January 19, 2018

The Honorable Melvin L. Watt
Director
Federal Housing Finance Agency
400 7th Street, S.W. Washington, D.C. 20024

Dear Director Watt:

The purpose of this letter is to respond to FHFA's Credit Score Request for Input (RFI) issued December 20, 2017, and to present a brief summary of my responses to specific questions posed in the RFI, which are attached.

The key issue raised in the RFI is whether the GSEs should accept the VantageScore either in lieu of or in addition to the FICO® Score, which is currently the industry standard. The main rationale for adopting the new score is that it would provide credit scores for millions of currently 'unscoreable' consumers, thereby providing access to the mortgage market. According to the CFPB, 'credit invisibles' or 'unscored consumers' are more likely to have lower-incomes and are more likely to be minorities.[1] VantageScore provides scores for these consumers by lowering the minimum criteria required to compute a credit score, including consumers with no recent credit activity.[2] However, it is not clear that a new score is a meaningful solution given other impediments to homeownership opportunities. For example, it is well-documented that the market for first-time homebuyers has been dampened by tighter underwriting standards, a limited supply of affordable housing units, and changing preferences of younger consumers[3]. There is also evidence suggesting that many consumers are opting out of homebuying and removing themselves from the applicant pool.[4] Adding a new credit score to the mortgage market would do little to address these issues.

Thus, based on my more than 20 years of research on credit access, I am not convinced that adding a new credit score will result in any substantial improvement in homeownership opportunities.[5] In

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[1] Kenneth P. Brevoort, Philipp Grimm, Michelle Kambara (2015), "Data Point: Credit Invisibles," Consumer Financial Protection bureau, May, http://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf

[2] " VantageScore 3.0: A credit score built for predictiveness," Vantage Score, https://www.vantagescore.com/pdf/VS30-FactSheet.pdf

[3] Bai, Bing, Laurie Goodman and Jun Zhu, "Tight credit standards prevented 5.2 million mortgages between 2009 and 2014," Urban Institute, https://www.urban.org/urban-wire/tight-credit-standards-prevented-52-million-mortgages-between-2009-and-2014

[4] http://www.corelogic.com/about-us/researchtrends/housing-credit-index.aspx#

[5] I have published several studies on credit scores, documenting the advantages of automated credit scoring versus manual underwriting (Gates, Susan Wharton, Vanessa Gail Perry and Peter M. Zorn (2002), "Automated Underwriting Systems and Lending Outcomes: Good News for the Underserved?" *Housing Policy Debate,* Fall.); as well as consumer confusion about credit scores (Perry, Vanessa Gail (2008), "Where Credit is Due: The Psychology of Credit Ratings,"

fact, it is more likely that the adoption of VantageScore would simply increase the pool of consumers with poor credit scores who either could not qualify for a mortgage or would enter the subprime market. At the same time, adopting a new score would expand the already widespread level of confusion among consumers about credit scores.

Moving forward, FHFA should consider the following points of caution:

- Proposed alternative credit scores rely on the same data and thus do not differ significantly from FICO scores. VantageScore, for example, relies on the same credit repository data as FICO, but expands the pool of consumers with credit scores by scoring consumers with dormant and, in some cases, non-existent credit activity. Using VantageScores would increase the number of consumers who, because of low credit scores, would become subprime borrowers, in a market characterized by high rates and fees and the kinds of predatory practices that contributed to the mortgage crisis.

- A fundamentally and substantively improved credit scoring model would look outside existing credit repository data, and incorporate more data from telecommunications, utility, and rental payments, as well as information on remittance transfers and other kinds of online transactions. Adopting the VantageScore does not accomplish this.

