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

Re: Credit Score Request for Input

Dear Sir or Madam:

On behalf of the American Bankers Association (ABA), I am pleased to offer comments on the Request for Input on credit scores used by Fannie Mae and Freddie Mac (the Enterprises, or GSEs) requested by the Federal Housing Finance Agency (FHFA).

The ABA welcomes the FHFA's examination of the credit score requirements used by the GSEs. Credit scores have become an integral part of the lending process and are key to loan origination and underwriting. As such, they have a significant impact on borrowers' ability to get a loan, on a lender's ability to appropriately underwrite a loan, and on an investor's willingness to purchase a loan, as well as other impacts across the lending and servicing spectrum. It is essential that credit scoring methods be accurate, predictive, fair, and treat all borrowers equitably. The GSEs have been using Classic FICO as the sole credit scoring mechanism for over a decade. It is appropriate and necessary that FHFA engage in an examination of credit scores to ensure that the GSEs are using the best scoring mechanisms available in terms of qualifying eligible borrowers, ensuring predictive and reliable underwriting and protecting taxpayers. ABA has a strong interest in credit scoring mechanisms which qualify the largest number of eligible borrowers in a reliable, predictive, empirically derived, and statistically sound manner as our members' business models depend upon making quality loans to all eligible borrowers with the ability to repay those loans.

There are a number of considerations which must be carefully and thoughtfully addressed as FHFA undertakes this process. Because of the integral role played by credit scores, any changes must be weighed carefully and undertaken with the recognition that changes will have, potentially, far-reaching consequences for all participants in the mortgage lending process. With those considerations in mind, we are pleased to offer the following comments and answers to some of the specific questions posed in the Request for Input.

General Questions on Credit Scores

Question A1.4

How would mortgage lenders and investors manage different credit score requirements from primary and secondary mortgage market participants? Is it important for your business processes that government guarantee programs in the primary mortgage market (e.g. FHA, VA, USDA-Rural Development) have the same credit score requirements as the Enterprises?

Generally our members engaged in mortgage lending would strongly desire standardized credit scoring, especially with regard to government guarantee programs across all agencies providing access to a government guarantee or insurance. Many lenders want flexibility in loan delivery, so it is important that loans not have to meet widely varying standards for different channels into which it may be sold. As credit scores have become an essential part of loan underwriting, it would be costly both to the lender and borrower to have to pay for and use multiple credit scores to maintain that flexibility. Further, the required credit score required by Fannie Mae and Freddie Mac has become the default standardized score used in loan underwriting, even for lenders who may not sell loans, but instead, hold the loan in portfolio. Multiple scores required from different agencies would complicate the loan origination process in ways that could lead to increased costs for lenders and borrowers, which, in turn, could harm borrowers by reducing the number of qualified borrowers. Further, different requirements from different agencies could lead to potential fair lending concerns for lenders. Additionally, as FHFA noted in the RFI, the cost associated with credit score changes (and requirements for multiple scores) may impact banks and non-banks differently, as federally insured banks have to comply with prudential supervisory guidance on model risk management while non-banks do not face the same supervisory oversight. The potential for multiple score requirements across different agencies would only add to the un-level playing field banks might face compared to non-banks.

Question A1.6

Do you have a recommendation on which option FHFA should adopt?

The FHFA lays out four options which they indicate they are evaluating. These are:

Option 1 – Single Score: The Enterprises would require delivery of a single score – either FICO 9 or VantgageScore 3.0 – if available on every loan.

Option 2 – Require Both: The Enterprises would require delivery of both scores, FICO 9 and VantageScore 3.0, if available on every loan.

Option 3 – Lender Choice on which Score to Deliver, with Constraints: The Enterprises would allow lenders to deliver loans with either FICO 9 or VantageScore 3.0, when available. Lenders would have to choose one score or the other for a defined period of time (e.g. no less than 12 months).

Option 4 – Waterfall: The Enterprises would allow for delivery of multiple scores(s) through a waterfall approach that would establish a primary credit score and secondary credit score. Where a borrower did not have a credit score under the primary credit score, a lender would have the option to provide the secondary credit score.

