

Federal Housing Finance Board

Memorandum

February 18, 1991

TO: Joseph A. McKenzie

FROM: Sharon B. Like *SLB*
Office of General Counsel

SUBJECT: Proposed Changes to Monthly Interest Rate Survey

In your Decision Memorandum to Executive Director J. Stephen Britt dated January 28, 1991, you recommend that FHFB (1) substitute new indexes for the mortgage commitment rate, combined construction/purchase loan, and 57-J and 57-K Reports indexes currently made available in FHFB's Monthly Interest Rate Survey ("MIRS"); and (2) publish the MIRS home loan data for the 32 metropolitan areas on a quarterly instead of monthly basis. As discussed below, the changes you propose to the MIRS are authorized under the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (August 9, 1989) ("FIRREA"), provided the appropriate notice and comment procedures of FIRREA are satisfied. A proposed Federal Register Notice, reflecting the revisions we discussed, is attached.

I. Authority to Substitute Indexes

Section 402(e)(3) of FIRREA provides that FHFB "shall take such action as may be necessary to assure that the indexes prepared by the ... Federal Home Loan Bank Board immediately prior to the enactment of [FIRREA] and used to calculate the interest rate on adjustable rate mortgage instruments continue to be available." However, section 402(e)(4) of FIRREA provides that "[i]f any agency can no longer make available an index," it may substitute a "substantially similar" index if it determines, after notice and opportunity for comment, that (1) the new index is based upon data substantially similar to that of the original index; and (2) the substitution of the new index will result in an interest rate substantially similar to the rate in effect at the time the original index became unavailable.

The MIRS, which was prepared by the Federal Home Loan Bank Board ("FHLBB") before the enactment of FIRREA, is now being conducted by FHFB pursuant to the requirement of FIRREA. A small number of mortgage lenders use the four MIRS indexes you propose to change to calculate the interest rate on existing adjustable

rate mortgage ("ARM") instruments.¹ Accordingly, pursuant to section 402(e)(3) of FIRREA, FHFB must continue to make these indexes available, except as provided in section 402(e)(4). However, it is unlikely that section 402(e)(3) is intended to require FHFB to continue publishing the exact same data provided by FHLBB simply because such data was published in the past. The intent of section 402(e)(3) appears to be to ensure that accurate, timely and reliable data continues to be made available, and to permit the substitution of substantially similar indexes where data is not sufficiently reliable. FHFB therefore has the authority and discretion to modify its survey methods from time to time to ensure that the public receives quality data. The current indexes at issue are not sufficiently reliable for statistical purposes, and need to be replaced with other more reliable and timely indexes.

In addition, FHFB arguably "can no longer make available" the indexes, pursuant to section 402(e)(4), because they are not sufficiently statistically reliable. As discussed in your Decision Memorandum, FHLBB's mortgage commitment rate survey fails to link the loans to a particular index, and therefore is not useful information to lenders or borrowers. In addition, the survey is subject to a five-week reporting lag and duplicates a similar weekly survey conducted by the Federal Home Loan Mortgage Corporation ("Freddie Mac"). The data on combined construction/purchase loans and the information in FHFB's internal 57-J and 57-K Reports are statistically unreliable because of the small sample sizes. The data on loans closed for the 32 selected metropolitan areas is statistically unreliable when published on a monthly basis because of the small sample size.

Accordingly, FHFB may substitute substantially similar indexes for the indexes discussed above.

II. Substitution of Substantially Similar Indexes

Under section 402(e)(4) of FIRREA, FHFB may substitute a substantially similar index if it determines, after notice and opportunity for comment, that (1) the new index is based upon data substantially similar to that of the original index; and (2) the substitution of the new index will result in an interest rate substantially similar to the rate in effect at the time the original index became unavailable.

1. However, ARMS based on mortgage rate indexes now comprise only a very small proportion of total new mortgages because most new ARMS are linked to either the yield on U.S. Treasury securities or a cost-of-funds index. In addition, most new ARMS that are linked to a mortgage rate use the "National Average Contract Mortgage Rate for the Purchase of Previously Occupied Homes by Combined Lenders," which will not be affected by the proposed changes.

All of the proposed new indexes are based upon data substantially similar to that of the original indexes. The Freddie Mac Primary Market Survey data, which you propose to replace the mortgage commitment rate index, uses similar mortgage commitment rate data but is based on standardized loans and is more timely than the MIRS mortgage commitment rate index. The MIRS newly built homes index, which would succeed the combined construction/purchase loans index, is based on a larger sample of newly built homes. The proposed National Average Contract Mortgage Rate for the Purchase of Previously Occupied Homes by Combined Lenders is based on national average rate data of a larger sample size than the similar regional average rate data contained in the current internal 57-J and 57-K Reports. Similarly, the proposed National Average Effective Mortgage Rate for the Purchase of Previously Occupied Homes by Combined Lenders is based on data similar to the effective rate series contained in the Reports but from a larger sample size. The MIRS data on loans closed for the 32 selected metropolitan areas will continue to be made available, except that it will be published on a quarterly instead of monthly basis (i.e., a quarterly series on metropolitan mortgage interest rates will be substituted for the monthly series).

In addition, because the new indexes are based on data substantially similar to the current data in the MIRS, they should result in interest rates substantially similar to the rates in effect at the time the original indexes become unavailable,

Accordingly, FHFB can be expected, after the notice and comment period, to determine that FIRREA's requirements for substitution of substantially similar data will be satisfied.

CONCUR:



Arnold Intrater
General Counsel

2-19-91
Date