HOUSING FINANCE AND REGULATORY AFFAIRS
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Federal Housing Finance Agency
Office of Housing and Regulatory Policy
400 Seventh Street, SW
9th Floor
Washington, DC 20219

RE: Credit Score Request for Input

Submitted via Electronic Delivery to: FHFA.gov

Dear Sir or Madam:

On behalf of the more than 140,000 members of the National Association of Home Builders (NAHB), I appreciate the opportunity to submit feedback in response to the Request for Input regarding a potential change to credit score requirements at Fannie Mae and Freddie Mac (the "Enterprises"). Credit scores have a considerable impact on access to and affordability of mortgage credit and NAHB believes it is appropriate for the Federal Housing Finance Agency (FHFA) to consider whether updating the current credit score model can benefit consumers while maintaining safety and soundness of the Enterprises.

NAHB is a Washington DC-based trade association representing, among others, companies involved in the development and construction of for-sale single family homes, including homes for first-time and low- and moderate-income homebuyers. The ability of the home building industry to meet the demand for housing, including addressing affordable housing needs, and contribute significantly to the nation’s economic growth is dependent on an efficiently operating housing finance system, including a robust and liquid secondary market for originated mortgage products.

Background

Since the mid-1990s when Fannie Mae and Freddie Mac first began incorporating the FICO credit score into their automated underwriting systems, credit scores have gained widespread acceptance in the mortgage industry as predictors of consumers' relative likelihood of defaulting on their mortgage payments. Named after the company that developed it, Fair Isaac Corporation, the FICO credit score plays a significant role in a consumer's ability to obtain a mortgage and in the price the consumer will pay. Though Fair Isaac has updated its modeling methodology numerous times and currently has a FICO 9 version available, the Enterprises continue to rely on the Classic FICO score they have used since 2005.

Fannie Mae and Freddie Mac's use of the FICO score has expanded considerably. Today, in addition to determining a mortgage loan's eligibility for purchase and loan level price adjustments (Fannie Mae) and delivery fees (Freddie Mac), FICO scores are disclosed to investors to inform their pricing decisions on credit risk transfer transactions and mortgage-backed securities (MBS). FICO scores also are reported in the Enterprises' quarterly and annual reports filed with the Securities and Exchange Commission and are used as an assessment factor for risk management and counterparty risk management. The financial and operations requirements established by FHFA and the Enterprises for private mortgage insurers (Private Mortgage Insurer Eligibility Requirements) call for borrower FICO scores to determine mortgage insurance pricing.

Fannie Mae's automated underwriting system, Desktop Underwriter (DU), does not incorporate the FICO score as a component of its automated risk assessment while Freddie Mac does incorporate the FICO score as a component of its Loan Product Advisor (LPA) automated credit risk assessment. Even though the Enterprises have not moved to an updated credit score model, both have enhanced their automated underwriting systems and their manual underwriting processes to incorporate components of a consumer's credit history that are not considered in the Classic FICO score. For example, Fannie Mae uses expanded information from a borrower's credit history at a trade line level (trended data) in DU and has a lengthy list of the types of nontraditional credit sources that may be used to develop a credit history for a consumer that does not have a credit score. When a credit score is unavailable to Freddie Mac's LPA, the loan still can be underwritten through the automated system and the lender is notified subsequently of the additional documentation required at delivery to show a credit history. By making these adjustments to their underwriting requirements, the Enterprises have acknowledged the limitations of the Classic FICO score in determining a creditworthy borrower.

Since FHFA's 2015 *Scorecard for Fannie Mae and Freddie Mac and Common Securitization Solutions*, the annual Scorecards have included a requirement for the Enterprises to work to increase single family mortgage credit for creditworthy borrowers, including underserved segments of the market. In 2015, this requirement specifically directed the Enterprises to "assess the feasibility of alternate credit score models and credit history in loan-decision models, including the operational and system implications to assess updated credit score models." The 2016-2018 Scorecards use similar language to call for a conclusion of the assessment and for the Enterprises to plan for implementation of a new credit score model.

In accordance with their Scorecards, the Enterprises analyzed three credit scores. Classic FICO, FICO 9 and VantageScore 3.0, were evaluated for credit score accuracy and borrower coverage and a simulated test of the Enterprises' automated underwriting system recommendations was assessed to determine whether more loans would qualify for purchase if a FICO 9 or VantageScore 3.0 score was used to evaluate the mortgage application rather than a Classic FICO score. FHFA concluded there are only marginal benefits to requiring either FICO 9 or VantageScore 3.0 rather than Classic FICO. The combination of other components of the Enterprises' automated underwriting systems not reflected in the third-party credit scores is able to provide a more precise prediction of mortgage default than the stand alone credit scores.

