March 21, 2019

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 Seventh Street SW, 8th floor
Washington, DC 20219

Re: FHFA Proposed Rule on Credit Scoring Models, RIN 2590-AA98

Dear Mr. Pollard:

The Center for Responsible Lending[1] submits this letter in response to FHFA's proposed rule on the validation and approval of credit score models. The proposed rule is aimed at implementing Section 310 of Pub. L. 115–174 to establish requirements for the validation and approval of third-party credit score models by Fannie Mae and Freddie Mac (the Enterprises). However, we understand FHFA and the Enterprises have been exploring related credit score model issues for years, and that the proposed rule is informed by FHFA's prior Request for Input as well as other research. Our primary concern is for Fannie Mae and Freddie Mac to promote inclusive credit scoring models, which was the major theme of our earlier response to the RFI. CRL is focused on ensuring that a credit-worthy borrower's credit score does not prevent them from accessing affordable and safe mortgage credit. Thus, our comments focus on how the proposed rule would help or hinder this result, both substantively and procedurally.

Below we set out our principal concerns, including: the impact of historic mortgage discrimination on credit scoring and the need for newer and alternative models; the barriers the proposed rule erects on new market participants; the pilot program; the impact of a borrower's credit score on mortgage pricing; and the proposed rule's fair lending provisions. We also set out our recommendations, including:

1) FHFA should promote the use of alternative data in order to encourage inclusive credit scoring models as well as competition between data providers and the credit reporting agencies.
2) FHFA and the Enterprises should reduce barriers on new market participants, particularly for the pilot.

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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.

3) FHFA and the Enterprises should eliminate the loan level price adjustments.
4) FHFA should strengthen the proposed rule's fair lending provisions.

I. FHFA Should Promote Alternative and Inclusive Credit Score Models as One Method to Combat the Legacy of Discrimination

The proposed rule provides FHFA the opportunity to set out a process that encourages alternative and inclusive credit score models. As detailed in the National Fair Housing Alliance's article on the discriminatory effects of credit scoring systems on communities of color, historic racial discrimination created pervasive and long-lasting consequences, including a dual credit market.[2] In the dual market, white and wealthier borrowers have access to mainstream credit while people of color and low-income families are limited to fringe financial services providers. Laws to limit racial discrimination were not enacted until the Civil Rights Acts of the 1960s. Moreover, most of those protections have never been fully enforced.

Prior to the enactment of the nation's anti-discrimination laws, government and private industry explicitly penalized borrowers for their race and ethnicity by unfairly using those characteristics as a factor to assess risk. People of color and homes in neighborhoods that were predominantly communities of color were deemed as riskier simply because they were nonwhite. These policies created situations where many families and communities of color were excluded from mainstream affordable credit based on now-protected characteristics, including race and national origin. This exclusion had generational impacts that still contribute to a racial wealth gap today.

Moreover, as credit scoring systems developed through the 1990s, they penalized borrowers who had anything other than mainstream credit. Because many of the factors that make up credit scoring systems rely on a dual credit market and its inherent racial discrimination, credit scoring contributes to the self-perpetuating cycle of restricted access to safe and affordable credit that has a dramatic disparate impact on communities of color.

Indeed, credit scores tend to "bake in" mortgage discrimination and unfortunately, despite some improvements, current credit scoring models disadvantage borrowers of color and do not adequately serve today's credit market. These models disqualify many first-time homebuyers with thinner credit files – disproportionately people of color who are likely to constitute a significant share of future potential homeowners. 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.[3] These consumers are disproportionately African-American, Latino, low-income, or young adults. Expanding the use of alternative credit

[2] Lisa Rice and Deidre Swesnick, Discriminatory Effects of Credit Scoring on Communities of Color, National Fair Housing Alliance (2012), available at https://nationalfairhousing.org/wp-content/uploads/2017/04/NFHA-credit-scoring-paper-for-Suffolk-NCLC-symposium-submitted-to-Suffolk-Law.pdf
[3] CFPB, Data Point: Credit Invisibles (May 2015), available at https://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf (figures are from 2010 Census).

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 alternative products could provide a useful and reliable credit score using data from specialty consumer reporting agencies, such as the National Consumer Telecom and Utilities Exchange. Products utilizing alternative data could provide a substitute score that could reliably score more consumers and responsibly open up the credit box. Furthermore, there are advanced analytical techniques that can utilize numerous data sources, *e.g*., cash flow analysis. These methods of analysis may capture a wider segment of the market.

Additionally, the major credit score providers in the marketplace today rely on the same repository of consumer data: the three national credit reporting agencies. 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 history, 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 telecommunications data for only 2.5 percent of consumers.[4] Rental data is found on less than 1 percent of all credit bureau files.[5] 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. And new credit scoring models that use this data must be developed and validated to ensure that future models are able to accurately and inclusively score a larger portion of the population. FHFA's proposed pilot program is an important way to advance this goal.

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

FHFA and the Enterprises 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. As the Enterprises still utilize credit scores in product eligibility and pricing, newer credit scoring models have the potential to responsibly expand the credit box and permit credit-worthy borrowers to qualify for more sustainable products and pay less for their mortgage.

For example, the improved treatment of medical debt is a game changer between older and newer models. We encourage FHFA to approve credit score models that lessen the impact of

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

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."[6] 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 Enterprises' pricing models, even a slight increase in score could result in significant savings to a borrower.

