Consumer Federation of America

March 21, 2019

Mr. Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 7th Street Southwest, 9th Floor
Washington, DC 20219

RE: Validation and Approval of Credit Score Models [RIN: 2590-AA98]

Dear Mr. Pollard:

Thank you for the opportunity to comment on FHFA's proposed rulemaking RIN: 2590-AA98, Validation and Approval of Credit Score Models on behalf of Consumer Federation of America, Leadership Conference on Civil and Human Rights (LCCHR), National Fair Housing Alliance (NFHA), and Woodstock Institute. [1]

In general, CFA supports competition in the market and the constant updating of models to collect and consider the widest range of data because we believe that it helps insure consumers have access to the best products at the lowest cost. We therefore support the provisions in Section 310 of the "Economic Growth, Regulatory Relief, and Consumer Protection Act" (P.L.

[1] The Consumer Federation of America is a nonprofit association of some 300 national, state and local pro-consumer organizations created in 1968 to represent the consumer interest through research, advocacy, and education

The Leadership Conference on Civil and Human Rights is a 501c(4) coalition that engages in legislative advocacy. It was founded in 1950 and has coordinated national lobbying efforts on behalf of every major civil rights law since 1957 and is charged by its diverse membership of more than 200 national organizations to promote and protect the civil and human rights of all persons in the United States.

Founded in 1988, the National Fair Housing Alliance is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights agencies, and individuals from throughout the United States. Headquartered in Washington, D.C., the National Fair Housing Alliance, through comprehensive education, advocacy, enforcement, and neighborhood-based community development programs, provides equal access to apartments, houses, mortgage loans, and homeowners insurance policies for all residents of the nation.

Woodstock Institute is a leading nonprofit research and policy organization in the areas of equitable lending and investment, wealth creation and preservation, and access to safe and affordable financial products, services, and systems. Woodstock has been a recognized economic justice leader and bridge-builder between communities and policymakers since it was founded in 1973.

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115-173) that this proposed regulation would implement. Requiring and providing guidance to Fannie Mae and Freddie Mac to facilitate and encourage the incorporation of evolving credit scores, updated models, and other alternative means of assessing borrowers' propensity to repay debts is an important factor in assuring that these dominant sources of mortgage capital are basing credit and pricing decisions on the best evaluations of credit risk available in the market.

We also note that the GSEs' modeling and assessment of credit risk relies much more heavily on proprietary underwriting algorithms than on credit scores, and that these are routinely updated without the extensive public review anticipated in this proposed rule. These are at least as opaque as credit scores, and consumer interest should drive FHFA to look more expansively at whether these are fully optimizing information about consumer practices and habits. The focus on credit scores is welcome, but incomplete. We agree with the comments submitted by the Center for Financial Services Innovation (CFSI) and the Urban Institute in response to the earlier RFI on this topic urging broader consideration of alternative means of assessing consumers' ability and propensity to repay mortgage debt[2]. In particular, advances in financial technologies that make examination of income and spending patterns both before and after loan origination scalable and efficient offer new potentially constructive insights into likely and continuing mortgage performance.

As the proposed rule points out, Fannie Mae does not use credit scores at all in its automated underwriting process, and Freddie Mac uses them only as a part of a larger, multifactor underwriting process in its automated application. However, FICO scores are used by both Enterprises as a basic minimum qualification for submission to their underwriting applications, and they are used in applying risk-based pricing premiums in combination with loan to value ratios. Insofar as the scores operate as a gatekeeper to GSE mortgage products, there is a strong public interest in promoting technologies that assess and score the largest possible number of consumers and to encourage a well-regulated competitive market in order to do so. This may or may not increase the number of eligible borrowers receiving approvals through the GSEs' underwriting engines. Indeed, the earlier RFI concluded that meaningful improvements in approvals are likely to be small, because the scores play such a minor role in GSE underwriting algorithms[3]. But it may increase the opportunity to be considered in the first

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[2] "We support FHFA's efforts to upgrade the GSEs' credit score requirements, as the current model is outdated. But updating to a newer model, while a step forward, does not go far enough because it does not encourage greater use of additional data, such as rent and utility payment data…. The crux of our RFI response is that the FHFA should take a broader view of competition with the credit scoring space—one that includes credit score modeling firms and providers of additional data." Urban Institute, *FHFA's Evaluation of Credit Scores Misses the Mark*, Karan Kaul and Laurie Goodman, https://www.urban.org/research/publication/fhfas-evaluation-credit-scores-misses-mark

[3] "FHFA concluded that the Enterprises' empirical findings revealed only marginal benefits to requiring a different credit score than Classic FICO. These findings suggest that, regardless of the credit score used in the underwriting process, each Enterprise's automated underwriting systems more precisely predicted mortgage defaults than third-party credit scores alone." *FHFA Request for Input, December 20, 2017, page 3*

place. This is especially important as increasing numbers of new households are entering the mortgage application marketplace with significantly different demographic, family and credit use profiles than in the past. There also is a significant public interest in making sure that the models used to assess consumers that will drive pricing decisions are as accurate and inclusive of relevant factors as possible. We believe competition will help drive continuing improvement in these models and benefit consumers as a result.

