Single-Family Adjustable-Rate Mortgage (SF ARM) LIBOR Transition FAQs

Under the guidance of FHFA, Fannie Mae and Freddie Mac are providing jointly prepared answers to frequently asked questions related to the GSE's transition away from LIBOR-Indexed products to SOFR-indexed products. The Enterprise section answers high-level questions applicable to all products followed by Q&A sections specific to Single-Family adjustable rate mortgages and PCs/UMBs, Credit Risk Transfer transactions, Multifamily adjustable rate mortgages and securities and Collateralized Mortgage Obligations.

Summary of Changes

The table below details the list of changes since the April 2021 version of the FAQs published on the Fannie Mae and Freddie Mac websites.

Section	Summary of change
October 2021	
Single Family	Q23. Updated Q&A to address usage of Term-SOFR

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?**

No. Effective January 1, 2021, the GSEs no longer purchase LIBOR ARMs.

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 are using the 30-day Compound Average SOFR 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 Compound Average SOFR in our new products, 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 reset period is more comparable to subsequent movements in interest rates than LIBOR with an annual reset 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 Average SOFR and the rate reset period is six months. The six-month rate reset period is unrelated to whether 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**. How are the SOFR and the 30-Day Compound Average SOFR rates calculated?**

Please visit the Federal Reserve Bank of New York's website for detailed information about how the SOFR Rate is calculated. For information on how the 30-day Compound Average SOFR is calculated, click here. .

Q8. **Why was the periodic reset cap changed to one percentage point?**

The change of the reset period from a 12-month periodic reset to a 6-month periodic reset created the need to lower the periodic reset 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 a year – which is the prevailing market convention.

Q9. **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 mortgage 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.

Q10. **What will the mortgage margin be for new SOFR-indexed ARM offerings?**

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

Q11. **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.

Q12. **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.

Q13. **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.

Q14. **When will the GSEs' respective systems be updated to reflect SOFR-indexed ARMs?**

All systems have been updated to support new SOFR-indexed ARMs. As of August 3, 2020, Fannie Mae provided the ability to purchase and securitize Single-Family SOFR-indexed ARMs. As of November 9, 2020, Freddie Mac has provided the ability to purchase and securitize Single-Family SOFR-indexed ARMs.

Q15. **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 made 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.

Q16. **Are the GSEs making additional changes under the Uniform Mortgage Data Program (UMDP)?**

The GSEs made updates to account for SOFR-indexed ARMs 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.

Q17. **Will SOFR-indexed ARMs be available for cash and guarantor execution?**

Yes. Sellers can deliver SOFR-indexed ARMs through cash or guarantor executions.

Q18. **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 noteholders 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.

Q19. **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.

Q20. **Have you chosen a replacement index for Single-Family legacy LIBOR-indexed ARMs?**

We have not chosen a replacement index for any of our legacy LIBOR-indexed ARMs. The GSEs are working together at the guidance of our regulator to address the replacement index.

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. As the industry focuses on the transition of legacy securities products, the GSEs will continue to follow regulatory guidance, particularly from the Consumer Finance Protection Bureau (CFPB) and FHFA. We also are working with the ARRC, which includes the Consumer Products working group focused on the 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.

Based on regulatory guidance, and informed by developments occurring during the transition period, the GSEs will seek fair outcomes to minimize the potential economic impact on both borrowers and investors to the extent possible. We will communicate details pertaining to legacy LIBOR products in advance to facilitate any legacy product transition.

Q21. **Could LIBOR-indexed ARMs become fixed rate?**

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.

Q22. **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.

Q23. **Why was term SOFR not used for the new ARM product? When there is a term SOFR, what will happen to this offering?**

The GSEs were tasked with creating a SOFR-indexed ARM offering using available rates. Accordingly, we designed the ARM offering using the existing 30-day Average SOFR, as published by the New York Fed. The availability of term SOFR rates will not impact the 30-day Average SOFR ARM product.

Q24. **Why are you retiring the CMT ARM offerings – 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 in current product offerings. In Fannie Mae Lender Letter LL-2021-05 and Freddie Mac Bulletin 2021-4 we announced that the GSEs will no longer purchase any CMT-indexed ARM that has an Application Received Date of July 1, 2021 or later. In addition, the GSEs will no longer purchase CMT-indexed ARMs on and after October 1, 2021, regardless of the Application Received Date or Note Date.

Q25. **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.

Q26. **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.

Q27. **Can the initial fixed rate on a SOFR ARM be lower than the mortgage margin?**

Yes. However, the initial fixed rate cannot be lower than the margin minus the initial reset cap. For example, for a 5 year/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) during the first 5 years when the interest rate is fixed.

Please note that the lifetime floor, which must equal the initial mortgage margin, only applies during the adjustable-rate period. If the initial margin is 2.5% and the initial fixed rate is 1%, the lifetime floor for the interest rate is 2.5%, but that floor only applies during the life of the adjustable rate period, not during the initial fixed rate period.

Q28. **Can Servicers provide disclosures to Borrowers based on the replacement index?**

Until such time as both LIBOR becomes unavailable and a replacement index is chosen, we note that the CFPB has issued LIBOR Transition FAQs that indicate that borrower notices under Regulation Z "must reflect the legal obligations of the consumer and creditor when the disclosures are provided." CFPB LIBOR Transition FAQs, Adjustable-Rate Mortgage Products, Question 6. Servicers should consult with counsel to ensure they provide accurate notices to borrowers prior to the legally effective change to the replacement index..

Summary of Prior Changes

Section	Summary of change
July 2020	
Single-Family Adjustable-Rate Mortgages (SF ARM)	Q 3. Added link to the SF Chapter in the Playbook for easy reference. Q 21. Added language to clarify where the fall back language applies.
August 2020	
SF ARM	Q24 and Q25 - Added as new questions.
September 2020	
SF ARM	Q7 replaced "adjustment" with "reset" Q8 Q9 and Q25 Added the word mortgage before margin
October 2020	
SF ARM	Q14. Updated language to reflect that Loan Product Advisor is now available as of 10/1/2020 for underwriting of SOFR-based ARMs.
April 2021	
SF ARM	Q2. Updated to reflect that GSEs no longer acquire LIBOR ARMs Q3, Q5, Q13, Q15, Q20, and Q27: cosmetic updates only Q7. Reworded existing information only Q14. Update to reflect that all systems have been updated to support SOFR-indexed ARMs Q16 and Q17. Updated to past tense and removed the second sentence in the response to Q17 because it is no longer applicable Q22 and Q25. Updated to add reference to CFPB LIBOR Transition FAQs Q24. Updated to add announcement of specific CMT-indexed ARM 2021 retirement dates Q27. Updated FAQ to clarify initial fixed rate and mortgage margin Q28. New FAQ to address Borrower Disclosures from Servicers