What might blockchain mean for the mortgage industry?

Blockchain technology may radically alter the process through which consumers buy a home, as well as the way financial institutions handle mortgages. Specifically, the technology could remove cost and friction from the process, create transaction records that are infallible and incorruptible, and facilitate near-instantaneous settlement. It could also dramatically change the way mortgages are serviced and sold on the secondary market.

Blockchain technology is being evaluated in many industries, with progressive companies already testing potential applications for their businesses. We’ve already written a few publications on this new and exciting technology. To learn more, start here: “Making sense of bitcoin, cryptocurrency, and blockchain.”¹ To better understand how blockchain could affect the mortgage industry, we sat down with PwC’s Pamela Johnston and Tim Davis.

Questions and answers

Q. Why are people thinking about blockchain and mortgages? What’s the connection?

In our “What is blockchain?” Q&A, we described the technology as a type of next-generation business process improvement software. And the mortgage process could use some improvement, given all the handoffs, exchanges of value, third-party certifications, and built-in delays.

Two of blockchain’s features—smart contracts and distributed ledgers—could help. Every time a transaction moves between ledgers, someone confirms that move. Blockchain could address this issue by updating ledgers immediately, automatically, transparently, and with traceability. It could also create and support smart contracts: code-based, defined sets of rules that sit on a blockchain database and execute only when something specific happens. So, if a loan is being sold into a mortgage-backed security (MBS) pool, say, but it falls outside of certain conditions that apply to a tranche, the loan would be automatically excluded.

Q. So this could affect the whole mortgage process?

Absolutely. At originination, blockchain might help establish more accurate recordkeeping. At fulfillment, it could provide immutable proof that loan estimates were sent within three business days. Smart contracts would speed up settlement flows. In the mortgage servicing process, blockchain could track the movement of payments. And in the secondary markets, it might provide transparency about the ownership of underlying assets. We think blockchain could be relevant at every stage.

In fact, all loan information relies on the accuracy of underlying source data. Blockchain can help validate and maintain the integrity of MISMO mortgage loan data and other documents, making it easier to transfer assets to servicers. Mortgage servicing rights (MSRs) could be transferred via blockchain, too. With a more streamlined MSR transfer process, impaired loans could be moved to specialty servicers more quickly—or even be taken back on board after a workout.

In the secondary market, smart contracts could help the securitization process. They could streamline how Master Services Agreements, Investor Contracts, and Pooling and Service Agreements inform these securities, too. And when mortgage-backed securities are created more efficiently, or

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4 Mortgage Industry Standards Maintenance Organization (www.mismo.org)
when MSRs are traded more quickly, this adds liquidity back into the market. That’s good for everyone.

Q. So is this primarily a business-to-business (B2B) issue? Or do borrowers benefit, too?

A better process helps borrowers as well as lenders. For one thing, a borrower could see lower closing costs. Having a third-party intermediary involved in a mortgage transaction can cost as much as 1% to 2% of a property’s value. Blockchain could reduce or eliminate the need for a third-party intermediary in the mortgage process and instead allow two parties to interact directly instead.\(^5\) We can imagine that borrowers might gravitate toward lenders who figure out how to streamline the mortgage process and reduce closing costs.

Better recordkeeping could also address fraud, a persistent challenge for the industry. When bad actors falsify documents or pretend to own assets that aren’t theirs, everyone suffers. By making it harder to tamper with ownership records, blockchain could reduce the odds of mortgage fraud.

Q. How does this fit with other blockchain activity in the financial industry?

Many financial services processes involve a certain amount of ‘friction,’ and this is where blockchain holds a lot of promise. When mortgages are packaged into a collateralized debt obligation, for example, you need an accurate way to track both the underlying assets and the associated data and documents. Blockchain holds appeal because distributed ledgers take trust out of the equation. This benefits would-be buyers and traders of securitized instruments.

While financial institutions certainly create value by giving advice, they also do so by acting as intermediaries and brokers, providing assurance to disparate parties. Blockchain offers confirmation, too (“here are the components of that collateralized debt obligation,” “yes, party #1 did meet its contractual terms,” etc.), in a neutral, automated way. So it could be highly disruptive, and financial institutions have a huge incentive to understand it, adapt it, and not be surprised by it.

Q. What’s the best way to get started with a blockchain mortgage project?

For now, the best way to start is to just start. Create a proof-of-concept. Test it. Iterate. First, think about what processes you’d like to improve. Develop a lot of use cases and then narrow them down based on some criteria: which tools make the most sense, which ideas have the right internal sponsors, how much time will it take to test the ideas, and so on.

For example, blockchain is a logical fit to track the components of securitization. It could also streamline clearing and settlement, but the existing DTCC process is relatively efficient and any alternative would require a lot of interparty cooperation.\(^6\)

There aren’t standards yet, but that’s actually an incentive; it’s an opportunity to learn about the technology while processes are still fluid. It’s also a good chance to understand the potential issues, so you can solve them on your schedule rather than in crisis mode. How will you handle the legal implications? What are the challenges associated with data quality or with working alongside legacy systems? Things have now progressed far enough that real lessons learned are available.

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\(^6\) Depository Trust & Clearing Corporation (www.dtcc.com)
We’d like to thank Scott Randa for his contributions to this publication.

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