At the outset it is important to note that ABA is not endorsing either FICO 9 or VantageScore 3.0, nor any other possible credit scoring model. The analysis of these models and their algorithms is beyond the scope of our research. Indeed, we see it as the proper role of FHFA as both regulator and conservator of Fannie Mae and Freddie Mac to engage in the considerable research, analysis, and evaluation necessary to determine the efficacy of each model and its desirability as a requirement for loan purchases by the Enterprises. Our comments are limited only to the likely impacts and concerns addressed or raised by the options presented, and are premised upon the assumption that FHFA will engage in the research, testing and other necessary work to ensure that any credit score model or models adopted by the agency will be appropriately predictive of default, based upon empirical, scientifically derived data, and score all potential borrowers equitably.

Of the four options presented, Option 1 – Single Score, is the most desirable from a lender standpoint. This is the most cost effective and simplest option. Ideally the single score would be adopted across all government guarantee providers. Under this option, lenders would be obligated only to gather (and pay for) a single score which would be acceptable for underwriting for loans sold to Fannie Mae, Freddie Mac, and if adopted by other agencies such as FHA, and USDA for any government guaranteed loan. We note that this option is closest to the existing requirement to gather a Classic FICO credit score, so it would also likely be the least disruptive of the options presented from an implementation and training standpoint.

Option 2 – Require Both, is not an attractive option for lenders, as it will increase costs for lenders and borrowers. Lenders would be required to gather and pay for both scores, and incorporate both into their underwriting. Given that FICO 9 and Vantage Score 3.0 are not readily comparable scores (e.g. a 700 FICO 9 score is not the same as a 700 VantageScore 3.0 score), this further complicates underwriting and increases cost. These increased costs almost certainly will be passed along to borrowers, likely making this a less attractive option from a borrower standpoint as well. Further, requiring both scores is complicated by the fact that some borrowers may not be scorable under both systems. This raises questions, which FHFA acknowledges in the RFI, about how underwriting by the GSEs would deal with loans on which only one score was available.

Option 3 – Lender Choice on Which Score to Deliver, appears to offer flexibility, but also raises a number of concerns. One of these, the potential for a "race to the bottom" is partially addressed by the FHFA in the RFI, in part, by proposing that a lender would have to choose which score to use, and lock that choice in for a set time, to avoid lenders using the "best" readily available score to qualify more borrowers, regardless of other potential risk factors. A "race to the bottom" is certainly a concern, especially in regards to mortgage brokers or other originators who may lack sufficient capital to back up any recourse on loans sold to the Enterprises, which later default. While we generally believe this concern would be less applicable to insured depositories, who would have the capital to back any potential loan recourse or put backs in any event, it remains a public policy concern in that it could lead to gaming of the system, even with a score lock time requirement in place.

There are further concerns with this approach from a lender standpoint. One of these is the potential for fair lending liability when a lender uses one model over another. Potentially if one model is shown (or even alleged) to score certain protected classes better than another model, a lender using the “less favorable” model could face fair lending litigation, even if that model was considered to be more predictive of default. Such concerns could force lenders to “choose” to use both models – again increasing costs to lenders and borrowers alike – or even driving lenders seeking to avoid fair lending litigation from mortgage lending entirely. Certainly, there are ways for the FHFA to address at least some of these concerns further. For example, FHFA could, in consultation with the Consumer Financial Protection Bureau (CFPB) and other regulators, establish that no fair lending claim could be pursued solely based upon a lender using one approved credit score model over another approved credit score model. While this and other steps can be taken to mitigate any concerns raised by Option 3, it remains less attractive than Option 1, the single score model. While “lender choice” may generally be viewed as desirable from a lender perspective, too many choices, absent the tools to properly evaluate and test any given choices, do not benefit most lenders. Instead, especially as it concerns standards required for sale to a third party, it may be more desirable to have a single, well-tested and proven model.

Option 4 – Waterfall, is perhaps the least attractive option. This option carries with it all of the additional costs associated with Option 2, the potential for a “race to the bottom” if not managed correctly (e.g. if lenders were able to switch which score was primary or secondary), and at least some of the potential for increased liability as Option 3.

