May 22, 2024

Submitted via email to RegComments@fhfa.gov.

Eric Bryant
Policy Analyst
Division of Housing Mission and Goals
Federal Housing Finance Agency
400 Seventh Street, SW, Washington, DC 20219

William Merrill
Associate Director
Division of Housing Mission and Goals
Federal Housing Finance Agency
400 Seventh Street, SW, Washington, DC 20219

Lyn Abrams
Associate General Counsel
Office of General Counsel
Federal Housing Finance Agency
400 Seventh Street, SW, Washington, DC 20219

Dinah Knight
Assistant General Counsel
Office of General Counsel
Federal Housing Finance Agency
400 Seventh Street, SW, Washington, DC 20219

Re: 'Proposed Enterprise New Product; Comment Request 'Freddie Mac Single-Family Closed-End Second Mortgages,' (No. 2024–N–5)

Upstart Network, Inc. ("Upstart") is the leading AI lending marketplace, connecting millions of consumers to over 100 banks and credit unions that leverage Upstart's AI to deliver superior credit products. With Upstart AI, lenders can approve more borrowers at lower rates across races, ages, and genders, while delivering the exceptional digital-first experience customers demand. More than 80% of personal loan borrowers are approved instantly, with zero documentation to upload. Upstart's affiliate Upstart Mortgage, LLC offers home equity lines of credit (HELOCs). Upstart Mortgage allows homeowners to borrow up to $250,000 for debt consolidation, home improvement projects, or other expenses.

Upstart has used proprietary technology to facilitate the making and servicing of more than $40 billion in consumer loans by participating financial institutions and lending partners through its web-based platform www.upstart.com. Upstart also sponsors an unsecured consumer loan securitization program known as the Upstart Securitization Trust ("UPST") ABS program. Upstart is a Board Member of the Structured Finance Association ("SFA"), the American Fintech Council, the Mortgage Bankers Association, and a founder of the MoreThanFair.com coalition.

Reasons For Concern with the Enterprise New Product Proposal

Upstart appreciates the role of FHFA and the GSEs in upholding the traditional 30 year fixed rate mortgage and protecting access to homeownership in the United States. FHFA has also correctly recognized that there is an opportunity for more homeowners to retain their low-cost first lien mortgages while responsibly tapping record equity in their home to affordably access liquidity. However, Upstart is

concerned that the proposed rule could distort an orderly and functioning private sector marketplace and reduce innovation.

Freddie Mac's size and influence is such that its process, rules, and restriction may begin to be viewed as 'market standard.' Other market participants – depositories, investors, warehouse lenders, ratings agencies – may utilize them as guidelines on 'market standard' practices making it harder to win acceptance for innovative approaches or increasing the cost of capital for applying them. This may limit private innovators ability to responsibly innovate on areas such as verification of borrower income using cash flow data, property valuation, lien-verification via digital searches, or the use of alternative data and AI models to expand access and reduce disparities in serving the traditionally underserved.

Innovation in these areas can help customers get firm offers online within minutes and close within days. According to the Mortgage Bankers Association, the industry average today is more than a month. Online applications, instant decisioning, and automated AI-powered underwriting can help more borrowers tap their equity when they need it most, benefiting from lower rates of a secured loan versus unsecured debt on a credit card or personal loan. It can reduce the cost of origination significantly, enabling borrowers to serve lower-balance borrowers at lower rates. And it can expand access and reduce disparities by considering alternative data such as cashflow or educational history.

If the proposed new product is implemented, we recommend considering how to implement it without ossifying the traditional, manual underwriting processes as a market standard. The goal should be to create a level playing field for innovative approaches to prove themselves out, with a clear path. While we do not claim to have a perfect policy solution, we think such measures may include:

- Defining standards or guidelines for agency approval of new verification methods, such as verification of income or property valuation
- Defining a pathway for how third party automated underwriting systems can win agency approval
- Approaches that enable originators to innovate on underwriting process as long as long as they share some of the risk to protect Freddie Mac (and taxpayers) from the risk of excess loss from these innovations

FHFA requested comments on the following questions:
1. To what degree might the proposed new product advance any of the purposes set forth in Freddie Mac's charter act?

The FHFA regulation on Prior Approval for Enterprise Products establishes a framework for identifying new activities and new products and a process for an Enterprise to provide FHFA with advance notice of a new activity and to request prior approval of a new product. The regulation also describes the factors that the Director may consider when determining whether a proposed new product is in the public interest. Those factors fall into three broad categories: (1) the impact of the new product on the Enterprise's public mission; (2) the impact of the new product on the stability of mortgage finance or financial system; and (3) the impact of the new product on the competitiveness of the housing finance market.

