Experian
475 Anton Boulevard
Costa Mesa, CA 92626

March 30, 2018

The Honorable Mel Watt
Director
Federal Housing Finance Agency
Office of Housing and Regulatory Policy
400 7th Street, S.W.
9th Floor
Washington, DC 20219

RE: Request for Input on Fannie Mae and Freddie Mac Credit Score Requirements

Dear Director Watt:

Experian Information Solutions, Inc., on behalf of itself and its affiliated entities (together, "Experian"), is pleased to submit this response to the Federal Housing Finance Agency's ("FHFA") request for information ("RFI") regarding credit scores.[1]

In our comments, we address two issues raised by FHFA in its RFI. First, we assert that the GSEs should be requiring and using models that reflect current and important changes in consumer credit behavior, market conditions, and data assets maintained by participants in the credit reporting system. FHFA should also ensure that the updated scoring models allow for competition in the marketplace. The models used and required by Fannie and Freddie were developed in the late 1990s and do not reflect important updates, which we outline more fully later in our comments. FHFA should require GSEs to adopt a governance program for reviewing and adopting new or updated models.

Second, Experian acknowledges that the processes supporting mortgage underwriting will continue to evolve as mortgage lenders innovate in the areas of speeding underwriting decisions and reducing underwriting costs. One specific topic of consideration is whether the current underwriting environment that relies on a tri-merge bureau report can be supported with two or a single bureau report. Regardless of how this topic evolves, Experian will remain sharply focused on delivering the most comprehensive and accurate data to mortgage lenders.

I. Credit scoring models required and used by Fannie Mae and Freddie Mac should be updated to ensure they are current and relevant

A. Existing score models used and required by the GSEs are outdated and do not reflect current and important changes in consumer credit behavior, market conditions, and data assets maintained by participants in the credit reporting system.

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[1] https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/CreditScore_RFI-2017.pdf (Dec. 20, 2017).

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Experian applauds the FHFA's decision to move forward with an RFI in an effort to better understand the potential benefits and challenges of GSEs updating credit scoring models that are both more current and more relevant. As the RFI notes, the GSEs currently require mortgage lenders to underwrite loans using the Classic FICO[2] version of the FICO credit score model. The Classic FICO was a market leader in the 1990s when it was developed, but it does not reflect learning gained by observing consumer and economic behavior that have shifted during the past twenty years or assessment of additional (new types of) data elements added to the credit bureau files during this time. Experian believes that the FHFA should require mortgage lenders to use newer versions of credit scoring models that incorporate more recent data, new scoring algorithms/technology and advanced analytic processes. In addition to moving to more current and relevant scoring models, Experian believes it is critical for FHFA to consider the positive impact that could be achieved if the policy objective of competition could be brought to the credit scoring environment within the mortgage marketplace. VantageScore LLC has submitted robust comments, with which Experian concurs, on the issue of competition, and we ask that FHFA fully consider VantageScore's opinion on this topic.

Consumer financial behavior and the financial services market have changed considerably since the late 1990s. For example, the Classic FICO version does not incorporate analytics and learning from the 2007 economic recession relating to consumer "strategic default" behavior that was associated with the housing market collapse. In the immediate aftermath of the housing bubble bursting, home prices across the country plummeted and millions of Americans found they owed more on their mortgage than their home was worth. What had once been a reliable, safe investment had now turned into a dragging liability on their family budget, severely impacting their cash flow. Some consumers who found themselves in this position decided to stop paying their mortgage loans, even though they likely had the means to do so. By engaging in "strategic default" consumers made the decision to re-prioritize payments on their debt obligations. Mortgage payments, traditionally the first priority, fell to a lower priority as consumers made auto and credit card payments a higher priority in order to maintain access to their car for transportation and to ensure that they can continue to use a credit card for electronic payment.[3]

The Classic FICO models also do not recognize changes occurring as a result of predictive analytics and software introduced recently by FinTech service providers for assessing creditworthiness. In just the past few years, the emergence of new lending models, primarily

[2] The GSEs use Equifax Beacon® 5.0 (1998 to 2000), Experian/ Fair Isaac Risk Model v2 (1995 to 1997) and FICO Classic 04 from TransUnion (1998 to 2000). These scores are collectively referred to as "Classic FICO."
[3] https://www.experian.com/assets/decision-analytics/reports/strategic-default-report-1-2009.pdf

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delivered to consumers over the Internet or a mobile device, have empowered consumers with an array of new credit options. Lenders have used these processes to bring new and faster means of credit underwriting to the marketplace in the areas of student loans, automobile loans, personal loans, mortgages and credit cards. To remain competitive, many big banks are also taking advantage of the enhanced technology that allows for advanced analytic options to be incorporated into their decisioning processes. The new FinTech market represents both a shift in consumer behavior and advances in technology that were not present when Classic FICO was developed.