Operational Questions on Credit Scores

Question A2.2

How significant are the operational considerations for a single score update?

As noted above, the adoption of a single, updated score is the least costly and disruptive approach. However, that does not mean that there are not significant operational considerations that must be addressed, no matter which option is chosen. The process which FHFA undertakes to select any future required credit score or scores will have far-reaching consequences. Even a fairly simple and straightforward “update” from Classic FICO to FICO 9 will involve significant changes to systems and forms, and will require staff training. All of the proposed options create implementation costs, and the more complex the options, the more costly the implementation. Those costs increase dramatically if multiple scores are introduced. If multiple scores are to be made available (or required), the number of systems and form changes increases, the staff training is compounded, and potential liability increases.

One significant operational concern for any update to the credit scoring model requirements is the impact on required lender disclosures. Under the combined Truth in Lending and Real Estate Settlement Procedures Act disclosures, lenders must disclose to the borrower certain information on credit scores used. A revision to a single new requirement will require updating of the processes involved in creating this disclosure, but a revised method involving multiple or a waterfall of scores (as contemplated in Options 2, 3, and 4) would significantly complicate the disclosures required of lenders.

A further consideration that must be acknowledged is the potential harm to lenders, the GSEs and ultimately taxpayers, if the scoring model, or models chosen by FHFA is flawed or otherwise results in unanticipated or otherwise harmful impacts to mortgage lending underwriting. The potential for a "race to the bottom" described by FHFA in the RFI is one possible negative outcome but there are others that may or may not be easily predicted and avoided. Because credit scores are so integral to the underwriting process, any flaw could be harmful across the spectrum of mortgage market participants - including borrowers who can just as easily be harmed by a too permissive credit score model that allows them to take on more credit than they can manage.

We raise this issue to reinforce to FHFA the vitally important role they are undertaking with regard to credit score analysis and approval. It is essential that any credit scoring model or models which are adopted are appropriately predictive of a borrower's credit behavior in all economic cycles and are shown to accurately gauge the creditworthiness of all potential borrowers. Again, we reiterate that we are not advocating for or against any specific scoring model. FHFA has the tools and the responsibility to engage in a rigorous, comprehensive and equitable vetting process before moving forward. This will likely take significant testing before a final decision is made. This testing may require "real world" testing, working on a voluntary basis with lenders to determine the impact of a change or changes on their ability to qualify borrowers and predict repayment behavior through different economic cycles. As a side note, we would observe that both FICO 9 and VantageScore 3.0 have been developed largely during a period of economic recovery and generally improving credit conditions. It would seem wise to engage in further testing of these models, and at the very least, simulating other economic conditions before making final decisions. Once a decision is made, FHFA should seek to provide lenders doing business with Fannie Mae and Freddie Mac a predictable timetable for any further changes to credit score requirements. Finally, we note that while the RFI presents options involving FICO 9 and VantageScore 3.0, it is possible and perhaps even likely that other scoring models will be developed and seek to enter the marketplace. As part of the current process FHFA might develop and articulate standards for evaluating both the current credit scoring models as well as any that may be developed in the future.

Question A2.9

Because credit score models are not interchangeable, what issues or challenges would you face if the Enterprises were to have different eligibility or pricing based on the credit score version? What implementation hurdles might exist? How would the differences in pricing be perceived by borrowers?

The challenges presented by different eligibility or pricing based upon different credit score versions would likely be very problematic from a borrower perception standpoint. Because borrowers have little to no control over which scoring method is used to score them – or even over whether they have a score from one or another scoring model, pricing or eligibility based upon the model used is likely to raise significant concern and potentially litigation from borrowers. If Fannie and Freddie continue to use Loan Level Pricing Adjustments, the impact of different credit scores would be even more pronounced and could lead to different pricing for borrowers based upon the model used, an outcome that would likely be very confusing and troubling to borrowers. Lenders, having the direct contact with the borrower, would bear the brunt of borrower dissatisfaction or ire. Whether such disparate pricing or eligibility would result in litigation we will not predict, but we observe that anything that makes such litigation more likely should be avoided.

