FIGURE DART

October 24, 2022

Office of Financial Technology
Federal Housing Finance Agency
400 7th Street, S.W.
Washington, D.C. 20219

Re: Fintech in Housing Finance Request for Information, July 2022

FHFA and its regulated entities are the dominant forces in the secondary market, and everything they do reverberates across the housing finance industry. The products the enterprises buy and guarantee tell the primary market what's safe to originate and tell the capital markets what's safe to invest in. The technologies the enterprises embrace set both the standard and the boundary for acceptable innovation.

Given this influence, and as the industry's largest risk-holder, FHFA and its regulated entities are in a unique position to connect every stakeholder in the mortgage lifecycle in a way that brings actual, meaningful value to the consumer. There's a critical need for that type of connectivity, but deployed in a way that facilitates innovation and competition – and that avoids the monopolization of integration points.

The mission of Figure and DART is to leverage blockchain to democratize access, and lower the barriers, to financial services, and we share FHFA's mission of using technology to promote a stronger, more efficient, and more inclusive housing finance system.

We sincerely appreciate FHFA's engagement with the mortgage fintech sector, and we are grateful for the opportunity to respond to FHFA's request for information. Our responses to some of the most critical questions in that request are below, and we look forward to working closely together to achieve our shared mission.

Sincerely,

Chris Karlsson, Senior Counsel
Leah Price, Vice President

Figure Technologies, Inc. and
Digital Asset Registration Technologies, Inc.

A.2 How could FHFA facilitate adoption of "responsible innovation"?

Commission a study on the enforceability of electronic notes.

Electronic promissory notes save borrowers, and the mortgage industry, money. The biggest drag on adoption is industry anxiety about the enforceability of electronic notes, despite the twenty-plus-year existence of statutory law explicitly approving of their use. The few reported decisions on this topic have generally confirmed the validity of the electronic contracts, and, in light of the volume of electronic notes created over the last decades, the dearth of case law on the topic demonstrates general judicial acceptance of those notes.

Nevertheless, anxiety persists, in both the agency and the non-agency markets. FHFA should commission a study that reports on the validity and value of electronic contracting, specifically detailing (with data) FHFA-regulated entities' success in enforcing loans with electronic notes, evaluating the successful adoption of electronic credit agreements in other industries, and documenting the overall use of electronic contracting in the economy more generally. Buying and guaranteeing electronic note mortgages demonstrates implicit support – but a more explicit and evidenced form of support is necessary to allay the worries of the lagging industry.

Re-evaluate electronic note technology.

The existing electronic note technology ecosystem – including siloed electronic vault providers, multiple registry points, and expensive implementation – is older than Blu-Ray video technology.

Particularly for smaller originators, lower balance loans, and chattel lending, the cost to implement that technology is too high, and even loans already leveraging electronically signed agreements are still treated like paper-based assets.

Advances in electronic signature creation and security, the ubiquity of electronic transacting more generally, and the advent of new technology like distributed ledgers and blockchain should be used to facilitate simple, integrated asset creation and storage solutions.

Ultimately, the cost to implement and maintain this legacy technology system neutralizes the potential benefits of electronic transactions, with the cost to implement and maintain the technology generally left to the parties with the least incentive to adopt or innovate.

Formalize a public-private partnership to align incentives for electronic transactions.

Just in the electronic promissory note context, despite the FHFA-regulated entities' general encouragement of the use of electronic notes, the industry's usage is low. One obvious reason is the misalignment of incentives for adoption. The bulk of the first-order benefits from electronic notes are realized in the secondary market – through faster settlement of trades, limited note movement, simpler diligence, and cheaper note storage – but the cost of moving from paper to electronic notes, often estimated above six figures, is borne by the originator. And particularly where all of an originator's financiers and loan buyers don't accept electronic notes, the initial and ongoing operational burden diminishes the value of making the switch.

This misalignment of incentives surrounding the adoption of new technology plays out all across the fragmented industry – from the challenge of integrating efficient technology into legacy operating systems to the acceptance of alternative credit models – to the detriment of consumers and the industry stakeholders themselves.

Beyond vendor-by-vendor approval and integration, no real avenue for transformational change exists. The FHFA and its Office of Financial Technology should create a formal public-private partnership (*e.g.*, an innovation counsel) that can serve as both an entry point for potential fintech change and a deployment mechanism to facilitate adoption of beneficial innovation by the industry broadly.