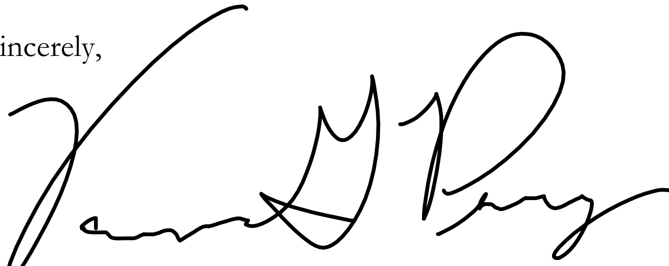
- Unnecessary changes to underwriting models can result in widespread confusion in the industry and higher costs to consumers. There is considerable evidence that consumers do not understand credit scores. Consumers are bombarded with confusing information about credit scores from credible as well as questionable sources, including information provided by the credit reporting agencies themselves that have been deemed misleading by the CFPB. Adding another credit score to the market will likely exacerbate consumer confusion, encourage 'credit score shopping,' and obfuscate the financial behaviors that render credit scores predictive.

In summary, I recommend that the FHFA choose FICO 9, the updated version of Classic FICO. Rather than introducing a new credit score to the market, industry leadership should focus on increasing affordability, lowering cost to consumers, and removing longstanding systemic barriers to homeownership.

Best of luck to you and the members of your dedicated team as you consider these alternatives.

Journal of Behavioral Finance, 9(1), 8-17; Perry, Vanessa G. (2008), "Is Ignorance Bliss? Consumer Accuracy in Judgments About Credit Ratings," *Journal of Consumer Affairs*. 42(2), Summer, 189-205; Perry, Vanessa G. (2012), "Charging Ahead: An Exploratory Study of Financial Decision-Making among Millennial Consumers," in *Consumer Knowledge and Financial Decisions: Lifespan Decisions*, Doug Lamdin, editor, Springer: New York; Perry, Vanessa G. (2014), "Consumer Decision Processes in Mortgage Markets," in *Introduction to Mortgages and Mortgage-Backed Securities*, Richard K. Green, editor: Elsevier Academic Press: San Diego, CA, 143-160.

Sincerely,



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Question A1.6: Do you have a recommendation on which option FHFA should adopt?

Based on consideration of the costs of adopting a new credit score relative to possible benefits to consumers, particularly prospective homebuyers, requiring that lenders provide a FICO score 9 is the most reasonable option, as discussed in the responses below.

Question A1.7: Do you have additional concerns with or insights to share on the Enterprises updating their credit score requirements?

VantageScore, the proposed alternative credit score, relies on the same payment data elements and thus does not differ significantly from the FICO score.[6] A fundamentally and substantively improved credit scoring model would look outside existing credit repository data, and incorporate telecommunications, utility, rental payments, remittance transfers and potentially other kinds of online transaction information. Access to credit has historically been a challenge for consumers in minority and lower-income communities due to differential access to and higher costs for financial services. Broadening the bases for credit scoring models would benefit minorities and residents of low-income communities. These consumers pay higher rates and fees for traditional financial services relative to similarly situated non-minority peers, due to risk-based pricing, redlining, and differential access to services.[7] Presumably, people who face higher payments are more likely to incur late payments, and as a result, credit scores are lower on average for minorities relative to similarly situated whites or residents of higher income areas. Finding ways to account for these disparities would be far more impactful in advancing credit scores and homeownership opportunities than the addition of another credit score to the market.

Question A2.7: What impact would any of the credit score options have on a need for consumer education? What impact would the multiple credit score options (options 2-4)

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[6] VantageScore (2016), "A Decade of Validation Demonstrates Superior Performance," https://www.vantagescore.com/resource/143/decade-validation-demonstrates-superior-performance

[7] Raphaël Charron-Chénier, Joshua J. Fink, Lisa A. Keister (2016), "Race and Consumption: Black and White Disparities in Household Spending," *Sociology of Race and Ethnicity*, Vol 3, Issue 1, pp. 50 – 67; Marion Fourcade, Kieran Healy (2013), "Classification Situations: Life-chances in the neoliberal era," *Accounting, Organizations and Society*, Volume 38, Issue 8, 2013, Pages 559-572; Stephen M. Dane (2006), "The potential for racial discrimination by homeowners insurers through the use of geographic rating territories," *Journal of Insurance Regulation* 24, (4) (Summer):,21-H; Galster, George(2006), "Do home insurance base premium-setting policies create disparate racial impacts? the case of large insurance companies in Ohio," *Journal of Insurance Regulation* 24, (4) (Summer): 7-H; Angwin, Julia, Jeff Larson, Lauren Kirchner and Surya Mattu, ProPublica, "Minority Neighborhoods Pay Higher Car Insurance Premiums Than White Areas with the Same Risk," https://www.propublica.org/article/minority-neighborhoods-higher-car-insurance-premiums-white-areas-same-risk.

have on consumers? Are there steps that FHFA, the Enterprises, or stakeholders could take that would mitigate any confusion about multiple credit score options?

