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March 21, 2019

Alfred M. Pollard, Esq.
General Counsel
Federal Housing Finance Agency
Eighth Floor
400 Seventh Street, SW
Washington, DC 20219

RE: RIN 2590–AA98: Validation and Approval of Credit Score Models by Fannie Mae and Freddie Mac

Dear Mr. Pollard:

The undersigned Bankers Associations are pleased to submit the following comments pursuant to the *Federal Register* notice of proposed rulemaking dated December 21, 2018, implementing Section 310 of the *Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018* (Pub. L. 115–174).[1] The Proposed Rule would establish a framework for the housing Government Sponsored Enterprises (GSEs) to consider consumer credit scoring models in addition to the FICO score now serving as the current GSE and industry-wide standard.

The Proposed Rule is mandated by Section 310 of the Economic Growth, Regulatory Relief and Consumer Protection Act, one of the major accomplishments of the 115th Congress. In 2017, when the FHFA issued a Request for Information (RFI) on possible changes to the GSE's credit scoring practices,[2] the response of the banking industry was all but unanimous in urging either extreme caution or expressing outright opposition. As the current Proposed Rule appropriately notes: a "central theme from RFI respondents was that the operational challenges of implementing a multi-credit score approach would outweigh any benefits."[3]

Chief among these operational challenges are the costs that would result from having to integrate a new, more-complex, and ongoing government-directed credit scoring system, and the resulting impact of those increased costs on the borrower's ability to afford a mortgage. For this reason, it is essential that a comprehensive cost-benefit analysis be done as a part of this process.

The American Bankers Association raised such concerns in response to the RFI and we are unaware of any market developments altering these previously indicated industry views.

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[1] Codified at 12 U.S.C. § 1454(d).

[2] https://www.fhfa.gov/media/publicaffairs/publicaffairsdocuments/creditscore_rfi-2017.pdf.

[3] 83 Fed Reg. 65575, 65577 (Dec. 21, 2018).

As discussed in further detail below, our general view is that the major provisions of the Proposed Rule are well-balanced and crafted as necessary to comport with the underlying statute. The current system relying upon FICO credit scoring has been in place for over 30 years and has performed very well in terms of its most important aspect, namely serving as a reliable indicator of loan performance. Over the course of the recent mortgage crisis, FICO scores remained a dependable source of objective data while other underwriting tools such as loan-to-value and debt-to-income ratios misrepresented credit quality, especially in the non-bank lending sector.

Claims are now being advanced that "alternative credit scoring models" could qualify millions of additional mortgage borrowers as contrasted with current industry standards.[4] The basis for this appears to be the potential inclusion of individuals with sparse, inactive or even no credit history at all.[5] Qualifying eligible borrowers is an important public policy goal, and one which the banking industry strongly supports, but it is not accomplished best by lowering standards to promote additional scoring outcomes. That actual result is much more likely to simply increase the number of consumers with credit scores that are effectively lower, and who might then be deemed subprime borrowers subject to the higher rates and fees, which were widely viewed as contributory to the mortgage crisis. We support the development of predictable, reliable alternative models that can score borrowers even thosewho have spare or limited credit history. If such models can be developed they must be tested and implemented in an orderly process that does not add unnecessary costs for borrowers or pose undue risks for lenders or borrowers.

A more positive approach and a market development already underway is the utilization of data sources traditionally outside the scope of payment histories monitored by the credit reporting agencies. These include telephone and cable bills, rent payments and other indicators of an individual's reliable financial performance.

Another more recently announced initiative toward the goal of expanding credit availability through measured means is the incorporation of bank data into existing credit scoring algorithms to create broader credit scoring input factors.[6] While not intended as a substitute for the traditional credit score, under this approach, consumers would have an option to contribute records of positive checking account practices and other asset information to supplement their current scores. For these reasons, we support §1254.11 of the Proposed Rule allowing the adoption of pilot programs that can promote continued innovation in the credit decision-making marketplace.

Experience from the last mortgage crisis convincingly demonstrated that stretching borrower qualifications has very real downside ramifications to borrowers, lenders and the public at large. A very apt analogy is the credit rating "shopping," which has been widely recognized as a leading contributor to the collapse of the private-label MBS market in 2007-08.

