October 14, 2022

FHFA Request for Information - Fintech

The Community Home Lenders of America (CHLA) writes to submit comments and recommendations in response to FHFA's Request for Information regarding Fintech in Housing Finance.

CHLA respectfully requests that FHFA and Fannie Mae and Freddie Mac (the Enterprises):

1. **Prohibit the use of "click fees" in conjunction with Enterprise mortgage loans, and**
2. **Prohibit the practice of "tying" optional software services fees to essential loan origination software fees in conjunction with Enterprise loans.**

In June, CHLA wrote the Justice Department and the Federal Trade Commission (FTC), asking them to "undertake a comprehensive antitrust review of the proposed $13.1 billion purchase by Intercontinental Exchange ("ICE") of Black Knight ("BKI")" and "to take such actions as are necessary and appropriate (including merger denial or approval conditions) to prevent anti-consumer actions (e.g., tying or bundling) and to maintain the competitiveness of the market for mortgage services."

The CHLA letter copied FHFA Director Thompson - and CHLA testified before last week's Fintech Listening session - because the provision of mortgage software and related services are integral and necessary to the process of originating Enterprise loans. Since these services perform an essential component of mortgage origination, these costs will generally be passed along directly to borrowers.

Just a few decades ago, a mortgage application was a cumbersome, complicated process. Consumers copied and faxed in reams of documents, then waited weeks for a loan approval. Today, the process is significantly streamlined. Personal financial input for mortgage applications is typically submitted electronically and is often instantaneous. Mortgage applications are approved in a fraction of the time. Borrowers can close the loan from the comfort of their living room through E-sign.

A lot of the credit for this transformation goes to third party fintech providers, which offer mortgage loan originators packages of software and other services to take the lender and borrower through the loan application process - as well as optional software tools and apps to help them compete more effectively.

However, if the ICE/Black Knight transaction is approved, the combined entities would control 80% of the market for third party software services for lenders that do not use their own proprietary systems (all but the very largest lenders). Additionally, the dominant market provider of services for loan origination (ICE) would be combined with the dominant provider of software services for servicing (Black Knight).

CHLA only represents small and mid-sized lenders - predominately independent mortgage banks. That is why this issue is so critical to us - and to the borrowers we serve. Our members don't have the economies of scale to develop our own proprietary software services products. Our members - like all smaller mortgage lenders - are fundamentally dependent on third party providers like ICE and Black Knight.

Borrowers pay the price for practices like click fees and tying, which unnecessarily add to the cost of mortgage origination. The ICE/Black Knight transaction would enhance the ability of these entities to engage in such practices, because competitive alternatives would be significantly diminished.

Click Fees Inflate the Cost of Enterprise Mortgage Loans

Click fees are basically toll fees - fees that ICE charges vendors that serve a lender – to access the lender's own data! Vendors and functions where click fees are routinely assessed include an appraisal, a credit report, title insurance, and flood certification. Together, they typically total as much as $50 a loan. If a lender has a typical pull through ratio of 80% of loans it is working on, this raises the cost per loan by over $60/loan.

In practice this can be magnified by a factor of 2 to 4 times that. A loan could be originated by a mortgage broker (one set of LOS fees) which is then sold to a mortgage banker (another set of LOS fees) prior to closing. In turn, the loan could be sold to a loan aggregator or investor (another set of LOS fees), which then brings in a subservicer (another set of LOS fees).

These click fees are essentially just add-on fees that correspond to no substantive service or value to the borrower. Therefore, CHLA is separately asking the Consumer Financial Protection Bureau (CFPB) to bar such fees as part of the CFPB's initiative to bank so-called "junk fees."

When used with Enterprise loans, these junk fees are going to be passed along to Enterprise borrowers.

Thus, CHLA is asking FHFA and the Enterprises to ban click fees in conjunction with Enterprise loans.