According to a recent study of consumer knowledge about credit scores: "While alternative measures of creditworthiness can be extremely valuable for expanding access to high-quality credit, particularly for consumers who do not have traditional credit scores, the proliferation of scores and scoring methodologies can contribute to consumer confusion."[8]
There is considerable evidence that consumers do not understand credit scores. A Center for Financial Services Innovation study found that 14 percent of Americans don't know their credit score or know they had a credit score, and 12 percent made inaccurate estimates of their credit score.[9] A recent survey sponsored by TransUnion revealed that 45 percent of consumers mistakenly believe that rental payments affected their credit score, and 47 percent believed that credit scores capture cell phone payments.[10] Meanwhile, consumers are inundated with advice from legitimate consumer advocates and popular media sources about credit scores, as well as from any number of scam artists and non-experts.[11] A Google search and cursory review of articles on this topic from even credible sources (e.g., forbes.com; bankrate.com) revealed a plethora of vague and contradictory information available to consumers (e.g. 'manage your credit utilization,' 'leave old debt on your credit report'). It is possible that marketing messages provided by credit reporting agencies have exacerbated consumer misunderstanding about credit scores. In 2017, the CFPB fined TransUnion and Equifax for deceptive claims in which these firms "represented, directly or indirectly, expressly or impliedly, that the credit scores it marketed and sold to consumers were the same scores typically used by lenders or other commercial users for credit decisions."[12] The CFPB subsequently fined Experian for a similar practice.[13] Given the existing state of confusion about credit scores, having multiple scores in the market will only increase consumer confusion.

Many sources widely-available to consumers suggest that different credit reporting companies collect different information. Clearly, this implies that different credit score

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[8] Castillo, Nancy, Aliza Gutman, James Schintz & Rachel Schneider (2015), Consumers & Credit Scores: Understanding Consumer Confusion to Target Solutions, Center for Financial Services Innovation, June, https://www.metlife.com/assets/cao/foundation/consumers-and-credit-scores.pdf

[9] Perry, Vanessa G. (2008), "Is Ignorance Bliss? Consumer Accuracy in Judgments about Credit Ratings," *Journal of Consumer Affairs*. 42(2), Summer, 189-205.; Perry, Vanessa Gail (2008), "Where Credit is Due: The Psychology of Credit Ratings," *Journal of Behavioral Finance*, 9(1), 8-17; Zorn, Peter M. and Gailey, Adam and Courchane, Marsha, Consumer Credit Literacy: What Price Perception? *Journal of Economics and Business*, Vol. 60, Nos. 1-2, March 30, 2007.

[10] https://newsroom.transunion.com/what-actually-affects-your-credit-score--transunion-survey-reveals-consumer-confusion/

[11] https://www.ftc.gov/news-events/media-resources/consumer-finance/debt-relief-credit-repair-scams

[12] CFPB Orders TransUnion and Equifax to Pay for Deceiving Consumers in Marketing Credit Scores and Credit Products, https://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-transunion-and-equifax-pay-deceiving-consumers-marketing-credit-scores-and-credit-products; https://www.smithdebnamlaw.com/2017/01/cfpb-consent-orders-with-consumer-reporting-agencies-focus-on-marketing-practices-not-credit-reporting/

