Federal Housing Finance Agency
Office of Housing and Regulatory Policy
400 7th Street SW, 9th Floor
Washington, DC 20219

February 20, 2018

Dear Federal Housing Finance Authority,

Prosperity Now and the undersigned are pleased to submit comments to the Federal Housing Finance Agency (FHFA) regarding the Request for Information on updating the scoring models used by the Government-Sponsored Enterprises (GSEs)–Fannie Mae and Freddie Mac.

Prosperity Now is a national nonprofit organization based in Washington, DC, that creates pathways to financial stability, wealth and prosperity for all people, especially people of color and those with limited income. With insights from our research, programs on the ground and local community leaders in our network, we advocate for systems-level change through policy development, analysis and advocacy. Prosperity Now recognizes that strong consumer protections are a necessary condition to help low- and moderate-income families get ahead.

Prosperity Now is committed to continuing its support of and partnerships with our movement of advocates and practitioners working to create a path to financial stability, wealth and prosperity. The Prosperity Now Community brings together more than 24,000 practitioners, advocates and researchers across all 50 states and the District of Columbia to forge strong connections between members of our community and mobilize action to create lasting social change. The Community includes Networks that bring together peers and other experts to share information, alerts and promising practices around financial coaching, adult matched savings, community tax preparation, racial wealth equity, affordable homeownership and more. In addition, Prosperity Now identifies key leaders in communities across the country to be our partners in advancing strong and effective programs and policies at all levels of government. These partners are called Prosperity Now's Community Champions. Community Champions are state, local and native groups that coordinate a network or coalition and are committed to advancing sound policies. There are currently 77 Community Champions in 42 states and Washington, DC.

The Importance of this Update

We applaud the FHFA for deciding to update which scoring models the GSEs use for underwriting and loan purchasing. It is important to modernize the scoring models based on developments in the industry, to more accurately measure risk,

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expand credit access and help lower the costs of borrowing, particularly for lower-income households.

Fannie Mae and Freddie Mac are responsible for guaranteeing more than half the mortgages originated in this country, pumping trillions of dollars into the mortgage market. The credit scores they use strongly influence the scores used by other lenders in their underwriting, and many lenders adopt the GSEs' preferred scoring models. In short, the scoring models chosen by FHFA could have a significant effect on the credit market and the financial well-being of homebuyers and potential homebuyers across the country.

Criteria for Choosing a Scoring Model

Before presenting recommendations about which scoring model or models we think should be adopted by the GSEs, we wanted to outline a set of criteria that we think represent the foundation of a strong scoring model. The best score for the GSEs would conform to these standards.

Scoring Models that Promote Inclusivity and Greater Parity Should be Prioritized

According to the Consumer Financial Protection Bureau (CFPB), approximately 45 million people are outside the credit mainstream because they have a thin credit file or no credit file at all. Low-income families and households of color are particularly hard-hit by limited access to credit.[1] Prosperity Now's most recent *Scorecard* indicates 49% of households with credit have "subprime" scores, meaning the number of households with poor credit is significant. Like those with no credit, [2] those with poor credit are disproportionately households of color[3] and low-income families.[4]

These numbers matter because the stakes are high. Credit reports and scores play a critical role in the financial lives of consumers. Having low or nonexistent credit makes a person ineligible for affordable loan products (lower fees and interest rates, etc.), if they are offered credit at all. Scores can also influence whether someone gets a job or a place to rent. Credit Builders Alliance (CBA) estimates that, over the course of a lifetime, people with low or no credit scores could pay over $200,000 more for lending products and services than people with high scores.[5] Since low-income families are more likely than others to have compromised credit, low-income consumers who can afford high-cost products end up stuck with them.

A good scoring model is inclusive and equitable, meaning it closes this credit gap by raising or creating scores for these consumers in a way that achieves more parity across race and income. By choosing this type of scoring model, Fannie Mae and Freddie Mac could bring a considerable number of consumers into the credit mainstream, particularly low-income families and households of color. This translates to more affordable loan products for hardworking families, saving them money and increasing their financial security. A fairer and more inclusive model would also advance the GSEs' Duty to Serve program, a requirement that Fannie

Mae and Freddie Mac actively find ways to increase access to credit for low- and moderate- income families who are traditionally locked out of the financial marketplace.

Incorporating Alternative Data into the Scoring Process Would be Beneficial

In the spring of 2017, Prosperity Now submitted a comment letter to the CFPB responding to their request for information on the use of alternative data in the credit reporting and scoring process.[6] Expenses that are not usually reported to the credit bureaus are called "alternative data," and include several types of debt obligations. In the letter, we supported the inclusion of rent, utility and phone payments—which are all forms of alternative data—into the credit reporting and scoring processes. Evidence exists to indicate that reporting these payments benefits consumers without compromising the quality or accuracy of the score.

In the remainder of this section, we outline in more detail the reasons for incorporating these types of data into credit reports.

