March 30, 2018

Director Mel Watt
Federal Housing Finance Agency
Office of Housing and Regulatory Policy
400 7th St SW, 9th floor
Washington, DC 20219

Re: Request for Information on Credit Scoring

Dear Director Watt:

The Center for Responsible Lending[1] submits this letter in response to FHFA's request for input on updating the Enterprises' credit scoring models. Thank you for the opportunity to comment. Our primary concern is for Fannie Mae and Freddie Mac (the Enterprises or GSEs) to promote inclusive credit scoring models. The accuracy and integrity of the data and the resulting credit score is key, both as a risk predictor as well as to ensure that credit scoring is not preventing credit-worthy borrowers from accessing affordable mortgage credit.

Below we set out our principal concerns, including the role of minimum credit scoring, the impact of a borrower's credit score on mortgage pricing, the impact of historic mortgage discrimination on credit scoring, and the advantages to newer credit scoring models. We also set out our recommendations, including:

1) FHFA should publish data on the credit score models it tests, and

2) FHFA should approve a pilot of alternative data credit score models.

I. The Role of Minimum Scoring Criteria and How Borrowers are Affected

The estimates vary, but the CFPB estimates that 26 million Americans are "credit invisible," meaning they have no file with the major credit bureaus, and 19 million are "non-scoreable" because their credit file is too thin or stale to generate a reliable score from the credit bureaus.[2] These consumers are disproportionately African-American, Latino, low-income, or young adults.

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[1] The Center for Responsible Lending (CRL) is a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation's largest nonprofit community development financial institutions. Since 1980, Self-Help has provided over $7 billion in financing to 131,000 families, individuals and businesses under-served by traditional financial institutions. It helps drive economic development and strengthen communities by financing hundreds of homebuyers each year, as well as nonprofits, child care centers, community health facilities, public charter schools and residential and commercial real estate projects. Through its credit union network, Self-Help's two credit unions serve over 130,000 people in North Carolina, California, Illinois, Florida and Wisconsin and offers a full range of financial products and services.

[2] CFPB, Data Point: Credit Invisibles (May 2015), available at http://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf (figures are from 2010 Census).

Minimum scoring criteria is an important issue, as it impacts the universe of consumers that will be able to obtain a credit score. In order to generate a credit score, FICO requires that a consumer have at least one tradeline reported to a credit bureau within the last six months and one tradeline that is at least six months old (can be the same or separate accounts). VantageScore does not require any tradeline reported to a credit bureau and does not require a tradeline to have a minimum age. While VantageScore claims to be able to score millions more consumers than FICO because of this difference in criteria, simply scoring more people should not be an end in and of itself, particularly as data indicates that relaxing minimum scoring criteria simply results in more consumers with subprime scores. Often the information that one must rely upon to generate a credit score for someone with stale credit history includes data such as unpaid collections or public records. Generally, the data relied upon will be derogatory and will not provide a positive boost to an individual's credit score. The data also could be out-of-date and inaccurate as a result.

Furthermore, both FICO and VantageScore rely on the same repository of data when generating credit scores for mortgage lending. As FHFA states in the RFI, the three national credit reporting agencies are the only source of the consumer data used to generate the credit scores that FHFA and the Enterprises are considering. The credit bureaus are limited to information provided by furnishers. Thus, there is very little alternative data that resides in the credit bureaus, such as rental payment, utility, and telecommunications data, as such data is not often reported to the credit bureaus. In fact, the credit bureaus have utility data for only 2.4 percent of consumers and teleco data for only 2.5 percent of consumers.[3] Rental data is found on less than 1 percent of all credit bureau files.[4] *If alternative data is a significant method to provide more people with a reliable credit score, then this data will need to be pursued outside the credit bureaus.* (See Recommendation IV.B below)

II. Impact of Credit Score on Mortgage Pricing for Borrowers

While the RFI questions are focused on costs to market participants in implementing a new system, we urge FHFA to also consider the impact of how they use credit scoring on borrower access to credit. The Enterprises currently consider credit scores with respect to product availability as well as pricing. Pricing structures have a significant impact on whether a credit-worthy borrower can afford a mortgage. Furthermore, although the Enterprises' automated underwriting system permits mortgage underwriting when the borrower has no credit score, borrowers without a credit score pay much more for a mortgage.

