

July 12, 2019

**ARRC Releases Consultation on Fallback Contract Language for New Closed-End, Residential Adjustable-Rate Mortgages for Public Feedback**

***ARRC Seeks Input from Wide Range of Stakeholders on Resilient Contract Language for New ARMs that will Help to Minimize Market Disruptions if LIBOR is No Longer Usable***

The Alternative Reference Rates Committee (ARRC) today released a [consultation](#) on U.S. dollar (USD) LIBOR fallback contract language for new residential adjustable-rate mortgages (ARMs). The consultation proposes improved fallback language for new ARM contracts that reference USD LIBOR in order to mitigate the risks associated with the potential end or disruption of LIBOR after 2021. LIBOR is currently the most commonly used reference rate for consumer ARMs.

Feedback should be submitted no later than 60 days from release of the consultation, or by September 10, 2019. This effort is part of the ARRC's mandate to help in addressing risks in contracts referencing LIBOR and builds on its work developing the [Paced Transition Plan](#), which outlines the steps for an effective shift to the ARRC's recommended alternative reference rate, the Secured Overnight Financing Rate (SOFR).

Current contract language in closed-end, residential ARMs typically allows lenders to select a replacement index to set payments if USD LIBOR is no longer available. Although this language has been used several times in the past for other index replacements, it does not provide much clarity to stakeholders about when an index is no longer available or the process to select a replacement. It also does not explicitly state that it may be necessary to make an adjustment to reflect differences between the current and replacement indices in order for the replacement index to be comparable.

The ARRC's proposed contract language is meant to benefit consumers and lenders by addressing these issues. To provide clarity and consistency, the ARM fallback proposal lays out clear and observable triggers and uses a replacement index selected or recommended by the Federal Reserve or a body convened or endorsed by the Federal Reserve, if such rate is available. Clear and actionable fallback language is necessary because the U.K Financial Conduct Authority has warned that LIBOR could end or be judged to no longer be representative of its underlying market after 2021.

The consultation was developed by the ARRC's Consumer Products Working Group, which includes a diverse array of lenders, consumer groups, investors, and servicers. In developing the consultation, the Working Group followed the [guiding principles](#) that the ARRC adopted for addressing consumer loan products, specifically:

- In determining proposed fallbacks for LIBOR in consumer products, the choice of the replacement index, spread or margin adjustment to the replacement index, succession timing, and mechanics should be easily comprehensible in order to be effectively communicated to all stakeholders in advance of the transition away from LIBOR, and should seek to minimize expected value transfer based on observable, objective rules determined in advance.
- Where flexibility or discretion are incorporated in fallbacks, it should be carefully considered and limited to the extent possible to ensure ease of application and to minimize the potential for disputes.

### **Submitting Feedback about this Consultation**

The ARRC welcomes responses to the consultation from the widest possible range of stakeholders. The release of the consultation marks the start of a public comment period during which the ARRC intends to work closely with stakeholders to solicit and incorporate their input. Following this comment period, the ARRC plans to recommend fallback language for closed-end residential ARMs for voluntary adoption in the marketplace.

Comments should be sent to the ARRC Secretariat ([arcc@ny.frb.org](mailto:arcc@ny.frb.org)) no later than September 10, 2019. Please coordinate internally and provide only one response in a PDF document and clearly indicate “Consultation Response” in the subject line of your email. Because the ARRC is committed to a fair and transparent process, all comments will be posted on the ARRC’s website after the close of the consultation period without alteration except when necessary for technical reasons. Comments will be posted with attribution unless respondents request anonymity. If your institution is requesting anonymity, please clearly indicate this in the body of your email and please ensure that the PDF document you submit is anonymized.

Questions regarding this consultation should also be sent to the ARRC Secretariat ([arcc@ny.frb.org](mailto:arcc@ny.frb.org)) and will not be posted for attribution.

### **About the ARRC**

The ARRC is a group of private-market participants convened by the Federal Reserve Board and Federal Reserve Bank of New York in cooperation with the Consumer Financial Protection Bureau, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the Office of Financial Research, the Office of the Comptroller of the Currency, the Commodity Futures Trading Commission, the Securities and Exchange Commission and the U.S. Treasury Department. It was initially convened in 2014 to identify risk-free alternative reference rates for USD LIBOR, identify best practices for contract robustness, and create an implementation plan with metrics of success and a timeline to support an orderly adoption. The ARRC accomplished its first set of objectives and identified SOFR as the rate that represents best practice for use in certain new USD derivatives and other financial contracts. It also published its [Paced Transition Plan](#), with specific steps and timelines designed to encourage adoption of SOFR. The ARRC was reconstituted in 2018 with an expanded membership to help to ensure the successful implementation of the [Paced Transition Plan](#), address the increased risk that LIBOR may not

exist beyond 2021, and serve as a forum to coordinate and track planning across cash and derivatives products and market participants currently using USD LIBOR.

Sign up [here](#) to receive email updates about the ARRC.

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