CFPB FURTHER AMENDS REGULATION Z'S LIBOR TRANSITION RULES*

Previously, the Consumer Financial Protection Bureau (CFPB) published a final rule in the federal register on December 8, 2021 to facilitate the transition from LIBOR with regard to loans subject to Regulation Z (the "Initial LIBOR Transition Final Rule"). 86 FR 69716. One of many things the CFPB addressed in the Initial LIBOR Transition Final Rule was to provide a safe harbor with respect to closed-end credit when transitioning from one-month, three-month or six-month USD LIBOR tenors to a specified replacement benchmark in order to avoid having to provide additional disclosures due to the change in the index, and to address related issues with regard to open-end credit subject to Regulation Z.

On April 28, 2023, the CFPB released an interim final rule to make changes to conform with the Federal Reserve Board's (FRB) regulation regarding the LIBOR transition, as well as to add the 12-month LIBOR index to the safe harbor (the "New IFR"). 88 FR 30598.

Below is a summary of the CFPB's rules regarding transitioning from LIBOR with regard to extensions of credit covered by Regulation Z as provided in the Initial LIBOR Transition Final Rule and amended by the New IFR. Note that since it seems that few BCG members extended Regulation Z-covered open-end credit covered tied to LIBOR, the discussion below primarily focuses on the LIBOR transition rules under Regulation Z for closed-end credit.

Background. The Initial LIBOR Transition Final Rule provided that for closed-end credit a creditor does not add a variable-rate feature, and thus trigger certain disclosures, by changing the index of a variable-rate transaction from the one-month, three-month, or six-month USD LIBOR index to the spread-adjusted index based on SOFR recommended by the Alternative Reference Rate Committee (ARRC). This safe harbor was provided because the spread-adjusted index based on SOFR recommended by the ARRC was deemed to be a comparable index to the corresponding USD LIBOR index.

However, the Initial LIBOR Transition Final Rule did not include the 12-month USD LIBOR in the safe harbor. This is because the CFPB reserved judgment on including the 12-month USD LIBOR in the safe harbor until the ARRC finalized its recommendation on a replacement for the 12-month USD LIBOR, which had not been done at the time the CFPB issued the Initial LIBOR Transition Final Rule.

1920 Main Street, Suite 800, Irvine, California 92614
Phone: (800) 742-3600 • Fax: (949) 474-0617
Email: bcg@ablawyers.com • Website: www.bankerscompliancegroup.com

On December 16, 2022, the FRB issued a final rule to implement the Adjustable Interest Rate (LIBOR) Act, as LIBOR (the "FRB LIBOR Final Rule"). 88 FR 5204. The FRB LIBOR Final Rule provides that for those loans covered by (and that transition under) the FRB LIBOR Final Rule and tied to the one-, three-, six- and 12-month LIBOR tenors, that they would automatically transition to a "Board-selected benchmark replacement" provided in the final rule. The "Board-selected benchmark replacement" is based on SOFR and includes a "tenor spread adjustment," and varies based on the type of loan and the pre-transition LIBOR tenor that applies to the loan. Notably, the Board-selected benchmark replacements are essentially the same as the replacement rates recommended by the ARRC. The FRB LIBOR Final Rule became effective February 27, 2023.

The New IFR now revises the CFPB's safe harbor for transitioning from the 12-month LIBOR, and makes conforming changes to be consistent with the FRB LIBOR Final Rule.

More Detailed Discussion of the Safe Harbor for Closed-End Credit. Following the consummation (or closing) of a closed-end credit subject to Regulation Z, the regulation generally does not require the creditor to provide additional disclosures. However, in certain situations, new disclosures may need to be provided even after the extension of closed-end credit. For example, creditors must provide new disclosures in the event of a "refinancing," which may also trigger the rescission and the ability-to-repay rules, among other requirements. A refinancing generally occurs when an existing closed-end obligation is satisfied and replaced by a new obligation undertaken by the same consumer. 12 CFR Section 1026.20(a). However, a disclosable refinancing also occurs if certain changes are made, even if the creditor accomplishes the changes through a loan modification (and not via a new promissory note).

Notably, while some changes to an interest rate may constitute a disclosable refinancing, changing the index on a variable-rate loan to a "comparable index," or substituting a new comparable index for one that no longer exists, does not constitute a refinancing under Regulation Z. Comment 20(a)-3.ii.B. As the CFPB put it in its LIBOR FAQs, if a creditor chooses an index that is not comparable to the existing index, that index replacement adds a variable-rate feature to the transaction and results in a refinancing (thus requiring, among other things, new disclosures). LIBOR FAQs, ARM Products FAQ #4.