A borrower's credit score (or lack thereof) has an enormous impact on the cost of mortgage credit. Excessive risk-based pricing by both the Enterprises and private mortgage insurers add significantly to the cost of loans for borrowers with lower scores and less wealth for a down payment. The combination of loan level price adjustments (LLPAs) and mortgage insurance

[3] Urban Institute, PowerPoint (Mar. 21, 2017), https://www.urban.org/sites/default/files/f_urban_institute_creditscoring_032017.pdf.
[4] *Id.*

premiums, for example, adds over 300 basis points to the cost of a mortgage for a borrower with a credit score of 620 and an LTV of 97%.[5]

We urge FHFA to acknowledge and reconsider the excessive weight placed on credit scores in pricing determinations. Much evidence shows that credit scores "bake in" past mortgage discrimination.[6] Indeed, existing wealth disparities rooted in previous historic federal housing policy advantaging white borrowers and disadvantaging African-Americans contributes to differences in credit scoring among racial and ethnic lines.[7] Additionally, recent abusive practices in the subprime mortgage market targeted neighborhoods of color, resulting in spillover effects that damaged the credit of many homeowners of color. As a result, borrowers of color have become a smaller share of mortgage borrowers even as their share of the population has risen, and despite a history of success in homeownership when receiving loans without risky product features.[8]

FHFA has the authority and duty to ensure the GSEs' promote broad access to mortgage credit, but this duty is undermined by FHFA's pricing requirements (e.g., LLPAs and PMIERs). If lenders may utilize the GSEs' automated underwriting system to responsibly underwrite a mortgage without a credit score, it makes little sense for the cost of credit to be so dependent on a borrower's credit score. Although ostensibly mortgage credit may be extended, credit-worthy borrowers are in effect locked out due to price.

The Fair Housing Act makes it clear that all executive departments and agencies that have programs or activities that relate to housing and community development have an affirmative obligation to promote fair housing.[9] This includes federal agencies that have regulatory or supervisory authority over financial institutions. Executive Order 12892 further requires federal agencies to affirmatively further fair housing in their programs and activities. Additionally, the Housing and Economic Recovery Act provides the FHFA director with the authority to review the GSEs' data to determine whether there are interest rate disparities on mortgages to racial minority borrowers as compared to borrowers of similar creditworthiness who are not racial minorities.[10] This provision, in the context of the affordable housing goals, indicates that FHFA should be doing more to encourage equity in the mortgage market. We concur with the discussion in the National Fair Housing Alliance's (NFHA) comment letter describing how FHFA's efforts to provide credit liquidity for underserved markets have fallen short. We urge

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[5] 350/4+225=312.5 basis points. Fannie's Mae's LLPA for this combination of credit score and LTV is a one-time fee of 350 basis points (see page 2: https://www.fanniemae.com/content/pricing/llpa-matrix.pdf); we assumed a LLPA multiple of 4 to convert this upfront fee to an ongoing cost comparable to the MI premium. Borrower paid MI from Genworth for this combination of credit score and LTV is a continuing fee of 225 basis points. See https://mortgageinsurance.genworth.com/pdfs/Rates/11370775.Monthly_Natl.FIXED.0616.pdf.

[6] National Consumer Law Center Racial Justice & Economic Opportunity Project, *Past Imperfect: How Credit Scores and Other Analytics "Bake In" and Perpetuate Past Discrimination*, (May 2016), available at https://www.nclc.org/images/pdf/credit_discrimination/Past_Imperfect050616.pdf.

[7] *Id.*

[8] UNC Center for Community Capital, Community Advantage Panel Study: Sustainable Approaches to Affordable Homeownership, http://ccc.unc.edu/contentitems/community-advantage-panel-study-sustainable-approaches-to-affordable-homeownership/.

[9] 42 U.S.C. § 808(d).

[10] 12 U.S.C. § 4561(d).

FHFA to analyze the impact of credit scores in creating lending disparities and study ways to mitigate the effect.

One of the primary ways to immediately mitigate the effect of credit scores on pricing is to eliminate the LLPAs. We also urge FHFA to consider the ways in which the PMIERs capital requirements have contributed to greater risk based pricing and differential pricing for private mortgage insurance. These new capital requirements were designed to ensure that mortgage insurers can fully pay claims as some failed this obligation during the most recent housing crisis. However, the new requirements coupled with LLPAs harm hardworking families by placing the burden of risk of a future crisis on their shoulders – despite substantial evidence that the foreclosure crisis was the result of systemic risk. Such action devastates the chances that the very families who were taxpayers and rescued the failing system can participate in the system today and in the future.