Tying Practices Inflate the Cost of Enterprise Mortgage Loans

"Tying" is a practice of mortgage service providers of essential mortgage origination services requiring or strongly pressuring a lender to purchase optional services that the lender does not want or need. Because of the mortgage software services that are essential to the loan origination process, lenders are vulnerable to having to accept optional services they don't need, or risk impairing their loan origination execution.

In turn, the cost of these unnecessary services will be passed along to the borrower.

Therefore, CHLA is asking FHFA to have the Enterprises establish mortgage origination guidelines that prohibit the tying of non-essential software services to essential mortgage origination software services.

Market Dominance in Mortgage Origination Services

CHLA's June letter outlined the likely impact of ICE's purchase of Black Knight. Such purchase would reduce competition, thus increasing monopoly pricing power. In turn, this increases the leverage of the new combined entity to impose click fees and engage in tying practices.

ICE became the leading provider of mortgage origination software services and systems, through its September 2020 acquisition of Ellie Mae, whose Encompass platform is being used for around 50% of all mortgage loans. ICE's largest competitor is Black Knight, whose market share exceeds 10% of the mortgage origination market. Therefore, the combined entity would now be in the estimated range of at least 60% of the entire mortgage origination market.

We also note estimates that as much as 25% of the market for mortgage origination services comes from proprietary systems developed by larger mortgage lenders. This may protect many of the big banks and big IMBs – but underscores the direct threat the ICE/Black Knight merger poses to smaller IMBs.

Moreover, when you exclude internal proprietary systems, the combined ICE/Black Knight market share for services provided to lenders as a product could easily exceed 80%.

Even this percentage may underestimate the true market share, since some of the proprietary systems may be for correspondent mortgage loan purchases by large aggregators of loans originated by smaller IMBs.

Market Dominance in Mortgage Servicing Services

Black Knight, through its MSP platform, already services 64% of all mortgages in the United States. MSP offers lenders' automation of servicing functions, such as setup and maintenance, escrow administration, account management, default management, and others.

ICE does not offer a competing servicing platform.

However, as noted the proposed merger would combine one firm with an already dominant share of mortgage origination software and related systems (ICE) with another firm (Black Knight) with an already dominant share of mortgage servicing software and related systems.

This raises concerns that the merger will create synergies to engage in anticompetitive practices with regard to tying software and systems between mortgage origination and servicing.

Pricing Concerns Regarding an ICE Purchase of Black Knight

CHLA appreciates that FHFA does not have a direct role in the approval of this transaction, although we would encourage the agency to weigh in by expressing concerns to the Justice Department and the FTC.

However, we do want to outline our concerns about the pricing impact of this consolidation, since this would affect borrowers with Enterprise loans.

Contracts for provision of such mortgage services are typically for a stated period of time, e.g., 3 years. This leaves lenders, particularly smaller IMBs, particularly vulnerable to the threat of non-renewal. Even a short transition or changeover period to a new services provider could shut down mortgage loan closings for a lender, which would be very costly and could harm the lender's reputation for execution.

This is not just a question of switching mortgage origination software (LOS). Many critical functions, such as regulatory compliance, pricing, and training are built around these software systems. Following are examples of ICE/Black Knight products integrally tied to loan origination:

- Mavent – regulatory compliance
- Velocify – consumer mortgage loan leads
- PPP – product and pricing engine
- E-Close – allows consumers to e-sign documents and disclosures
- POS – Consumer Connect – controls consumer web applications and borrower portal

As a result, a combined ICE/Black Knight with a dominant market share could easily use leverage to demand significant and unwarranted price increases upon renewal. A smaller lender might have no practical option other than to accept the significant and unwarranted cost increases, since the difficulties of transitioning to a shrinking group of competitors risks a period in which loans are not efficiently executed, which would have both a financial and reputational impact.

Thank you for consideration of these comments and recommendations.

Sincerely Yours,

COMMUNITY HOME LENDERS OF AMERICA