Housing Finance & Regulatory Affairs
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Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA98
Federal Housing Finance Agency
Eighth Floor
400 Seventh Street, SW
Washington, DC 20219

RE: Validation and Approval of Credit Score Models (RIN 2590-AA98)

Submitted via Electronic Delivery to: FHFA.gov

Dear Mr. Pollard:

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 Comment regarding the Federal Housing Finance Agency's (FHFA) proposed rule on the validation and approval process of credit score models for use by 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 FHFA to consider alternative processes in the selection of credit score models that can most effectively benefit consumers while maintaining the 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

The Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018

The proposed rule implements Section 310 of *The Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018.* Section 310 includes requirements for the validation and approval of third party credit score models by Fannie Mae and Freddie Mac. While the law does not require an Enterprise to use third party credit scores as part of its business operations or purchase decisions, it does provide that if an Enterprise elects to condition the purchase of a mortgage loan on the provision of a borrower's credit score, that credit score must be produced by a model that has been validated and approved.

The law requires FHFA to first issue regulations establishing standards and criteria for the validation and approval of credit score models by the Enterprises. Each Enterprise must then publish a description of a validation and approval process that it will use to evaluate applications from credit score model developers, consistent with the standards and criteria established by FHFA regulation. As per Section 310, Fannie Mae and Freddie Mac must consider several factors in the validation and approval process, including the credit score model's integrity, reliability and accuracy, its historical record of predicting borrower credit behaviors (such as default), and consistency of any model with Enterprise safety and soundness.

Specifics of Proposed Rule

The proposed rule would establish a four-phase validation and approval process: (1) Solicitation of applications from credit score model developers, (2) an initial review of submitted applications, (3) Credit Score Assessment, and (4) Enterprise Business Assessment. In addition, the proposed rule would set the minimum standards and criteria for each step in the process.

As part of the solicitation phase of the process, each Enterprise would publish a Credit Score Solicitation that would include a specific time period during which the Enterprise would accept applications from credit score model developers. The published solicitation would include a description of the information that must be submitted with the application, instructions for submitting the application, a description of the Enterprise process for obtaining data for testing including a description of the Enterprise's process and criteria for conducting a Credit Score and Enterprise Business Assessment; along with other content as determined by an Enterprise.

As part of the application review phase of the process, an Enterprise would determine whether each application submitted by a credit score model developer is complete and could request additional information if necessary. An application would be complete only after the Enterprise has received all required fees and information and an Enterprise would not be obligated to conduct an assessment of a credit score model if the application is not completed within the timeframes in this proposed rule.

During the Credit Score Assessment phase of the process, each credit score model would be assessed for accuracy, reliability and integrity, independent of the use of the credit score in the Enterprise's systems, as well as any other requirements established by the Enterprise. A credit score model must pass the Credit Score Assessment to be reviewed by an Enterprise during the Business Assessment phase. Each Enterprise would conduct this assessment phase independently for each application.

During an Enterprise Business Assessment phase, which is the fourth and final phase of the process, the Enterprise must assess the accuracy and reliability of credit scores used within the Enterprise's systems and the possible impacts on fair lending and impact on the Enterprise's operations and risk management. An Enterprise also must consider impacts on the mortgage finance industry, assess competitive effects, conduct a third party vendor review, and perform any other evaluations established by the Enterprise as part of the Enterprise Business Assessment. The Credit Score Assessment and Enterprise Business Assessment steps may not necessarily happen sequentially. However, in order for a credit score model to be approved for use, the credit score model would have to pass both a Credit Score Assessment and an Enterprise Business Assessment.

The proposed rule would also require that an Enterprise update its credit score requirements to reflect the outcome of the validation and approval process. However, the proposed rule does not address how an Enterprise's credit score requirements would be updated should a new credit score model be approved. FHFA would provide direction outside of the final rule, but consistent with statutory obligations, on the implementation of approved credit score model(s), including the timeframe for the Enterprises to transition from one credit score to another score or scores.

The proposed rule would allow the FHFA periodically to require the Enterprises to solicit applications from credit score model developers and includes specific timing and notifications the Enterprises would be required to meet. An Enterprise would not be allowed to approve an application received outside of the periodic solicitations required by FHFA. However, the proposed rule would allow FHFA to approve pilot programs for the use of credit scores.

NAHB Comments and Recommendations

Support for the Requirement to Consider New Credit Score Models

The mortgage industry is dynamic in nature and relies heavily upon technology to accurately assess a borrower's creditworthiness. As technology continues to improve and the availability of data continues to increase, the mortgage industry is often presented with opportunities to improve the processes for more accurately underwriting aspiring home buyers. Updating and improving scoring models at the Enterprises has been under consideration for some time with little movement. NAHB is pleased that the Enterprises are being required to seek new and improved ways to identify credit models that best meet the needs of borrowers.

Support for Pilot Scoring Models

Pilot programs often provide a platform to try a completely different approach to solving traditional problems and may yield the most effective solutions.

NAHB appreciates that the FHFA has raised the possibility that the Enterprises may use credit score pilots to assess a credit score model that has not yet achieved a performance history that meets the proposed validation and approval standards. We believe certain requirements in the proposed rule could preclude the newest, and perhaps most innovative, credit score models from being submitted for consideration under the proposal. Pilot programs that would allow for the testing of new credit score models that lack usage by the industry would offer new entrants an opportunity to demonstrate a model's performance and possibly compete under the requirements for full review and validation in the future. For example, the Enterprises could conduct a pilot program on a subset of borrowers that did not have a credit score and were manually underwritten by the Enterprises to assess how well a new credit score model predicts the propensity of these borrowers to repay their mortgages.