At the same time, FHFA's earlier conclusion that changes in credit scoring technologies used by the Enterprises will have minimal effects on actual loan performance and financial impact on their books of business suggests that the extensive and lengthy examination process laid out in the proposed rule, and the very high barriers to entry by new competitors it would erect are unlikely to have a significant impact on either granting of consumer credit through the Enterprises' own underwriting systems or on their financial safety and soundness. But because credit scores remain a critical element in gaining access to these more sophisticated, multi-factor underwriting processes, and in pricing mortgages approved through them, barriers that reduce the growth of responsible competition in the credit scoring space potentially forecloses opportunities to expand access to those systems for the largest possible pool of candidates.

The effective monopoly that FICO has as the only authorized source of GSE credit scores reduces its incentive to update and improve its models, and even though FICO has updated its models and offers models that include more data points and improved analysis – partly in response to competition from other score vendors -- neither GSE has adopted them, making this monopoly potentially even more disadvantageous to consumers. The GSEs also have failed to adopt new models such as those offered by VantageScore, even when those models may represent positive new ways to include more consumers for consideration for mortgage credit and potentially more effective and affordable risk pricing. This failure to update the models that can play such a significant role in controlling access to GSE mortgage credit is unacceptable. It also differs from creditor practices in other markets, including markets where loans are bundled into securities. A 2018 Oliver Wyman study concluded that "…VantageScore credit scores continue to be used across the entire lifecycle of consumer lending and across every relevant category except mortgage origination…"[4]

[4] Carroll and Schiavone, *2018 VantageScore Market Study Report*, Oliver Wyman, 2018 https://www.vantagescore.com/images/resources/2018%20VS%20Market%20Adoption%20Study%20-%20FINAL.pdf "In the 12-month period between July 1, 2017 and June 30, 2018, approximately 10.4 billion VantageScore credit scores were used by more than 2,800 users (20% and 3% increases respectively relative to last year's study). The large increase in VS score use was most pronounced at consumer websites (this channel has become key for marketing, generating leads, and engaging with customers), personal loan companies, resellers and retailers.", p. 1

We also note that other means to verify consumer spending and income to support underlying credit decisions through new technology applications are being piloted or adopted without a similarly extensive process laid out in the proposed rule, although they could mark an important expansion of credit-related data incorporated into the Enterprises' risk management approach. We support innovations such as these, as long as they are properly evaluated and monitored. Indeed, we urge FHFA to encourage the more rapid deployment and testing of these rapidly emerging technologies and their incorporation into more traditional credit assessment tools, as is the case with Ultra FICO and Experian Boost, both of which CFA has discussed with industry but neither of which can be used by lenders to qualify borrowers to be submitted to the Enterprises' automated underwriting regimes.

We support FHFA direction to the GSEs not only to incorporate the latest tested and verified credit scoring models available, but also to open up their process to other scores than FICO and over time other models that may emerge. This would bring the mortgage marketplace in line with other credit markets and, we believe, help assure the broadest possible access to GSE mortgage credit.

Validation Solicitation and Process

The proposed rule outlines an extensive and time-consuming process for validation and adoption of credit scoring technologies that we believe overlooks the opportunity to carry out some of the detailed reviews simultaneously, rather than serially, thereby significantly lengthening the time required to reach a decision and adding time and costs that could be a deterrent to new competitors in the market.

Moreover, the focus of the evaluation laid out in the proposed rule appears to focus more heavily on the likely impacts of any credit scoring changes on the Enterprises' risk profiles and lender business operations than the potential risks and benefits to currently underserved and unserved consumers. We urge FHFA to disclose publicly its criteria for any cost-benefit analyses associated with any final rule and to specifically require an assessment of consumer costs and benefits in such an analysis.

Long delays in adopting updated scoring technologies has potentially greater impacts on communities of color, who have been systematically excluded from traditional credit sources for decades. A legacy of this *de jure* and *de facto* racial discrimination in credit is that many African-American and Latino consumers do not have well established credit histories with traditional, conventional creditors.[5]

[5] "As a result, people of color are disproportionately represented among those who use non-traditional credit. Forty-six percent of African Americans, 40% of Latinos, 38% of American Indian and Alaska Natives use alternative or non-traditional financial services. Comparatively, 18% of Whites use these services. In the lead up to the crisis, borrowers of color disproportionately were targeted for and

We also note that while model validation described in the proposed rule certainly adds a significant degree of confidence in services used by the Enterprises when considering credit decisions, it stands out among the various third-party service providers upon whose judgment the Enterprises also rely outside of their own proprietary underwriting decisioning. Approval and use of other third-party providers is delegated to the Enterprises with clear guidance provided by FHFA, and the proposed rule specifically references FHFA's guidance on approving and managing third party vendors, although the credit scoring agencies are not direct vendors to the Enterprises.[6]

Careful consideration of new credit scoring or assessment tools is merited. But requiring the extensive and time-consuming process in the proposed rule could be a significant barrier to the adoption of new and improved tools and we urge FHFA to consider how it can combine and/or streamline the requirements in the proposed rule to reduce such barriers. Model validation should be easier in the case of models that are already in wide use outside the mortgage market.