Questions on Credit Score Competition

Question A3.3

What would be the benefits of lender choice if the number of qualified borrowers remained unchanged or changed only modestly from the credit score you are using today in underwriting borrowers for loans sold to the Enterprises?

We see little benefit to lender choice of a credit score model or even a change from the existing Classic FICO, if the number of qualified borrowers remains unchanged by adoption of a new model or models. Lenders have a strong interest in qualifying the largest number of eligible borrowers possible, but a change which does not increase the number of eligible qualified borrowers, only increases costs for lenders and borrowers alike, potentially hurting borrowers who will bear at least some of the costs associated with any changes in scoring model requirements. Conceivably a new model might better reflect risks of delinquency and default without qualifying more borrowers, but that result seems unlikely.

Questions on Merged Credit Reports

Question B1

If the requirement to pull data from all three credit agencies were replaced with the flexibility to pull data from just two CRAs or one CRA, what could be the benefits or disadvantages to borrower and your business? What could be the benefits or disadvantages to the credit reporting industry and the mortgage industry in general?

We would generally support providing lenders with the flexibility to pull data from just two, or even one credit reporting agency, under certain circumstances.

Many borrowers have chosen to place "freezes" on their credit scores in reaction to various breaches. These freezes can complicate the mortgage origination process by slowing lenders' ability to pull all three credit reports. For this reason we would support flexibility which would allow a lender to pull data from only two or even one CRA under certain circumstances. We recognize that it will be necessary for reasonable limits on the waiver of the tri-merge requirements to ensure that the necessary information is available to adequately underwrite and "score" a borrower. Further, we note that there are efforts underway to allow for a more streamlined process for a borrower to "unfreeze" a credit report for specific purposes, which may alleviate the need for this flexibility. However, if those efforts are not successful or prove to still create bottlenecks or other hurdles to the mortgage underwriting process, we do urge the FHFA to explore greater flexibility in the tri-merge requirement.

Further, we would urge the FHFA to consider allowing flexibility in not just the pulling of information, but also in the reporting of information to the three bureaus. The recent Equifax breach exposed millions of borrowers' credit information and left them vulnerable to potential, ongoing exposure of information until the breach issues were solved. During that time period, lenders were placed in an awkward position of continuing to report credit information on borrowers to an entity that had failed to protect that information. Recognizing that there may be Fair Credit Reporting Act or other considerations that must be addressed before allowing a lender to not report information, we nevertheless believe that under certain, specific circumstances, (such as a borrower request to withhold information from a specific CRA for an articulated reason), such flexibility may serve the privacy and identity protection interests of borrowers. If flexibility can be granted in this area in a manner that does not undermine the quality and content of credit information used to score a borrower, it should be allowed.

Conclusion

Credit scores have become an essential part of the underwriting process. Because they play such an important role in qualifying borrowers for mortgage loans, ABA welcomes the FHFA's effort to review the credit score requirements for the GSEs. It is in borrowers' and lenders' interests that the scoring models used are fair, equitable and reliably predictive so that the greatest number of eligible borrowers can be served. It is vital that the scoring models be empirically derived, scientifically based, and accurately predictive of default to protect borrowers, lenders, investors and taxpayers. As the regulator of the GSEs the FHFA plays an important role in evaluating different credit scoring models which exist or become available, and in setting the standards required by the GSEs for loan purchases. Many lenders will rely on these requirements for their own underwriting whether they sell to the GSEs or not. The evaluation process must be thorough and transparent, and must take into account the significant costs that will result from changes to the credit scoring process, and seek to minimize those costs where possible, while still ensuring that any model or models required are reliable and fair. One way to minimize those costs, which we strongly urge, is the adoption of a single credit scoring model for not only GSE eligible loans, but all loans guaranteed or insured through federal programs. We anticipate that this is only the beginning of a long, complicated process and we stand ready to engage with the FHFA, the GSEs and other industry and government stakeholders to advance this important work. If you have questions or would like to discuss any of these issues in more detail, please contact the undersigned at 202-663-5480 or JPigg@aba.com.

Sincerely,

Joseph Pigg
Sr. Vice President and Sr. Counsel
American Bankers Association