 45-day Non-Delay[1]




## 55-day Non-Delay[1]



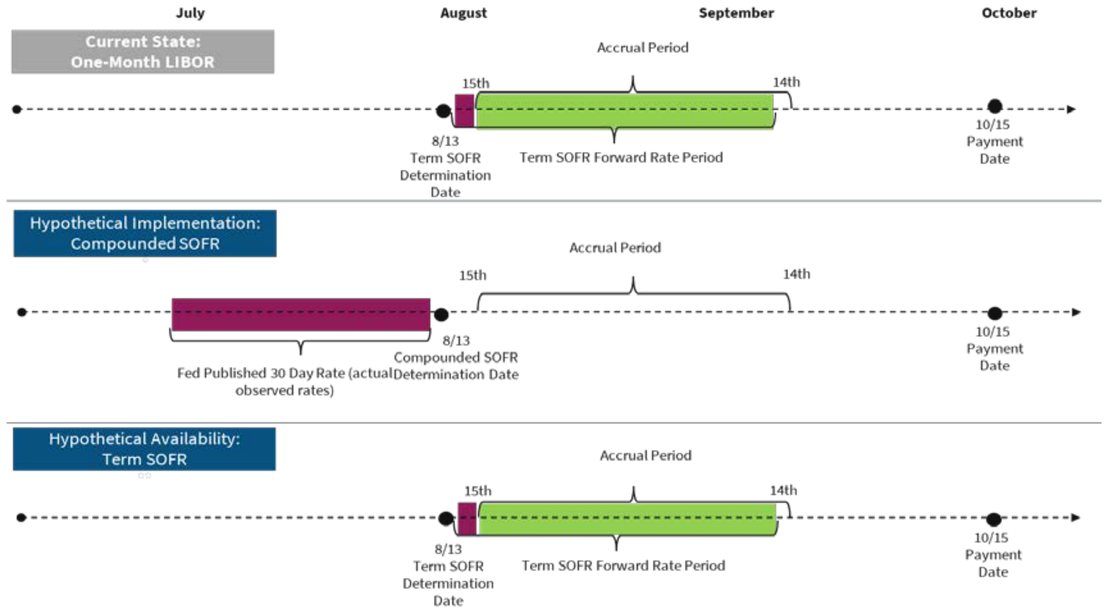

1

**Legend**

= Rate Aligns with Accrual Period

= Rate Does Not Align with Accrual Period

### 75-day Non-Delay[1]




## 4.6 Disclosure changes

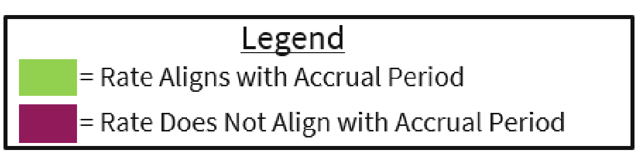
### ❖ Key updates

Index rate disclosure files now contain a new column titled "Current Month Payment Indicator" which contains a "Y" if the rate applies to the current month's payment factor calculation and an "N" if it does not.

CSS will publish index rate files on BD1 (for all Delay securities), on the 15th of the month minus 2 business days (for Non-Delay 45-day and 75-day securities), and the 25th of the month minus 2 business days (for Non-Delay 55-day securities) at **6:30 PM**; the previous schedule had the posting of files at 4:30 PM for Freddie Mac.

### ❖ Actions to consider

Discuss changes to disclosures with your disclosure vendor to ensure that your system can correctly apply the new "Current Month Payment Indicator" value.

1 

## 4.7 Approach for transitioning legacy CMOs

The GSEs are continuing to work on defining the timing and strategy for transitioning legacy LIBOR-based CMOs to an ARR. The GSEs are coordinating closely with FHFA on this important matter. The Enterprises each recently announced that they intend for their respective legacy LIBOR-indexed CMOs to be treated the same as their new-issue LIBOR-indexed CMOs in the event LIBOR ceases to be published or is declared to no longer be representative, in that the legacy LIBOR-indexed CMOs would also transition to Term SOFR (depending on its availability) or Compounded SOFR. For more information, see the announcements made by Fannie Mae and