Data maintained by nationwide credit bureaus has also changed since the Classic FICO score was developed. These changes have forced recalibration of scoring models used by most lenders, and these changes should also be reflected in scoring models used by the GSEs.

All three major credit bureaus have made several enhancements to their data assets in the last 20 years. Specifically, at Experian, trended data was introduced in 2001 and throughout the years new data fields were made available to credit scoring models. Some examples of new data fields include enhanced type codes that provide more detail on account types such as the ability to distinguish a flexible spending card from a traditional credit card, original creditor classification code which allows a collection agency account to be identified as a medical collection, and actual payment amount which provide the ability to understand if a consumer is paying down their full balance on credit cards or if the consumer is paying additional principal on their installment loans such as mortgage accounts.

In March 2015, Experian, Equifax and Trans Union announced an agreement, the National Consumer Assistance Plan (NCAP), as part of cooperative work with a group of state Attorneys General. The effort was aimed at enhancing the accuracy of consumer information and improving consumers' ability to manage their credit reports with the nationwide consumer reporting agencies. Since the announcement, a series of mandatory updates to data reporting and collections procedures have been announced and implemented. The NCAP required furnishers to use the Metro 2 format and prohibited the inclusion of medical debt on a consumer's credit file until the debt is at least 180 days old. The NCAP agreement also eliminated the reporting of debts that do not arise from a contract for agreement by consumers to pay, such as parking tickets. NCAP also included enhancements to the consumer dispute resolution process that helped to make it easier for consumers to address potential errors. The three nationwide bureaus also agreed to improve the sharing of data to improve accuracy, this includes items such as deceased indicators, death notices and mixed files. In a continuation of their work on NCAP, on July 1, 2017, the nationwide consumer reporting agencies announced that they would enact new standards for the inclusion of tax liens and civil judgments on a consumer's credit file.

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Finally, the Classic FICO score does not use more advanced modeling methods like machine learning and big data analytics. Several financial institutions as well as modeling vendors are using gradient boosted trees and random forests in their modeling process. These machine learning techniques are providing significant predictive lift in many areas. The main uses seen today are in the generation of new more predictive attributes for use in credit scores and as a new modeling methodology to generate new credit scores.

Taken together, these changes in strategic default, the advent of FinTech, the NCAP agreement's impact on data assets, and advances in machine learning and data analytics demonstrate significant evolution in consumer behavior, the marketplace and the credit reporting system since the development of the Classic FICO model. Newer scoring models are more reflective of these shifts in the consumer credit ecosystem in a way that allows for lenders to better assess and manage credit risk. As a result, the GSEs should update their mortgage underwriting guidance to allow for the use of these newer scoring models that are more current and relevant than the Classic FICO score used today

B. FHFA should require the GSEs to establish a clear review process for scoring models and a mechanism for updating scores as appropriate.

The GSEs should establish a clear process for routinely reviewing the effectiveness of a model and develop a mechanism for updating models, as appropriate. This process and mechanism will be necessary, regardless of which scoring model/models mortgage lenders use in the future, as required by future GSE policy. There are several scoring models in the marketplace that are more current and relevant to use when assessing an individual's eligibility for a mortgage. Regardless of which score or scores are designated by the GSEs for future use, Experian urges adoption of a program in line with the OCC's Model Risk Governance Guidance. Such a program would allow for innovation that can benefit consumers, lenders and the economy.

A process similar to OCC's April 2011 Model Risk Governance Bulletin[4] and similar relevant guidance and documents asserts that "effective validation helps ensure that models are sound" and "identifies potential limitations and assumptions, and assesses their possible impact." In their Bulletin, OCC recommends that validation activities should continue on an ongoing basis after a model goes into use. Further, OCC suggests that there is a periodic review — at least annually, but more frequently if warranted — to determine whether the model is working as intended. The OCC states that "effective model validation helps reduce model risk by identifying

[4] https://www.occ.treas.gov/news-issuances/bulletins/2011/bulletin-2011-12a.pdf

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model errors, corrective actions, and appropriate use." Again, the OCC has made clear that it expects that the institutions it regulates follow the model review and validation procedures outlined in the 2011 Bulletin. Therefore, the GSEs should develop a system for reviewing and validating models, as well as a clear mechanism for making changes to the model allowed to account for changes in learning and data over time.