The CFPB's Initial LIBOR Transition Final Rule added text to Comment 20(a)-3.ii.B. which provides that the spread-adjusted index based on SOFR recommended by the ARRC for consumer products are "comparable" to the corresponding one-, three- and six-month LIBOR-based indices. Thus, transitioning from a one-, three- and six-month LIBOR-based index to the corresponding spread-adjusted index based on SOFR recommended by the ARRC would not result in a disclosable refinance.

The New IFR amended Comment 20(a)-3.ii.B. to address transitioning the index from the 12-month LIBOR tenor, as well as to make changes to align the CFPB's commentary with the FRB LIBOR Final Rule to reference the Board-selected benchmark replacement. Specifically, Comment 20(a)-3.ii.B (as amended by the New IFR) now states:

> *A creditor does not add a variable-rate feature by changing the index of a variable-rate transaction to a comparable index, whether the change replaces the existing index or substitutes an index for one that no longer exists. For example, a creditor does not add a variable-rate feature by changing the index of a variable-rate transaction from the 1-month, 3-month, 6-month, or 12-month [USD] LIBOR index to the Board-selected benchmark replacement for consumer loans to replace the 1-month, 3-month, 6- month, or 12-month [USD] LIBOR index respectively because the replacement index is a comparable index to the corresponding [USD] LIBOR index.*

Comment 20(a)-3.iv. also includes various factors that should be considered with regard to whether a replacement index is "comparable." This comment was revised by the New IFR to include an exception when the replacement index is the Board-selected benchmark replacement for closed-end loans. Specifically, the CFPB added the following sentence to Comment 20(a)-3.iv: "*[t]he Board-selected benchmark replacement for consumer loans is considered comparable with respect to the LIBOR tenor being replaced, and therefore, these factors need not be considered*."

Open-End Credit. Section 1026.40(f) of Regulation Z imposes limitations on home equity lines of credit (HELOCs). For example, a creditor may not change any term unless an exception applies. One of those exceptions enables the creditor to change the index and margin used under the HELOC when the index is no longer available (referred to as the "Unavailable Provision"). 12 CFR Section 1026.40(f)(3)(ii). In other words, the Unavailable Provision does not allow a creditor to be proactive and replace an expiring index prior to its expiration. The Initial LIBOR Transition Final Rule added another exception, the "LIBOR-Specific Provision." This provision allows for, in certain situations, transitioning from LIBOR before it becomes unavailable.

Under the Initial LIBOR Transition Final Rule, a creditor may use either the Unavailable Provision or the LIBOR-Specific Provision to replace a LIBOR index so long as specified conditions are met. Comment 40(f)(3)(ii)-1. As summarized in the LIBOR FAQs, for both the Unavailable Provision and the LIBOR-Specific Provision, the creditor must meet all of the following conditions to change the index and margin: (1) a trigger for index replacement must occur, either when the index becomes unavailable under the Unavailable Provision, or to replace LIBOR on or after April 1, 2022 under the LIBOR-Specific Provision; (2) generally, the replacement index must have historical fluctuations substantially similar to those of the index being replaced (the "Historical Fluctuation Comparison" condition, although this condition does not apply if the replacement index is newly established); and (3) the replacement index and replacement margin must result in an APR substantially similar to the APR in effect at the time either the index becomes unavailable under the Unavailable Provision or, if using the LIBOR-Specific Provision, the APR calculated using the LIBOR index values generally on October 18, 2021, and the account's existing margin (the "APR Comparison" condition). LIBOR FAQs, HELOC Products, FAQ #5.

The Initial LIBOR Transition Final Rule added commentary to provide that the ARRC's corresponding recommended replacements based on SOFR have "historical fluctuations" that are substantially similar to those of the one-month, three-month, or six-month USD LIBOR-based indices. The New IFR amended the commentary to include the 12-month LIBOR tenor, and made other changes to align the index transition rules for open-end credit with the FRB LIBOR Final Rule, such as to reflect that the term "Board-selected benchmark replacement for consumer loans." Comment 40(f)(3)(ii)(A)-2.ii.

Note that Regulation Z also has specific rules for transitioning from an index for credit cards, which are similar to those for general open-end credit with some nuances. Since it seems that few BCG members have issued open-end credit tied to LIBOR, these rules are not discussed in detail here. For questions regarding transitioning from LIBOR for open-end credit (including credit cards), please contact the Law Firm.

For a detailed discussion of the rules for transitioning from LIBOR for closed-end credit and open-end credit (including credit cards), as amended by the Initial LIBOR Transition Final Rule (but not the New IFR), see BCG's Handout #22-2A, "CFPB Revises Regulation Z To Facilitate Libor Transition" (February 2022).