Similarly, the proposed rule's requirement that new solicitations be carried out on a seven-year cycle could discourage the development and adoption of new technologies whose market and product cycle is significantly shorter. We appreciate the burdens rapid changes in approved technologies can mean for the Enterprises' lender customers, where the downstream cost effects of changes will be most clearly felt and likely passed on to consumers. But given the rapid product cycles that characterize new technologies, and the fact that the Enterprises themselves change their core underwriting models and processes more frequently argues for a shorter cycle time for considering and adopting new alternative products or refinements of existing products. As for investors in the Enterprises' MBS, another important stakeholder, it appears that securities backed by other assets where multiple and frequently updated models are used do not face insurmountable hurdles in accommodating such improvement cycles. The proposed rule does not reference how other asset-backed securities' prices or liquidity are affected by using multiple credit scoring technologies. This should be a factor considered in formulating a final rule.

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received subprime loans, even when they qualified for prime credit. Moreover, consumers of color are less likely to have a credit card than their White counterparts. One study revealed that 47% of African Americans and 30% of Hispanics did not have access to a credit card as compared to 20% of White consumers." Comments on 2018 RFI submitted by National Fair Housing Alliance, March 2018

[6] "A regulated entity's program should enable oversight of third-party provider relationships in accordance with the level of risk presented, the nature of the relationship, the scale of the outsourced product or service, and the risk inherent in the relationship. Because of this risk-based approach, aspects of this AB may not apply to every third-party provider relationship. The regulated entities should ensure that the quality and extent of third-party provider risk management corresponds with the level of risk and the complexity of these relationships." https://www.fhfa.gov/SupervisionRegulation/AdvisoryBulletins/Pages/Oversight-of-Third-Party-Provider-Relationships.aspx

FHFA already carried out extensive testing of at least three alternative credit scoring approaches in preparing the 2018 RFI. This suggests that these models could be quickly approved without having to go through a duplicative, lengthy and costly review and we urge FHFA to move quickly to consider the approval of updated models that could expand the universe of consumers eligible to be considered through the Enterprises' systems based on that earlier review.

Ownership Interests

The proposed rule would "…exclude common ownership or control of the credit score model developer and the owner of consumer credit data. To implement this prohibition, the proposed rule would require each application to include a certification that no owner of consumer data necessary to construct the credit score model is related to the credit score model developer through common ownership or control." This proposed rule specifically references only one current score provider, VantageScore, in this provision. We strongly object to this approach. While we agree there are valid reasons to monitor potential adverse competitive impacts of credit scoring models where consumer reporting agencies (CRAs) or other interested parties have an ownership stake in the model provider, the proposed rule fails to identify any actual case of harm that has resulted from the current competitive market in credit scores in other asset classes. Litigation brought against VantageScore alleging anti-trust and anti-competitive harm in the past was resolved in its favor.[7] Alleged cases of competitive harm can avail themselves of existing law that constrains such behavior, based on evidence. The proposed rule cites no evidence beyond theoretical harm to justify this exclusion, and completely ignores the fact that the CRAs themselves have a monopoly-like lock on data that FICO, VantageScore and potentially other credit scoring technologies in the future may use. We are unaware of any similar restrictions on any level of ownership interest in other important third party service providers, such as inspection services, appraisals, or credit insurance. Meanwhile, the current effective prohibition against incorporating VantageScore's products in the limited ways credit scores are now used by the Enterprises would solidify and ratify the current monopoly position enjoyed by FICO, a situation whose efficacy and consumer benefit should be a significant consideration in the proposed rulemaking.

[7] *Fair Isaac Corp. v. Experian Info. Solutions, Inc.*, 645 F. Supp. 2n 734, 752 (D. Minn. 2009)

Pilots

The proposed rule seeks comment on enabling the Enterprises to carry out, with FHFA approval, pilots using credit scoring systems or models that do not meet the current test of being in active and validated use. We strongly support this provision in the proposed rule. We suggest that in doing so FHFA maximize the transparency of such efforts by regularly informing the public of approved pilots, publicly sharing results from the pilots and informing the public about Enterprise and FHFA actions that follow such pilots.

Thank you again for the opportunity to comment on this important proposed rule.

Sincerely,

Barry Zigas
Director of Housing Policy