[13] O'Shea, Beverly (2017), "Cutting through consumer confusion after Experian fine," https://www.usatoday.com/story/money/personalfinance/2017/03/24/cutting-through-credit-score-confusion-after-experian-fine/99566796/

providers rely on different information as well. A google search on 'which credit score matters the most' returned over 1 million results. For example, one of the first sites to appear in a google search on the keywords 'how to improve credit score', states: "Each consumer-reporting agency operates differently. They have unique sources, methods of matching data, and lender usage patterns. Therefore, the equations adjust to account for these systemic anomalies. They output a number that is often different for the same person at each bureau."[14] Similarly, the FTC states in their consumer information materials: "Because nationwide credit reporting companies get their information from different sources, the information in your report from one company may not reflect all, or the same, information in your reports from the other two companies."[15] It stands to reason that if consumers are already confused about which of the FICO credit scores matter most, they will be even more perplexed to discover that lenders may rely on a different score all together. Thus, we cannot expect consumers to understand the nuanced and highly technical differences between these scores. What we can expect, however, is for an additional credit score to further confuse consumers about mortgage loan requirements and provide new opportunities for credit repair scam artists and others who stand to benefit from misleading consumers. The preventative solution is for mortgage market participants to agree on consistency across scoring methodologies and implementation approaches as well as clear explanatory language and messaging to lenders, consumers, investors, and other stakeholders.

Question A3.1: Given that the CRAs own VantageScore Solutions, LLC and set the price for both FICO and VantageScore credit scores, and own the data used to generate both scores, do you have concerns about competition? If so, please explain.

Adopting the Vantage Score would increase the industry's reliance on data from the credit reporting agencies, and would place VantageScore Solutions in a position to shut out any competition in the market for credit scores. In other words, these options would create a monopoly position for VantageScore Solutions. This kind of monopoly is likely to inhibit innovation, resulting in increased risks to investors and higher costs to consumers.

Question A3.2: Would allowing multiple credit scores in the mortgage underwriting process encourage new entrants into the scoring marketplace? If the requirement remains to keep a single credit score in the mortgage underwriting process what impact would this have on whether new entrants join the credit scoring marketplace?

FHFA should welcome new entrants to the credit scoring marketplace that can demonstrate a substantial improvement over existing credit scores in terms of predictive accuracy as well as market coverage. There is a general consensus among experts in the credit industry that a fundamentally improved credit score would incorporate data that is not currently collected by credit repositories. In doing so, an improved credit score could give consumers that

[14] https://www.savvyoncredit.com/credit-bureau-scores-lowest/
[15] https://www.consumer.ftc.gov/articles/0155-free-credit-reports

currently have no, thin, or stale files a fair shake at entering the mortgage market without compromising the score's ability to assess risk.

Question A3.4: If FHFA allowed the Enterprises to use multiple credit score models by adopting options 2, 3, or 4, would this competition translate into far-superior credit scoring models available to the housing finance markets? Would competition in the mortgage origination process create an incentive to incorporate more credit data for consumers with "thin files" or no credit history? How should FHFA balance these considerations with accuracy and mortgage credit risk?

A 'far-superior' credit scoring model would look outside existing credit repository data. The mortgage industry should be looking towards a radical innovation in credit scoring with benefits that would ultimately outweigh the substantial switching and other regulatory costs. For example, if credit scoring models, FICO or otherwise, were to incorporate a broader range of non-credit payment data, credit scores should be attainable for a broader segment of consumers. Proposed alternative credit scores, such as the VantageScore, rely on the same payment data elements and thus do not differ significantly from FICO scores. Looking outside the data that are currently maintained by the credit repositories would be an important shift in credit models, yet this problem would not be solved by either of the proposed options.

According to the CFPB, approximately 45 million consumers in the U.S. do not have a traditional credit score, and approximately 25 million have no score because they have no payment data on file at either of the CRAs.[16] The key policy question is the extent to which these 'credit invisibles' include a pool of creditworthy prospective mortgage borrowers that cannot qualify because they lack traditional credit profiles. These prospective borrowers may not have credit cards, mortgages, or auto loans from traditional lenders, but they are likely to pay rent, and to make payments for telecommunications services such as mobile phones, internet, or cable. Many consumers who do not rely on traditional financial services make regular remittance transfers, and there have been prior efforts to include these in credit scores.[17] There may be opportunities to serve this market segment by tracking payments made to mobile phone applications, via social media platforms and other online money transfer systems, such as PayPal. Recent trends in digital analytics have sparked interest in the use of online transaction and social media data sources in credit scores; smartphone records, including location, call and text information, are also being investigated for potential inclusion in credit scoring models. A recent pilot study sponsored by the U.S. Department of the Treasury found that deposits made to prepaid Visa accounts often mimic credit card payment behavior.[18] Thus, the addition of these and other unexplored variables could expand opportunities for consumers who currently operate outside of traditional credit markets. Although data on these kinds of transactions may

