Overview of the ARRC's Proposed Models of SOFR ARMs

- The ARRC's White Paper demonstrates that there are models of SOFR-indexed adjustable-rate mortgages (ARMs) that can be consistent with the ARRC's principles, meet consumer needs, and be attractive to both borrowers and investors at interest rates consistent with, and as determined by, competitive markets. The Working Group actively engaged with consumer groups, lenders, investors, servicers, and other market participants in discussing the many considerations laid out in this paper.
- Most aspects of a SOFR-based ARM would use the same conventions that currently exist in US Dollar LIBOR-based ARMs, including the range of fixed-rate periods available, the timing of payment determinations, and the structure of caps on the amount that mortgage payments can rise at the end of the fixed-rate period and over the life of the mortgage.
- However, a few key components would differ:
  - These ARMs would be based on a 30- or 90-day average of SOFR, rather than 1-year LIBOR. Because SOFR tends to be lower than 1-year LIBOR, the margin for newly originated SOFR-indexed ARMs would likely be adjusted upward so borrowers' overall floating-rate payments are comparable to existing LIBOR-based ARMs.
  - In order to ensure that these SOFR-indexed ARMs can be offered at rates consistent with other competitive rates in the market, under the proposed models SOFR-indexed ARM, the borrower's monthly floating-rate payment would adjust following the fixed-rate period once every six months rather than once every year, as is currently the market standard for LIBOR-based ARMs in the United States.
  - To safeguard against unexpected payment increases to the borrower, the proposed models would cut the periodic adjustment cap to 1 percent. As a result, the borrower's payment, even in a period of rapidly rising interest rates, would not change by more than 2 percent over a 12-month period, in accord with the current market convention for LIBOR-based ARMs.
- Nothing in this paper is intended to limit the range of possible products developed or enhancements based on SOFR, or the terms and conditions under which market participants transact in any ARM products based on SOFR or any other rate.

Summary of the Proposed Models of SOFR ARMs

	Current LIBOR ARM Model	Proposed Model of SOFR ARMs
Fixed-Rate Period	3, 5, 7, or 10 Years	No Change to Current Structure
Floating Rate Index	1-Year LIBOR	30-Day or 90-Day Average of SOFR
Floating-Rate Adjustment Period	1 Year	6 Months
Rate/Payment Determination	New Rate Determined 45 days in Advance of Payment Change Date	No Change to Current Structure
Initial Caps	2 Percent for 3/1 and 5/1 ARMs 5 percent for 7/1 and 10/1 ARMs	No Change to Current Structure
Subsequent Caps	2 Percent	1 Percent
Lifetime Cap	5 Percent	No Change to Current Structure
Margin	2.25 Percent	Likely in Range of 2.75 to 3 Percent