It is critical that the GSEs ensure that any review process for the credit scoring models consider potential systemic risk impacts. Properly validated credit scoring models are an effective and integral tool to ensure that both the GSEs and lenders have a complete and full picture of credit risk across their entire mortgage portfolio. If the GSEs were to continue to rely upon outdated credit score models it could present substantial risks to industry, their regulators, consumers and the larger economy. Using relevant and current credit score models provides for greater predictability given the expanded data available, improved analytics and the fact that they would incorporate learning from the 2007 recession. To that end, the GSEs could be confident that their model validation process is properly accounting for operational and credit risk. Moreover, a clear review process and mechanism for change would also allow for greater competition in the score model marketplace. By requiring a process for change and review process, the GSEs would in effect be incentivized to ensure that the models they were requiring for mortgage underwriting were continuing to evolve with consumer behavior and other macro-economic trends.

C. Current and relevant scoring models are beneficial to consumers

In addition to improving the ability of lenders and GSEs to better assess credit risk, more current and relevant credit scoring models would provide benefits to consumers. Current scoring models score more consumers and more properly assess the credit risk of consumers who are on the cusp of qualifying for a loan. Also, consumers are more aware of their credit scores and the fact that there are different scores. Consumers can even see their scores regularly through services provided by many different companies including Experian.

The CFPB has estimated that more than 45 million American consumers are "credit invisible" meaning that they either have no traditional credit file or one that does not have enough information to allow them to be scored by automated underwriting systems, like those currently used by the GSEs. Research by the developers of leading score models has shown that the use of newer and more relevant scoring models could help reduce the number of consumers that are deemed credit invisible. As an example, VantageScore LLC has said that its new scoring model

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could score an additional 30-35 million consumers who were previously unscoreable[5]. These changes are reflective of two significant updates since the Classic FICO score was developed.

First, newer scoring models can more easily incorporate alternative credit data sources, like rental data, that would allow for more consumers to be scored. Both FICO 9.0 and VantageScore 3.0 incorporate rental payment data into their scoring model analysis, when the information is available on a consumer's credit report. In a July 2014 study[6], Experian found that, on average, consumers who had rental data added to their file saw a lift of 29 points in their VantageScore 3.0 score. In addition, 19 percent of consumers previously considered subprime migrated to at least one less risky risk segment. It also showed enormous potential for helping consumers that either have a thin-file or no-hit credit file. Following the addition of the positive rental tradelines, Experian was able to generate a score for 100 percent of the previously no-hit consumer files in the study population. In addition, 23 percent of thin-file consumers migrated to the thick-file category with three or more tradelines on file.

In addition to the inclusion of more data sources, newer scoring models have incorporated advanced analytic techniques that helps to either score consumers that were previously unscoreable, or that provides a more accurate score that allows for them to more responsibly access credit. For example, new scoring models, like VantageScore 4.0, include the ability to analyze trended data. The inclusion of trended data allows for an analysis of traditional trade line information in a time series to understand a consumer's credit behaviors and payment patterns over time. This provides lenders with the ability to better understand that while a consumer may have debt or issues in the past, they are making payments on-time, for more than the minimum amount and gradually improving their credit standing. Newer credit scoring models also have more nuanced treatment of certain derogatory data included on a consumer's credit file. For example, the most recent versions of credit models treat medical debt differently than non-medical debt.

Congress has recognized the value that credit score competition would bring to consumers and the economy. As passed by the Senate on March 14, S. 2155, the Economic Growth, Regulatory Relief and Consumer Protection Act, includes a provision by which Fannie Mae and Freddie Mac would develop a mechanism to validate and approve new scoring models used for mortgage underwriting.

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[5] https://www.vantagescore.com/scores-more-people
[6] http://www.experian.com/rentbureau/credit-for-renting.html?WT.srch=PR_CIS_CreditforRenting_20140729_pressrelease_Report

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II. Experian supports efforts by FHFA and the mortgage lending industry to better understand the environment for three-bureau reports.

A. Experian support efforts to understand whether tri-merge is necessary in the future, the alternatives and how the transition may occur

Experian recognizes that mortgage lenders are currently attempting to reduce underwriting costs and, therefore, to understand whether the requirement to pull a tri-merge report should be considered at some time in the future. As the FHFA points out in the RFI, non-mortgage lenders — such as card issuers and auto lenders — do not typically use three bureau reports to underwrite loans. We are supportive of the mortgage lending industry's attempts to research whether tri-merge reports are necessary and what potential impacts this change could have on the ability of lenders to properly assess credit risk and ensure a safe and sound mortgage industry.

B. Experian will continue to focus our efforts on delivering the best, highest quality data to mortgage lenders so they can ensure they are properly assessing risk.