Though the Enterprises believe the Classic FICO score they have been using since 2005 remains a reliable predictor of default risk, advancements in credit score methodology over the past 12 years should not be ignored. All three credit scores analyzed by the Enterprises are calculated using data from the same three credit bureaus, Equifax, Experian, and Transunion, though each credit bureau evaluates the data differently to calculate the consumer's score. FICO 9 incorporates additional data from a consumer's credit report and reconsiders the treatment of certain other categories of debt to improve the predictive power of the credit score. VantageScore 3.0 uses data from trade lines in the consumer's credit report that are very new and those with no recent activity to generate a score for borrowers for whom FICO is unable to generate a score, therefore scoring more borrowers than FICO.

None of the three scores use data from "alternative" or nontraditional sources that could indicate a borrower's ability and willingness to meet financial obligations and expand the number of borrowers who can be scored. Monthly or regular payments of rent, utilities, telecom contracts, car insurance, payday loans, and even the management of checking accounts and length of time in one's residence all can help assess the creditworthiness of a consumer and can be obtained through various data providers. Payments on these financial obligations generally are not reported to the credit bureaus or are reported only when they have been reported as delinquent and would have a negative impact on a consumer's credit score. Consumers that would benefit the most from using these nontraditional credit sources to assess their creditworthiness often are first-time homebuyers, millennials, and minorities. Unfortunately, reliable credit scores using these types of financial data are not available to the mortgage industry at this time.

NAHB Comments and Recommendations

NAHB appreciates that after 12 years of using the same FICO credit score model to evaluate and price mortgage applications, FHFA has required the Enterprises to assess the potential value of replacing Classic FICO. It is past time for the Enterprises to consider the benefits of updated credit score methodology to the industry and consumers. However, NAHB believes FHFA is missing a valuable opportunity to examine the broader universe of alternative credit scores and credit score models by focusing this RFI on questions specific to FICO 9 and VantageScore 3.0 and the burden to market participants that could result from a change in credit score requirements. Rather than focusing on concerns related to implementation of new credit scores, FHFA should encourage the development of innovative credit score models that incorporate new and alternative data from sources not currently reported regularly to the three credit reporting agencies. NAHB believes the use of alternative credit data and alternative credit score models would offer mortgage opportunities to borrowers lacking access to mortgage credit due to a low, inaccurate or unavailable FICO score.

Adopt Newer Credit Score Models

There have been significant advances in credit scoring technology and methodology which could and should be incorporated into the Enterprises' systems today. Due to the considerable impact of credit scores on the availability and cost of mortgage credit, it is important to update the credit score model used by the Enterprises as soon as practical to provide the benefits of these advances to creditworthy home buyers and homeowners. Classic FICO should be replaced with an improved credit score model or models that utilize updated technology and incorporate data about financial behavior shown to be predictive of a consumer's probability of repayment of debt obligations. Adopting FICO 9 and/or VantageScore 3.0 is a good first step toward establishing a practical and transparent process to change credit score models as new methodologies are developed, validated and approved.

Allow Alternative Data

Though most nontraditional credit and payment data is not sent to the three credit bureaus, some alternative data is being collected by various sources and used by other industries. Utilities and telecom contracts are reported to the National Consumer Telecom and Utilities Exchange (NCTUE). The development of credit score models that are able to obtain data from NCTUE and collect consumer payment histories from additional sources of credit such as landlords, payday lenders, insurance companies, and banking institutions is critical to expanding mortgage credit to underserved consumers. Leadership by the Enterprises is key to such efforts. Given their influence on the mortgage market, Fannie Mae and Freddie Mac are in a prime position to incent the development of alternative credit score models that compete to be innovative, predictive and allow more consumers to be scored if they establish procedures for their credit score requirements to be updated periodically.

Establish Procedures to Update Credit Score Models in the Future

NAHB believes if FHFA requires Fannie Mae and Freddie Mac to have a predetermined process in place that requires them to evaluate new credit score models, the industry would be encouraged to create partnerships and develop innovative credit score models that utilize relevant data currently not being used effectively to support underserved consumers. New credit score models should be subject to a validation and approval process established by FHFA and should be adopted only if determined to be more predictive or able to qualify additional creditworthy borrowers.

NAHB recommends FHFA and the Enterprises establish a transparent protocol for evaluating new or updated credit score models and subsequently updating credit score requirements. NAHB suggests there should be specific indicators that would trigger future reviews of credit score models. Some options to consider for triggering evaluations of new or updated credit score models include: 1) set number of years, 2) a third-party evaluation indicates significant improvement in score accuracy and predictiveness, 3) a third-party evaluation determines a new model allows lenders to qualify an expanded number of creditworthy consumers for mortgage financing, and 4) the new model incorporates additional or alternative personal and financial data about the consumer that is not used today.

Conclusion

Thank you again for the opportunity to provide NAHB's perspective on the Enterprises' credit score requirements. If you have any questions regarding these comments, please feel free to contact Rebecca Froass, Director, Financial Institutions and Capital Markets, at 202-266-8529 or rfroass@nahb.org.

Sincerely,

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