Rent Reporting History

Available evidence on the impact of reporting rent payments to credit bureaus shows they boost the scores of many households and create scores for many previously "credit-invisible" consumers, without lowering the accuracy of the score or reducing consumer safety. Results from a rent reporting pilot launched by CBA in 2012 found that approximately 80% of participants experienced an increase in their score – by an average of 27 points – and 100% of participants initially without a score (invisibles) ended up with either a high nonprime or prime score by the end of the pilot.[7] Participants in a case study of rent reporting two years later received an average credit score increase of 57 points,[8] and private sector research by Experian found that 95% of the borrowers in their rental database either saw a score increase or their score stayed the same after performing a simulation on the data, with many more receiving a boost than no change.[9]

Phone and Utility Payment History

Like rent, utility and phone bills are usually not reported to credit agencies, but there is evidence that suggests these payments also have a positive impact on scores when they are included in credit reports. Since 2005, the Policy & Economic Research Council (PERC) has examined the impact of including expenses like utility and phone payments in the reporting process, and they have consistently discovered the benefits of doing so. For example, one PERC study showed the inclusion of utility payments boosts the number of scoreable borrowers by more than 60%, while adding phone payment data lifts the number by more than 67%.[10]

Private research by Experian backs up these findings. Approximately 97% of the sample population from a 2015 study either experienced a score boost or no change when utility payments were included,[11] and a second study a year later yielded similar results.[12]

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The request for information indicates that the FHFA is not considering FICO XD because it includes data like utility, cable and phone payments that “may not be suitable for use by mortgage applicants.”

While we are not arguing that Fannie Mae and Freddie Mac consider FICO XD at this stage, we want to discourage the dismissal of scoring models that include these payment histories going forward. Existing evidence shows the benefits of considering these expenses. Moreover, for the sake of growing our body of knowledge about the effect of these payments on credit reports and scores, there would be value in the FHFA and GSEs studying their impacts further and more closely in the future.

Medical Debt Should Have Less Impact on Credit Scoring Models

While any debt can lower a credit score, medical bills are particularly dangerous because they are less predictive of creditworthiness than other forms of outstanding debt. A CFPB report released in early 2014 indicated that credit reports with mainly medical rather than non-medical debt had delinquency rates comparable to those with scores 10 points higher.[13] This misalignment means that people who are truly creditworthy may be denied access to important credit opportunities, or they receive less favorable terms that make a bigger impact on a borrower’s finances.

When you consider the number of people who are impacted by medical bills, the significance of this issue becomes clear. According to a Census Bureau Supplemental Poverty report from 2015,[14] approximately 11 million people were pushed into poverty in 2014 because of medical debt. A Centers for Disease Control & Prevention survey conducted in 2012[15] estimates that more than one in four households were saddled with burdensome medical bills. The medical debt is particularly problematic for low-income households,[16] but even insured middle-income Americans are finding it difficult to pull together enough money to deal with co-pays and deductibles.[17]

Considering this, the ideal scoring model would lower the weight given to medical bills to make them more in line with their actual predictive value.

Any Scoring Model Should be Accurate and Protect Consumers

At the same time, the inclusion of alternative data and the reweighting of medical debt does not appear to compromise accuracy and consumer protections. This is critical. Whatever score is chosen must be predictive of creditworthiness and safeguard consumers from predatory financial practices. A score that is more equitable and inclusive but erodes accuracy and consumer protections should not be adopted. The GSE mission includes a responsibility to “operate in a safe and sound manner,” and we fully support this duty. As such, the right score should strive for greater parity and comprehensiveness without eroding predictability and the need to protect consumers from harm.

The Right Balance Between Lowering Operational Burdens and Encouraging Innovation Needs to be Struck

A proper balance needs to be struck between simplicity and cost on the one hand, and competition and innovation on the other. The FHFA's Request for Information presents four potential options for updating the credit score. One would endorse the use of only one score, another would require the use of both, a third would let the lender decide which one to use (with some constraints), and the forth would allow multiple scores, where one would be selected as the priority or primary score and another as a secondary score. Requiring only one score makes the process less complex and lowers operational costs and burdens for the entities impacted by the change, but having only one lowers competition (monopolistic) and discourages innovation. Competition and meaningful innovation are extremely important, and newer, more progressive models need to be encouraged and have a realistic chance of being adopted in the future. Incorporating innovation comes with a cost, but if those costs are reasonable, newer and better scores should be implemented.

Recommendations Based on Criteria

Based on these criteria, Prosperity Now is making the following recommendations as to which scoring models the GSEs should adopt and what processes should be used to routinely re-examine these models:

FICO 9 and VantageScore 3.0 are Both Improvements Over Classic FICO, Which Should be Replaced

We think the two new scores the FHFA is considering—FICO 9 and VantageScore 3.0—are both better options than Classic FICO, which is the current scoring model used by the GSEs. As such, if the FHFA decides to replace Classic FICO with one or both scores, this would be an improvement over the status quo. These scores exclude debts in collection that are paid off, including medical debt. FICO 9 goes one step further and weighs medical debt less, to address the misalignment discussed earlier. As mentioned, medical debt is a significant problem for households in this country, and these changes alone make them better options than Classic FICO.

