CFPB Announces Final Rule for LIBOR Transition

By: Jann Swanson | Thu, Dec 9 2021, 11:08 AM

LIBOR has taken longer to exit the stage than Lawrence Olivier, but the final curtain call is coming for the index. The Consumer Financial Protection Bureau (CFPB) has now **finalized the rule for how creditors must select replacements for LIBOR**, the London Interbank Offered Rate, once used for adjusting many financial products including derivatives and adjustable-rate mortgages. The CFPB release says no new financial contracts may reference LIBOR as the relevant index after the end of 2021 and it cannot be used for existing financial contracts as of June 2023.

LIBOR's demise began in 2012 after it was revealed that a number of large international banks were falsely inflating or deflating their rates so as to profit from trades, **or to give the impression that they were more creditworthy than they were.** The dates for ending its use have been repeated extended to allow for an orderly transition.

CFPB Director Rohit Chopra said that this "criminal manipulation" of LIBOR, which at one point dominated adjustable-rate mortgage contracts, was extremely costly to this country. "For years, the interest rate that underpins hundreds of trillions of dollars of financial contracts, including the exploding adjustable-rate mortgages, was a lie," he said. "Many large financial institutions would later plead guilty to criminal price-fixing."

Approximately $1.4 trillion of consumer loans, to assist individuals to buy a home or finance their education, are currently tied to LIBOR, Chopra added. "Families and homeowners, students seeking higher education, and **other borrowers all paid too much when LIBOR was falsely inflated.** Structural flaws in the financial system stoked collusion and rent-seeking over fair competition."

CFPB's final rule, effective April 1, 2022, includes closed-end credit provisions that require creditors to choose an index comparable to LIBOR when changing the index of a variable rate loan, or consider it a refinancing for purposes of Regulation Z. To help creditors determine a comparable index for closed-end loans, the rule identifies certain Secured Overnight Financing Rate (SOFR)-based spread-adjusted indices recommended by the Alternative Reference Rates Committee (ARRC) for consumer products as examples to illustrate a reference rate that would be comparable to replace 1-month, 3-month, or 6-month tenors of USD LIBOR.

Interestingly, while Freddie Mac announced their support of the Secured Overnight Financing Rate (SOFR) as a mortgage reference index in December of last year, CFPB says it is reserving judgment on the SOFR-based spread-adjusted replacement index to replace 1-year USD LIBOR until it obtains additional information. "Once the Bureau knows which SOFR-based spread-adjusted index the ARRC will recommend for replacing the 1-year USD LIBOR index for consumer products, the Bureau will consider whether that index meets the comparability and "historical fluctuations are substantially similar" standards and, if so, whether to codify such determinations in a supplemental final rule."

The final rule and its LIBOR-specific provisions for mortgages and for open-end loans, including HELOCs, can be downloaded here.

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