As outlined in the request for comment, Congress created Freddie Mac to serve four public purposes: "(1) provide stability in the secondary market for residential mortgages; (2) respond appropriately to the private capital market; (3) provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low and moderate income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and (4) promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing."

The proposal, while well intended, may not end up advancing the above stated purposes set forth in Freddie Mac's Charter. First, the language of the Charter itself is clearly aimed at first lien residential mortgages that are used to help Americans purchase a home, and thus the proposal falls outside of Freddie Mac's primary stated mission. In fact, "second mortgages" or "home equity" credit products are not identified by this key language of the Charter at all. Furthermore, as outlined in responses to other questions below, the proposed product may not serve the long-term economic interests of low and moderate income homeowners, or lead to a "more equitable distribution" of investment capital available for residential mortgage financing throughout the nation.

2. To what degree might the proposed new product advance Freddie Mac's Duty to Serve Underserved Markets activities and support Freddie Mac in meeting its housing goals?

This proposal appears to fall outside of Freddie Mac's core mandate of promoting home ownership and may do little to help underserved communities that are the target of housing goals. Less well-off homeowners, including those who may live in areas where home prices have not appreciated, those with lower credit scores, and those with higher debt burdens relative to their income who may not pass the Seller's manual underwriting, would be at risk of failing to qualify for Freddie Mac's proposed new product. A potential result in the broader market could be a bifurcated market where relatively well-off homeowners who have benefited from rising home prices are subsidized by the GSE's government subsidized low cost funding, while less fortunate borrowers who have seen their financial picture deteriorate may see no such benefit. In fact, it is likely that less fortunate borrowers, labeled by this new product as "high risk" and pooled exclusively with those with similar credit characteristics and financial pictures could see their funding costs rise, rather than fall, due to this proposal. A second possible unintended consequence could be a drying up of home equity financing options for those borrowers.

Second, underserved homeowners typically need access to affordable home equity credit *quickly.* Today, market participants are unleashing the power of technology, including AI, to deliver huge wins in the speed of funding. Upstart Mortgage's HELOC team has cut the traditional time it takes from when a borrower begins an application online to when the borrower receives funding by *two-thirds*, by working to solve tough challenges in the following areas:

- Instant income verification
- Automated valuations

- Digital lien search
- Instant credit decisioning
- Remote online notarization

Fast access to liquidity helps underserved borrowers avoid racking up revolving credit card debt balances, more expensive unsecured personal loans, or, far worse, payday loans. With the proposal's emphasis on manual underwriting (see qualification table) it is unlikely that Freddie Mac rules will permit purchases of second lien mortgages that were closed with processes that are at the cutting edge. The presence of a large government-backed market participant may slow the adoption of innovative processes that would greatly benefit borrowers over the long run.

3. To what degree might the proposed new product already be supplied by other market participants?

According to Transunion's 2023 Q4 Home Equity report, homeowners have over $20 trillion of tappable home equity, while carrying nearly $800 billion of non-mortgage debt, including credit cards and unsecured personal loans. Americans can save tens of billions of dollars a year in higher interest payments by leveraging a home equity loan or line of credit to consolidate their current debt, before even considering the savings of home equity financing compared to the cost of taking on new unsecured debts in this higher interest rate environment.

Given these compelling economics, the FHFA should consider carefully whether or not the second lien mortgage market is already being well served by the private market. For example, credit unions have increased holdings more than $50 billion from 2022 through the end of 2023. Private securitization volume is expected to exceed $10 billion this year, more than doubling from $4.5 billion last year. Furthermore, more than a half dozen nonbank financial technology platforms have launched HELOC or closed end second-lien lending programs in the last two years, many offering similar innovations that make it easier to apply and faster to fund. In short, homeowners looking to access second lien mortgage products today have more options than ever and are already poised to save billions of dollars in higher interest payments when compared to the cost of relying on unsecured credit or other products.

4. To what degree might the proposed new product promote or lessen competition in the marketplace?

As outlined in this letter, private sector competition will be harmed by this new product. It will likely result in a de-facto two-tier system that benefits well-off borrowers while slowing the innovation that could help the underserved.

5. To what degree might the proposed new product overcome natural market barriers or inefficiencies?

Our concern is that the proposed product will act to displace the innovation rapidly occurring in the private sector with a product that will "bake in" dated practices as the "market standard." The risk is

inefficiency and that the potential benefits of the government backed liquidity will overwhelmingly flow to relatively well-off homeowners.

6. To what degree might the proposed new product raise or mitigate risks to the mortgage finance or financial system?

Because second liens loans within Freddie Mac's proposed guidelines are relatively low risk, we view the proposal as neutral to the effect on credit risk borne by the GSEs. We believe the biggest risk is slowing the development of a secondary market outside the GSE buy box and manual underwriting requirements.