As the need for a tri-merge report is assessed, Experian will remain focused on delivering the best, highest quality data to mortgage lenders. We believe that our work to boost the inclusion of alternative data sources and to continually strive to improve data quality will ensure that our credit reports will serve mortgage lenders' needs — whether it is through a single credit report, two reports or a tri-merge.

Experian has a long history of advocating for and using alternative credit data to help lenders make better lending decisions. Extensive research has shown that there is an immense opportunity to facilitate greater access to fair and affordable credit for underserved consumers through the inclusion of on-time telecommunications, utility and rental data in credit files.

As an example, Experian currently incorporates on-time rental payment data furnished through RentBureau[7] into Experian consumer credit reports and makes this information available to all entities that have a permissible purpose to obtain a credit report. Experian's RentBureau receives updated rental payment data every 24 hours from property management companies and electronic rent payment processors across the nation. Experian is also engaged in extensive outreach with utility and telecommunications companies to encourage them to begin reporting

[7] http://www.experian.com/rentbureau/rental-payment.html

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positive data. For the most part, these entities primarily only report negative data to the nationwide consumer reporting agencies. We are convinced of the consumer benefits that would be derived if these furnishers would fully participate in the credit reporting system. Many consumers have a proven track record of paying their telephone and utility bills on time. These on-time payments are predictive of creditworthiness and consumers should be given credit for responsibly paying their bills and not just be judged only on derogatory data.

In addition, Experian is on the leading edge of helping to harness and utilize consumer-permissioned account aggregation services that provide access to financial account data. In 2017, Experian entered into a partnership with Finicity® to develop new tools that will make it easier for consumers to apply for a loan and accelerate loan underwriting. The tools are used for consumer authentication, verification of income and assets, and cash flow analysis. They will also help to improve accuracy and reduce fraud risk for lenders, thereby broadening access to loans. The inclusion of this data will give consumers the opportunity to secure mortgages and other types of loans with less paperwork and hassle by connecting with financial institutions digitally. While this information is in limited use in credit risk analyses for consumer lending today, we believe that consumer-permissioned account aggregation platforms will provide an opportunity to collect and analyze recurring payment information relevant to lenders. For example, consumer-permissioned data from a consumer's bank account could demonstrate the individual's payment history for utilities and telecommunications services, as well as for monthly rent.

Most important, Experian has been and will continue to be an industry leader in data accuracy and data quality. We have developed a Business Intelligence practice that is solely dedicated to the production of sophisticated analytics and effective programs to support data accuracy management. We also invest heavily in systems to provide visibility to our data furnishers about the quality of the data they report to us, and have applied a relentless mindset toward continual improvement of data reporting standards. The system has enabled us to consult with data furnishers to reconcile errors when a failed record occurs. Our data furnisher monitoring program, includes monthly review of data furnishers against a series of standards and triggers remediation efforts to address problems. This includes efforts to bolster dispute handling by furnishers, improve fraud detection and alert furnishers of potential late submissions of data. Our work does not only impact Experian credit reports, but benefits the entire ecosystem of credit reporting.

Our data accuracy team has also developed the Accuracy Indicator Rate, which monitors conditions that may be associated with credit reporting errors. This program has been praised by our clients and regulators alike for demonstrating not only thought leadership but producing actual

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results in reducing conditions associated with errors. The program has seen tangible results with an increase in our overall Accuracy Indicator Rate to 99.6%, which is up 1.5 points since we first began the program. Our data accuracy program has also led to a reduction in non-updated trades by 93%, which has yielded significant improvement in our accuracy indicator.

CONCLUSION

Experian commends the FHFA's decision to seek comments from stakeholders on an array of matters related to the credit scoring models currently used by Fannie Mae and Freddie Mac. As we outline in our comments, we believe that the GSEs must update their underwriting requirements to allow for the use of more current and relevant credit scoring models. Newer models take into account significant changes in consumer behavior, the marketplace and credit reporting since the Classic FICO score was developed twenty years ago. Further, FHFA should consider the need for greater competition in the credit risk model marketplace and we ask that FHFA fully consider the comments, with which we concur, submitted by VantageScore. Experian also believes it is critical that the GSEs implement a clear model review process and a mechanism for updates as necessary. Experian is supportive of efforts by the mortgage lending industry and the GSEs to understand whether a tri-merge report will be necessary in the future. No matter what the mortgage industry decides about the need for a tri-merge report, Experian will continue to focus on delivering the most comprehensive, accurate credit data to lenders to ensure they are properly assessing credit risk. This includes seeking out new alternative data sources and continuing to implement an enterprise wide data accuracy and quality program.

Sincerely,

Alex Lintner
President
Experian Credit Information Services