III. Newer Credit Scoring Models Provide for Increased Accuracy and Benefits to Borrowers

Aside from fundamental changes to pricing policy, FHFA and the GSEs should focus on ways to improve access to credit in a reliable manner – including using updated credit score models. Several helpful changes have been implemented in newer versions of the credit score models, namely the treatment of unpaid medical collections (versus unpaid non-medical collections) and the exclusion of paid third-party collections from the score calculation. Newer credit score models likely will continue to make adjustments that increase accuracy as well as increase benefits to borrowers. FHFA concludes that that the Enterprises' empirical findings reveal only marginal benefits to requiring a different credit score than Classic FICO, *i.e*., the Enterprises' automated underwriting system more precisely predicts mortgage defaults than a third-party credit score alone. However, FHFA acknowledges that the updated scoring models provide "a slight increase in accuracy, which would ultimately benefit borrowers and investors." Indeed, the improved treatment of medical debt is a game changer between Classic FICO and FICO 9. We concur with the discussion about medical debt in the National Consumer Law Center's comment letter. We encourage FHFA to use credit score models that lessen the impact of medical debt, particularly as the CFPB found that "[c]redit scoring models that differentiate medical collections from other collections are likely to more accurately reflect the actual creditworthiness of consumers."[11] Using an updated model that incorporates these changes may significantly increase a borrower's credit score and affect whether the borrower qualifies for a GSE-backed loan. Moreover, given the pricing models, even a slight increase in score could result in significant savings to a borrower.

[11] Consumer Financial Protection Bureau, Consumer Credit Reports: A Study of Medical and Non-Medical Collections 5 (Dec. 11, 2014), available at https://files.consumerfinance.gov/f/201412_cfpb_reports_consumer-credit-medical-and-non-medical-collections.pdf.

IV. Recommendations

A. FHFA Should Publish Data on the Credit Score Models It Tests

FHFA states that the Enterprises tested Classic FICO, FICO 9 and VantageScore 3.0 on their own portfolios. We encourage FHFA and the Enterprises to release data so the public may understand and assess the impact, accuracy, and predictability of credit scores in the mortgage underwriting process. This data may also be helpful when developing alternative data products.

B. FHFA Should Approve a Pilot of Alternative Data Credit Scoring Models

Historic racial discrimination created pervasive and long-lasting consequences. As NFHA describes in their comment letter, we have a dual credit market. We concur with their comment letter stating that FHFA's empirical evaluation is insufficient and should be expanded. Credit scores tend to "bake in" mortgage discrimination and unfortunately, despite some improvements, current credit scoring models do not adequately serve today's credit market. These models disqualify many first-time homebuyers with thinner credit files – disproportionately communities of color who are likely to constitute a significant share of future potential homeowners. Expanding the use of alternative credit scoring models is a critical element to reverse declines in homeownership, particularly for low- and moderate-income communities and communities of color.

The approximately 19 million "non-scoreable" consumers are the individuals that alternative data may be able to reach. We believe products like FICO XD could provide a useful and reliable alternative data score. FICO XD uses data from specialty consumer reporting agencies, such as the National Consumer Telecom and Utilities Exchange, to provide a score for otherwise non-scoreable consumers. Thus far, FICO XD has only been utilized by bankcard issuers, not in mortgage lending. However, we urge FHFA to consider a pilot using FICO XD (and similar products that may emerge) to provide a credit score for mortgage lending. FICO XD and similar products that utilize alternative data could provide a substitute score that could reliably score more consumers and responsibly open up the credit box. Still, we caution FHFA to continuously monitor any alternative credit score models to ensure these models do not perpetuate the racial disparities of traditional credit scoring models.

V. Conclusion

Credit scores have an enormous impact on borrowers' ability to access affordable mortgage credit. In its review of whether to adopt an updated credit score model, FHFA should also consider the impact of credit scoring in general on mortgage pricing for borrowers. We urge FHFA to publish data on the credit score models it tests. We also urge FHFA to continuously tests the models for potential racial disparities. Furthermore, FHFA must look at data outside the major credit bureaus to generate a reliable alternative credit score, and should pilot test new models, such as FICO XD in the mortgage lending context.