II. The Proposed Rule Imposes Too Many Barriers on New Entrants

Considering the importance of using updated and new credit scoring models, and the legislative aim to create credit score competition, we are disappointed that the proposed rule erects excessive barriers on new market entrants. The likely result of the proposed rule will be the status quo. While we understand that the process must be robust and ensure accuracy, reliability, and integrity of the credit score model, the rule will make it difficult for new models to gain approval. The biggest barrier is that the Enterprise Business Assessment subjects applicants to unlimited costs and the assessment has no scope limits. In addition to or instead of an upfront application fee, the proposed rule would permit the Enterprises to assess applicants for the costs associated with acquiring third party data and credit scores. It is unlikely that companies will apply for approval without some reasonable limitations on costs. Furthermore, although we understand that it takes time for the Enterprises and industry to adjust to changes, every seven years is too long of a timeframe to accept applications. Model and data improvements occur far more frequently. FHFA and the Enterprises should encourage innovation and competition in credit score models. Maintaining the status quo for seven years does not promote either goal.

III. Pilot

In our response to FHFA's Request for Input on credit scoring, CRL urged FHFA to approve a pilot of alternative data credit scoring models. We are pleased to see a pilot as part of the proposed rule. It is true, as FHFA notes, that limiting applications to credit score models that have been used to make credit decisions (and therefore have performance data), would impede innovation and potential market acceptance of new credit score models. We urge FHFA to establish a pilot program that does not impose unlimited costs on applicants. Furthermore, we encourage FHFA to accept applications for pilot tests on a more frequent basis, such as every three years. Additionally, if alternative credit model pilots were approved, 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. Lastly, to encourage transparency, it would be extremely useful for FHFA to keep the public apprised of new pilots and share results in its annual reporting to Congress.

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[6] 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. FHFA Should Lessen the Impact of Credit Score on Mortgage Pricing for Borrowers

We urge FHFA to again consider the impact of how the Enterprises use credit scoring on borrower access to credit and the excessive weight placed on credit scores for the purpose of determining the price of a mortgage. 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 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%.[7]

We urge FHFA to acknowledge and reconsider the outsized role of credit scores in determining mortgage pricing. Much evidence shows that credit scores "bake in" past mortgage discrimination.[8] 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.[9] Additionally, recent abusive practices in the subprime mortgage market targeted neighborhoods of color, resulting in spillover effects that cost those communities $1 trillion in wealth to families living in proximity to foreclosure that ultimately damaged the credit of many homeowners of color.[10] 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.[11]

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[7] 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.

[8] 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.

[9] *Id.*

[10] Debbie Gruenstein Bocian, Peter Smith and Wei Li, *Collateral Damage: The Spillover Costs of Foreclosures*, Center for Responsible Lending (October 2012), at 2, available at http://www.responsiblelending.org/mortgage-lending/research-analysis/collateral-damage.pdf.

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

FHFA has the authority and duty to ensure the Enterprises promote broad access to safe and affordable mortgage credit, but this duty is undermined by FHFA's pricing requirements (e.g., LLPAs and PMIERs) and the disproportionate impact of credit scores in this context. If lenders may utilize the Enterprises' 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. We urge 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 and compounded greater risk based pricing and differential pricing for private mortgage insurance. These 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.

V. Fair Lending Certification

We are pleased that FHFA included fair lending considerations in the proposed rule, but believe the FHFA should be more explicit in its requirements to protect against discrimination in lending. As discussed in section I above, access to fair credit is a major problem and traditional credit scoring models present fair lending concerns. As part of the credit score assessment process, the proposed rule would require each applicant to provide a certification that no characteristic that is based directly on or is highly correlated solely with a prohibited classification was used to develop the model or used as a factor in the model. Each application must address compliance of the credit score model and credit scores produced by it with federal fair lending requirements, including any fair lending testing and evaluation of the model. As written, there is no requirement that the credit score model undergo fair lending testing, only that information on such testing be included in the application if it exists. Thus, the proposed rule creates a disincentive for companies to complete this testing. CRL recommends that the regulation explicitly require that the credit score model undergo fair lending testing and evaluation prior to submission.

Furthermore, as part of the accuracy testing requirement, the proposed rule states that the Enterprise must test accuracy on subgroups of loans. We recommend that FHFA conduct fair lending testing as part of the accuracy testing, not solely as a separate process in the later Enterprise Business Assessment.

The Enterprise Business Assessment requires an evaluation of the fair lending risk and fair lending impact of the credit score model in accordance with the Fair Housing Act, Equal Credit Opportunity Act, and Safety and Soundness Act. We urge FHFA to require the fair lending assessment to go beyond traditional fair lending risk and compliance testing to consider whether the credit score model has the potential to promote access to safe and affordable mortgage credit for creditworthy applicants across all protected classifications. Moreover, the Enterprises should be required to evaluate whether the credit score model has a disparate impact.

VI. Unaddressed Issues

Finally, the proposed rule leaves open-ended several important issues. For instance, the proposed rule does not address how approved scores will be implemented. In addition, the proposed rule is silent on how market participants should proceed if multiple credit scores are validated and approved. The Enterprises have the option to stop using a previously approved credit score model, with no obligation or liability of any kind. They can also “retire” an approved model and replace it with a new model. These decisions are likely to create consumer and industry confusion if they are done without proper notice and process.

VII. Conclusion

We urge FHFA to finalize a rule that helps ensure the Enterprises promote inclusive credit scoring models and support access to safe and affordable mortgage credit. Thus, we recommend that FHFA use this rulemaking to encourage the use of alternative data; reduce barriers on new credit score model applicants, particularly for the pilot program; and strengthen the proposed rule’s fair lending provisions. Thank you again for the opportunity to comment.

Sincerely,

Center for Responsible Lending