B.1 What kind of fintech activities have the greatest potential to positively impact the housing finance sector? Describe several situations in which a product or service has been or could be used, the factors considered in determining importance, and associated impacts.

So much of the tech innovation in the mortgage industry has been focused on lowering costs for originators (lower customer acquisition cost, more efficient origination, etc.), with the effect of only lowering originators' cost of generating the volume of loans that meets the existing demand of the secondary market.

Technological innovation must also focus on expanding secondary market demand – through cheaper transaction costs, lowered risk, and reduction of rent-seeking intermediaries, including trustees, custodians, paying agents, and clearinghouses – because studies have shown that that type of innovation directly leads to increased credit supply in the origination market and increased access to credit for underserved markets.

Ultimately, leveraging digital assets – both electronic notes and tokenized mortgage-backed securities – on a financial-services oriented blockchain will provide a solution to the connectivity and friction problems of the current siloed, legacy-system-dominated secondary market.

B.4 What are the existing data challenges that most prevent data-driven decision-making in the mortgage lifecycle?

One glaring data challenge for the industry is the absence of a clear source of truth for a mortgage asset across its entire lifecycle. At any one time, there are several purported sources of truth for a loan and its data, each of which only capture a portion of the asset, representing only a partial, temporal snapshot of the holistic asset: at origination, the asset creation records are in the loan origination system, which may get updated post-service release; servicing records are across several servicing systems, none of which are precisely in tune; ownership records are in two or three transaction management and registry systems.

The only record that may be reliably, auditably tracked is the note, but the loan asset is more than just that one record – it's the borrower and collateral profile, payment records, current credit picture, proof of servicing and origination compliance, and ownership interests – and the true state (and history) of the entire asset should be maintained with the same rigor as the promissory note.

The industry is not valuing data integrity for the holistic loan asset, but it's certainly paying for it, *explicitly* (to multiple registries, custodians, vaults, storage vendors, servicing and origination systems, transaction management systems etc.) and *implicitly* (via slower and riskier transactions, repetitive diligence, servicer onboarding/data transfer lag, extended enforcement times, unnecessarily high litigation success and settlement rates, etc.).

And by not maintaining data integrity across the lifecycle, the industry's ability to make any valuable decisions based on its data is hampered. Nearly all of all the data needed to originate a refinance is already in the "system," but just spread out across various siloed "sources of truth." When a refinance candidate is recognized, an originator will start an application, pull all new data, and essentially build an entirely new borrower-property-loan profile from scratch. If that data were appropriately maintained and validated – and could be permissioned to a potential originator at the borrower's option – originators could make the same decisions with the same accuracy from that existing data (and only supplemented as needed) at a fraction of the time and cost.

FHFA and its regulated entities should develop and designate a validated, shared source of truth for loan assets as part of an effort to lower costs in the industry by enabling useful decisions based on the industry's existing data.

C.1 What new fintech tools and techniques are emerging that could further equitable access to mortgage credit and sustainable homeownership? Which offer the most promise? What risks do the new technologies present?

On the critical path to equitable access to homeownership are alternative equitable-housing-related lending products (like chattel lending and special purpose credit programs), which may not trade in the FHFA-regulated entities' traditional securities markets, but also would not necessarily need to be held by those entities in portfolio.

FHFA should support its regulated entities in accessing and developing alternative marketplaces for these guaranteed, non-traditional, equitable-housing-related assets. Along with facilitating cheaper product digitization standards and efficient data/asset movement, fintech can support the effort by lowering the enterprises' selling/issuance costs, by facilitating digital-native issuance of financial instruments like securities, supporting efficient and decentralized marketplaces for those instruments, allowing for a real-time remittance of regular payments, and automating cashflow/waterfall management and disbursement to investors.

When developing a plan to launch alternative equitable-housing-related lending products, FHFA and its regulated entities should reconsider the costs of intermediation and rent-seeking that have been accepted as part of the lifecycle for traditional lending products – from origination through securitization and servicing – and these costs should not (because the primary goal is affordability) and cannot (because of the need to offer a competitive return) be accepted for alternative mission-focused products.