We are also not aware of any evidence that suggests either FICO 9 or VantageScore 3.0 are less predictive than Classic FICO, or are more harmful for consumers. The details of how these scores are tested, and the exact composition of the adopted algorithms are proprietary, for the most part. TransUnion describes FICO 9 as the "most predictive" FICO score to date, with "better risk assessment,"[18] and similar claims are made about VantageScore 3.0.[19] Moving away from Classic FICO and adopting either of these newer scores is a step in the right direction.

The GSEs Should Require the Reporting of Both Scores

Due to the lack of transparency mentioned above, Prosperity Now does not have enough information at this stage to endorse one score over the other. FICO 9

prudently recalibrates the impact of medical bills, which is welcome news, while VantageScore 3.0 states that it is a highly inclusive model that can score up to 35 million previously unscoreable consumers.[20] Both outcomes are a boon for consumers, and makes it hard to definitively endorse one over the other.

Requiring that both scores be reported (Option 2) would provide some choice and flexibility, without being overly burdensome to implement, or at least not as complex as allowing multiple scores. Ideally, the GSEs would have a system that allows the incorporation of the newest and most innovative models whenever they emerge, but political realities and needed operational changes make this challenging. We think the reporting of both scores strikes a sensible balance between providing choice and avoiding undue operational burdens. With that said, room needs to be made for innovation and competition, and our final recommendations (below) suggest ways to do this.

Moreover, we prefer this approach over letting the lender decide (Option 3), even with a time constraint that locks them into the use of one model, which is currently proposed. We think the GSEs themselves should have both scores to help them decide which loans to purchase, not the lender. This would also provide additional data on the scores themselves, which will help evaluate their safety and performance over time.

Build in Systematic Scoring Reviews

As Criteria 5 indicates, innovation and competition need to be fostered, even if some operational costs result. To make room for more progressive models, we recommend a process where every five years, the GSEs are required to re-examine the models used in their underwriting and purchasing, and send out a notice for feedback, similar to the current request. This would help determine whether there are newer models that are more equitable and inclusive—while also being predictive and safe—that should replace outdated models.

Provide a Mechanism for Early Adoption of Promising Models

At the same time, if there are innovative products that surface in between these five-year time frames, the FHFA could adopt a process that allows early review of these products. It would have to satisfy a set of criteria created by the agency that would include establishing predictive value, safety, and greater inclusivity and equity, among other requirements. If these can be shown, the model could be onboarded early. An alternative would be to launch a pilot for testing a newly vetted score. Whoever is suggesting the upgrade would need evidence and time to back the switch, which would discourage the submission of less promising models.

Conclusion

Credit scores play a very powerful role in the financial marketplace. They decide whether a person is a good risk to pay back a loan. The lower the score, the lower the trust and greater the perceived risk, which translates to higher fees and interest

rates, or more expensive products. Over time, this can drain a significant amount of money out of the pockets of those with low or nonexistent scores. That is why it is so important to get credit scoring right. The scores used by large, influential entities like the GSEs need to be equitable and inclusive, while still being predictive and safe. For example, they should be scores that do not favor those who have the money to pay for a down payment to get a mortgage rather than poorer households that can only afford to rent but faithfully pay their rent on time each month. We are excited to see the FHFA take action to upgrade GSE credit scores, and think the two models that are being considered—FICO 9 and VantageScore 3.0—are a step in the right direction. We also hope the FHFA will systematically revisit which models are used over time to make room for innovation and competition into the future. A substantial number of households could benefit from this move, and Prosperity Now and the undersigned are highly supportive of these efforts.

Sincerely,

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Prosperity Now and the undersigned organizations

Local Initiatives Support Corporation (LISC)
Unity Economic Development Corporation (MD)
Florida Alliance of Community Development Corporations, Inc.
Southwest Minnesota Housing Partnership
Belmont Housing Resources for WNY, Inc.
North Carolina Assets Alliance
Northwest Cooperative Development Center (WA)
Kalispel Tribe of Indians Victim Assistance Services (WA)
CASA of Oregon
North Carolina Coalition Against Domestic Violence
Singing Trees Wellness (MD)
Lutheran Services in Iowa
Brazos Valley Affordable Housing Corporation (TX)
Vision To Reality, LLC (TN)
War on Poverty - Florida/RAISE Florida Network
Northcountry Cooperative Foundation (MN)
Pathways Pennsylvania

Catalyst Miami
AHEAD, Inc. (NH)
Rural Dynamics, Inc. (MT)

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