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[16] Kenneth P. Brevoort, Philipp Grimm, Michelle Kambara (2015), "Data Point: Credit Invisibles," Consumer Financial Protection bureau, May, http://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf

[17] Kenneth R. Harney, "Defying convention, HAUS makes homes for underserved Hispanic borrowers," July 22, 2007, http://articles.chicagotribune.com/2007-07-22/business/0707201211_1_fico-scores-subprime-american-mortgage-market; CFPB Report on remittance transfers, Report to the President, the Senate Committee on Banking, Housing, and Urban Affairs, and the House of Representatives Committee on Financial Services, JULY 20, 2011, https://www.consumerfinance.gov/data-research/research-reports/report-on-remittance-transfers/

[18] "Prepaid-to-Credit Pathway: Building Credit for America's Underbanked," Banking Up, TOS-14-F-0018 November 1, 2016

not currently be reported in a manner that could easily and systematically be included in credit scoring models, these are solvable problems. Clearly these data are being collected, and one way to help consumers would be to explore ethical and meaningful model improvements that leverage these kinds of data sources.

Question A3.5: Could competing credit scores in the mortgage underwriting process lead to a race to the bottom with different vendors competing for more and more customers? What steps could FHFA take to mitigate any race to the bottom?

Empirical comparisons of FICO with VantageScore have found differences in the minimum scoring criteria as well as differences in model fit and predictive accuracy, and these differences would undoubtedly result in the same consumer having different scores.[19] The proverbial 'race to the bottom' would occur as lenders find ways to adopt the credit score that is most likely to result in loan approval, i.e., the score with the lowest standard. This kind of shopping around to obtain loan approvals for high-risk borrowers is precisely the kind of practice that was largely responsible for the mortgage crisis. Lenders provided loans to borrowers with profiles that were riskier than they appeared, various stakeholders found ways to 'game' the system, and many borrowers were able to qualify for loans that they ultimately could not afford. The mortgage market is still recovering from the losses to homeowners, communities, investors and taxpayers.

Question A2.10: How would you approach evaluating when the benefits of new or multiple credit scores sufficiently exceed the costs and potential risks associated with making such a change?

An analysis of the benefits and costs of adopting an additional credit score is complicated by the widespread impact of such a change on multiple stakeholders in the short- and long-term. According to the FHFA,

> "Updating the Enterprises' credit score requirement would generate industry-wide effects among stakeholders, including impacts on mortgage applicants, mortgage lenders, mortgage insurance companies, CRAs, consumer credit reporting resellers, mortgage-backed security investors, credit risk transfer investors, and other market participants (including the Federal Housing Administration, Veterans Administration, and Rural Development). The entire mortgage finance industry will incur operational and transition costs that could result in higher borrowing costs for consumers."[20]

As such, it would be important for FHFA to consider the following questions before accepting a new credit score:

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[19] VantageScore (2016), "A Decade of Validation Demonstrates Superior Performance," https://www.vantagescore.com/resource/143/decade-validation-demonstrates-superior-performance

[20] "Credit Score Request for Input," FHFA, December 20, 2017, https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/CreditScore_RFI-2017.pdf, p.4.

1. Does the new score or multiple score approach demonstrably outperform existing scores in predicting default risk? A credit score that could more precisely predict loan performance would certainly appeal to investors and could potentially lower costs to consumers.
2. To what extent is the lack of a credit score a major impediment to homeownership versus other factors (e.g., lower demand for homeownership among Millennial consumers; high debt balances; low savings; house prices)?
3. At the same or lower risk, does this new score expand homebuying opportunities for consumers who are currently unscoreable? An expanded market would not just generate credit scores for a broader segment of the population, but would need to result in an increased pool of creditworthy borrowers.