The requirements for implementing a pilot program should be significantly less restrictive and time intensive than the proposal's requirements and could help the Enterprises determine what to look for when soliciting and reviewing credit score model applications. Allowing this approach may inspire developers to "think out of the box" in terms of updating and improving their technology to more effectively assess a borrower's credit worthiness.

Allow Alternative Data

Both Fannie Mae and Freddie Mac use automated underwriting systems (AUS) and have updated their systems in recent years to process loans for borrowers who lack a credit score. NAHB believes that the ability of an Enterprise AUS to assess borrowers who lack a credit score by utilizing alternative data should be strongly considered by FHFA and taken into consideration in future credit scoring models used by the Enterprises. The Consumer Financial Protection Bureau (CFPB) estimates that forty-five million Americans, or 20 percent of the population are either "credit invisible," meaning they have no credit history with any of the three nationwide credit reporting agencies, Equifax, Transunion or Experian, or are "unscorable," meaning their credit history has little or no recent activity.[1] Exploring the potential of a credit score that uses alternative data could be a criterion for approving a limited pilot program.

As mentioned in our March 30, 2018 comment letter in response to FHFA's credit score request for input (RFI), while most non-traditional credit and payment data is not reported 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. This alternative data that is being collected presents an excellent opportunity for the Enterprises to demonstrate their leadership in innovation and modernization to better serve creditworthy aspiring homeowners.

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 by establishing procedures for their credit score requirements to be updated periodically.

Monitor Impact on Uniform Mortgage-Backed Security

NAHB recently responded to FHFA's proposed rule to require Fannie Mae and Freddie Mac to align programs, policies and practices to support the successful adoption of the Uniform Mortgage-Backed Security (UMBS), the Enterprises' effort to create a single TBA-eligible security that will eliminate trading differences between Freddie Mac and Fannie Mae MBS. In the letter, NAHB expressed support for the UMBS and stated that NAHB agrees with the widely-accepted sentiment that it will be key to the success of the UMBS for the market to trust there is a transparent process in place to ensure new products or changes to existing products will be aligned within the Enterprises.

The proposed validation and approval of credit score models within the Enterprises does not appear to meet the general parameters for alignment as recommended in the UMBS proposed rule. As proposed, the process for evaluation, validation and approval of new credit score models would take place separately at each Enterprise with no coordination between them. This could possibly result in each Enterprise reviewing applications from different credit score models and further result in each Enterprise reaching different conclusions about which credit score models are approved for use.

Even though the Enterprises may use credit scores differently within some of their business operations, they always have used the same credit score model. NAHB is concerned that if the Enterprises begin to use different credit score models to assess the creditworthiness of borrowers, there is risk that there could be a divergence in the performance of loans collateralizing their MBS, causing prepayment speeds to differ in the UMBS. This could result in investors stipulating a preference for a Fannie Mae or a

[1] The CFPB Office of Research, Data Point: Credit Invisibles May 2015, Page 6

Freddie Mac security, undermining the goals of the UMBS, which are enhanced market liquidity and pricing parity between the Enterprises' MBS.

NAHB recommends the Enterprises work together or engage a third party to undertake the Credit Score Assessment for completed applications submitted for review. Applicants would apply to a joint solicitation and following a joint credit score assessment of each eligible model, each Enterprise would conduct its own Enterprise Business Assessment on the models that pass the credit score assessment. An approved and validated credit score model would be implemented by both Enterprises.

Evaluate Trended Credit Data

NAHB believes another important factor that should be considered in the proposed credit score model approval and validation process is the use of trended credit data. Existing scoring models merely take a “snapshot” of a borrower’s credit at any given moment in time, which tells the lender only part of the story. For example, two borrowers can have the same credit score, but one borrower’s score may be improving while another borrower’s score may be in decline. In situations like these, it could be helpful for lenders to know the whole story. In order to accomplish this, lenders could require the ability to leverage trended data to assess a consumer’s credit behavior over time. By analyzing historical payment information, lenders can determine if a consumer is consistently paying more than the minimum payment, has a demonstrated ability to pay and shows no signs of payment stress. Trended data also can identify if a consumer is making only minimum payments and has increasing payment stress.

In September 2016, Fannie Mae announced the release of Desktop Underwriter (DU) Version 10.0. Fannie Mae’s DU 10.0 is unique in that it allows lenders to use trended credit data for an enhanced credit risk assessment. According to Fannie Mae, the use of trended credit data will give borrowers greater ability to control their credit evaluation and will benefit borrowers who regularly pay off, or pay more than the minimum required amount of their revolving debt, thereby increasing the likelihood that they will receive an “Approve” recommendation from DU.[2]

Insight in to how a consumer uses credit, or pays back debt over time, could help lenders offer the right products and terms and to identify profitable consumers, avoid those with payment stress and limit loss exposure. Using a consumer’s historical payment information could provide a more accurate assessment of future behavior, which in turn could help effectively manage changes in risk and provides additional insight for additional lending strategies. NAHB recommends that FHFA and the Enterprises evaluate the ability of trended credit data to predict borrower behavior and consider whether this should be a required component of an approved credit score model to potentially allow more “unscorable” or “credit invisible” borrowers to qualify for a mortgage.

Conclusion

Thank you for your consideration of NAHB’s comments. NAHB looks forward to working with FHFA, the Enterprises, and all housing market participants to promote a safe and sound lending environment.

[2] “Fannie Mae Enhances Its Industry-Leading Automated Underwriting Tool,” Pete Bakel, September 26, 2016

Please contact Curtis Milton, NAHB's Director of Single Family Finance (email: cmilton@nahb.org or phone: 202-266-8597) if you have any questions about this letter.

Sincerely,

Jessica R Lynch

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