For these reasons it is especially important to cautiously proceed, both as to the FHFA designation of a credit scoring assessment process and any set implementation period for industry to effectively comply. The Proposed Rule properly noted industry concern in the feedback to the

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[4] "VantageScore 4.0 2015-2017 Validation Study," p.2 (June, 2018).

[5] *Id.* at p.6.

[6] "Why Your FICO Score Could Get a Boost in 2019," Wall Street Journal (Oct. 21, 2018).

RFI, which recommended a phase-in period of approximately 18-24 months as necessary for industry to adapt to a new credit scoring system.[7]

Further analysis, in light of the many additional factors discussed at length in the Proposed Rule, demonstrates that the adoption of multiple alternative credit scoring models is even more complicated than earlier examination. The first step will have to be the complex business judgment as to whether a given bank would want to assimilate alternative scoring models just for its mortgage originations intended for sale to the GSEs or across its full lending program. That issue, of course, turns on what options the third-party computer program vendors, which will be necessary in almost all situations, plan to offer and what the pricing parameters will be.

Upon completion of the initial rulemaking, there are indeed two distinct execution periods: (1) Outside program vendors will have to develop and market their compliant product range and (2) user banks will need time to select and assimilate any new program into their existing systems. In this context, the previously suggested 18-24-month preparation period strikes us as being on the short side. In addition, this will, of course, be an ongoing process as new credit scoring companies may seek designation. For this reason, we also support §1254.5 of the Proposed Rule and would suggest that it be a minimum of seven years between renewal periods.

In general, our principal concern regarding this entire process is that the additional costs factored into the mortgage origination process (i.e. new systems, employee training, record keeping, etc.) will become just one more factor driving community banks out of the mortgage origination business. We have already seen how increased liability, narrow margins, and a vastly expanded regulatory environment have driven many community banks from mortgage lending.

There is also the inevitable confusion from the use of a different system which incorporates, as is now the case, the same numeric parameters as FICO. Section 1254.7(b)(4) would allow the GSEs to establish additional criteria for purposes of assessing credit score models, but a better approach would be further specification that new models be distinct so as not to be confusing to either consumers or industry users.

The Proposed Rule also leaves open the question of potential variances or other lack of alignment between the two GSEs in terms of their validation and approval outcomes.[8] This would, in and of itself, be an immensely complicating factor for nearly all mortgage market participants from primary market providers across the spectrum to secondary market investors.

Section 1254.6 sets forth a fair lending certification that any credit scoring model and the credit scores it produces comply with "federal fair lending requirements."[9] This requirement is appropriate, but must recognize that federal fair lending requirements are in a considerable state of flux. Since the Department of Housing and Urban Development initially finalized its 2013 rule

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[7] 83 Fed. Reg. 65588.

[8] 83 Fed. Reg. 65578.

[9] 83 Fed. Reg. at 65590.

implementing the Fair Housing Act's disparate impact standard,[10] several Supreme Court cases have been decided by way of delimiting that rule. These include, in 2015, *Texas Department of Housing and Community Affairs v. The Inclusive Communities Project, Inc.,*[11] and, in 2017, *Bank of America Corp. et al. v. City of Miami*.[12]

As a consequence of these more recent cases, HUD has already initiated an Advance Notice of Proposed Rulemaking, seeking public comments on necessary revisions to its Disparate Effects Standard Impact to bring them abreast of current law under the Federal Housing Act.[13] This agency action is also being mandated by specific litigation on this subject.[14] Our recommendation would be that §1254.6 be modified to include the word "current" before the phrase "federal fair lending requirements" to ensure the fair lending certification requirement addresses the significant differences between the 2013 HUD Rule and the subsequent and controlling Supreme Court precedents.

We appreciate the opportunity to submit these comments. If you have questions or would like to discuss any of these comments in more detail, please contact American Bankers Association's Senior Vice President and Senior Counsel, Joseph Pigg, at JPigg@aba.com or on 202-663-5480. Thank you.

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[10] 24 C.F.R. Part 100.

[11] 135 S. Ct. 2507 (2015) (only artificial, arbitrary, and unnecessary barriers can invoke disparate impact doctrine).

[12] 137 S. Ct. 1296 (2017) (Fair Housing Act "requires some direct relation between the injury asserted and the injurious conduct alleged").

[13] 83 Fed. Reg. 28560 (June 20, 2018).

[14] *American Insurance Association et al. v. United States Department of Housing and Urban Development et al.,* No. 13-cv-00966 (D.D.C. 2019)

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