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# LIBOR: How Can We Miss You If You Don't Go Away?



**T**he Consumer Financial Protection Bureau (CFPB) is getting a jump on a sizable shift in the financial world: the discontinuance of the LIBOR index.

The specific date on which the LIBOR will become unavailable is unknown; while it is generally expected to expire in 2022, the entities that regulate and administer the index have not made any guarantees about its continued publication or representativeness going forward.

In light of LIBOR's impending but unpredictable demise, the CFPB proposes to amend its regulations under the Truth in Lending Act (TILA) to clarify how lenders may go ahead and replace the index (and the margin) on their existing LIBOR-based mortgage loans and home equity lines of credit (HELOCs). (The proposal also addresses replacement of LIBOR in credit card accounts.)

## HELOCs AND CHANGES IN TERMS

TILA and its Regulation Z prohibit a creditor from changing a HELOC's terms except in limited circumstances. For instance, a creditor may change a HELOC's index and margin if the index is no longer available, the replacement index has a historical movement substantially similar to the original, and the replacement index and margin

would have resulted in an annual percentage rate (APR) substantially similar to the rate in effect at the time the original index became unavailable.

However, it is unclear when LIBOR will be "no longer available," or how a lender can choose a substantially similar index or margin without that knowledge. To address that uncertainty, the proposed rule would pick a date that lenders may use for that determination.

Specifically, under the proposed rule a creditor would be able to replace the LIBOR index and change the margin on or after March 15, 2021, so long as:

- The historical fluctuations in the LIBOR index and the replacement index were substantially similar.
- The replacement index value in effect on December 31, 2020 and replacement margin will produce an APR substantially similar to the rate calculated using the LIBOR index value in effect on December 31, 2020, and

the margin that applied to the rate immediately prior to the replacement.

In addition, to reduce uncertainty in selecting a similar replacement index, the CFPB is proposing to name two sets of indices with historical fluctuations similar to LIBOR:

- The prime rate published in the Wall Street Journal (Prime).
- Certain spread-adjusted indices based on the Secured Overnight Financing Rate (SOFR) recommended by the Alternative Reference Rates Committee (ARRC).

If the creditor otherwise seeks to use a newly established index without a history, the regulatory commentary would continue to allow the creditor to do so if the index and margin produce a substantially similar rate.

The proposed rule does not provide guidance on the uncertainty of what constitutes a “substantially similar” APR, other than one that is exactly the same. Accordingly, it is unclear how much leeway a creditor would have in choosing the replacement margin.

Of course, Regulation Z is not the only consideration for creditors ready to swap out LIBOR. They also must abide by the terms of the loan contracts themselves.

Some LIBOR contracts may require the creditor to wait until the index becomes unavailable, and arguably prohibit replacement in advance. Accordingly, while the CFPB’s proposed revisions would allow replacement of LIBOR on or after March 15, 2021 (so long as the other requirements are met), the creditor may still be constrained by the contract from doing so.

For those creditors, the CFPB’s proposal would allow replacement at the time that LIBOR becomes unavailable, with an index and margin



*Under the proposed rule a creditor would be able to replace the LIBOR index and change the margin on or after March 15, 2021 [if certain conditions are met].*



To the contrary, currently a creditor would not need to provide the notice if the margin is decreasing. However, the CFPB is proposing to require the creditor, on and after October 1, 2021, to provide a change-in-terms notice regarding the replacement of LIBOR and the new margin, whether the margin is increasing or decreasing.

The proposal also encourages, but would not require, creditors to include that information in change-in-terms notices provided earlier than October 1, 2021, so that consumers understand how the variable rates on their plans will be determined when LIBOR is replaced.



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that produces a substantially similar APR either as of that date of unavailability, or it may use December 31, 2020 as the date for comparison.

## DISCLOSURE OF CHANGE IN INDEX/MARGIN

In order to replace a LIBOR index in a HELOC, Regulation Z requires the creditor to provide a change-in-terms notice at least 15 days in advance (unless the borrower has agreed to the change). The creditor also must provide advance notice of a change in the margin, if that margin is increasing.

The requirement for a 15-day advance notice of change in terms highlights the difficulty of waiting until the LIBOR index becomes unavailable.

Allowing replacement of LIBOR in advance of its unavailability (if permitted by contract) allows HELOC creditors to avoid being left without an index to use before the replacement index and margin become effective. That buffer also would allow creditors to send change-in-terms notices on a rolling basis if desired.

## NEW TRANSACTION UNLESS ‘COMPARABLE’ INDEX

The transition away from LIBOR also may affect closed-end mortgage loans. Regulation Z provides that certain changes to such a loan constitute a new transaction, requiring an ability-to-repay determination (or assurance that the loan is a qualified mortgage) and a new set of disclosures.

Currently, if the creditor changes the index of a variable-rate closed-end loan to an index that is not a “comparable index,” that change may constitute a new transaction, triggering those requirements.

To provide a bit of a safe harbor, for this purpose the CFPB is proposing to identify the recommended SOFR-based indices as examples of a “comparable index” to certain LIBOR indices. If the creditor replaces the LIBOR index with the recommended SOFR index, the creditor will not need to make a new ability-to-repay determination or provide a set of new disclosures.

The CFPB is requesting comment on all these proposals, including whether there are any other replacement indices that it should identify as “comparable.”

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