7. To what degree might the proposed new product further fair housing and fair lending?

It is unclear whether the proposed new product will advance fair housing and fair lending goals. Traditional manual underwriting practices, such as those promoted by Freddie Mac, tend to lock Americans – including many young people, low and moderate income people, Black and Hispanic people, and anyone who lives in areas with a high concentration of minorities, renters, and foreign-born people – out of the mainstream credit market. Fresh approaches such as real-time income verification, automated valuations, digital-lien verification, and remote online notarization can transform home equity lending to help those borrowers who have traditionally been left behind. These process improvements, coupled with the use of alternative data and AI in lending can address biases by incorporating alternative data sources – like a college degree or bank account cash flow data – to enhance fairness and more accurately reflect creditworthiness across diverse demographics. This can help improve inclusive access to credit while also increasing compliance with fair lending laws like the Equal Credit Opportunity Act (ECOA). Unfortunately, this proposed new product, powered by the weight of the GSEs in the marketplace, may disrupt an innovative industry that is delivering a combination of credit application processes optimized for today's mobile devices.

8. To what degree might borrowers benefit from or be adversely affected by the proposed new product?

First, it is clear that many homeowners who are fortunate enough to have a first lien mortgage that was eligible for Freddie Mac, can pass a Seller's manual underwriting review, and also have an appropriate LTV would potentially benefit from this proposed new product's infusion of liquidity. The broader borrowing public, however, could be adversely impacted by the new product in two ways. First, unlike a primary mortgage where the purpose of the product is to purchase and own a home, the primary reason for accessing a second lien home equity financing is a need for cash to consolidate debt, or to pay down – or avoid – more expensive unsecured debt. Customers need access to this liquidity quickly. Enshrining Freddie Mac's traditional processes and manual underwriting requirements as the 'market standard' could limit private sector market participants' ability to bring innovation to critical friction points in the application process such as income-verification, lien-verification, as well as alternative data and AI modeling that is proven to expand access for the traditionally underserved. While it is tempting to think that those innovations would simply occur in the product outside of Freddie Mac's "buy box," experience has shown that the presence of the GSEs in the marketplace can distort the broader expectations of market participants and slow down innovation.

Second, those who do not fit in the narrow traditional biases about who is "creditworthy" will not benefit from the proposed new product. This is due to the likely exclusion of alternative data and modeling in favor of traditional hard decline reasons typically used in manual underwriting that is required of the Seller in the proposed product structure.

Upstart has shown that automated underwriting innovation can pay huge dividends for the underserved. By factoring in alternative data and using AI, in 2022, Upstart's personal loan model has been shown to increase loan approvals by 44% overall.[1] Moreover, these AI-enhanced approvals can lead to more accurate, affordable pricing for credit. For example, in Upstart's case, alternative data analyzed by its AI models led to much lower interest rates (APRs) – 36% overall, with 29% and 34% reductions for Black and Hispanic borrowers respectively.[2] This is critical to facilitating greater economic equity and enabling borrowers to build credit and wealth, particularly through eventual home ownership. In fact, third party academic research from Harvard and LSU shows that those who secured a (unsecured) personal loan from Upstart became more likely to be approved for a mortgage in the near future.[3]

9. Are there any other factors that the Director should take into consideration concerning the proposed new product?

Upstart appreciates the opportunity to raise these considerations regarding this proposed new Freddie Mac product. Recent research from the Philadelphia Federal Reserve suggests that there may be higher levels of racial inequality in second lien mortgages than in purchase mortgages. Two particular factors – traditional lender discrimination and lack of automation in underwriting – were identified as the likely culprits.[4] Progress must be made to address the bias in this market, and Upstart's experience working in other credit products has clearly indicated that automated and inclusive underwriting would show significantly less bias than traditional approaches, and this gap could begin to be closed. Upstart believes that given the proposal to involve Freddie Mac in this market, the FHFA should consider these broader implications, including the likely market participants who will be most involved and the role of manual underwriting requirements.

Thank you for the opportunity to provide these comments. Please feel free to contact Nat Hoopes at nat.hoopes@upstart.com if you have any questions or if you would like to discuss our comments further.

Sincerely,

Nat Hoopes
Head of Government & Regulatory Affairs, Upstart

[1] https://www.upstart.com/lenders/regulatory-compliance/access-to-credit-report/
[2] Ibid
[3] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3937438
[4] "Can Everyone Tap into the Housing Piggy Bank? Racial Disparities in Access to Home Equity." Working Paper by James N. Conklin, Kristopher Gerardi, Lauren Lambie-Hanson