



MORTGAGE BANKERS ASSOCIATION

March 21, 2019

Mr. Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20219

RE: Validation and Approval of Credit Score Models [RIN: 2590-AA98]¹

Dear Mr. Pollard:

The Mortgage Bankers Association (MBA)² thanks the Federal Housing Finance Agency (FHFA) for the opportunity to comment on the proposed rule to create a process for validating and approving credit score models used by Fannie Mae and Freddie Mac (the Enterprises). MBA believes that a transparent, competitive process for determining the Enterprises' credit score requirements, such as the process envisioned in the recent legislation³ that provides the basis for the proposed rule, would be preferable to the process currently in place.

There are numerous areas, however, in which we believe the proposed rule can be strengthened to produce better outcomes for the market. The recommendations that follow seek to build on the positive features of the proposed rule and address gaps that currently exist to further facilitate competition and enhance transparency.

¹ 83 FR 65575, "Validation and Approval of Credit Score Models," December 21, 2018. Available at: <https://www.federalregister.gov/documents/2018/12/21/2018-27565/validation-and-approval-of-credit-score-models>.

² The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, DC, the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,300 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, credit unions, thrifts, REITs, Wall Street conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

³ Public Law 115-174, Section 310.

Principles for Credit Scores

As MBA noted in its response to the FHFA *Credit Score Request for Input* (RFI) issued in December 2017,⁴ “regulations governing the use of credit scores at the Enterprises should foster a fair and competitive market that supports innovation and access to affordable credit.”⁵ To achieve this outcome, MBA offered the following principles to guide FHFA and the Enterprises when developing and implementing Enterprise credit score requirements:

- 1) Any decisions regarding existing credit score requirements should be data-driven and analyzed thoroughly;
- 2) Any accepted credit scoring models—regardless of provider—should be subject to frequent, rigorous testing of their predictive capacity by FHFA and/or the Enterprises;
- 3) Competitive forces typically produce better results in the market by stimulating innovation and lowering costs; therefore, changes to the existing requirements, as well as the review process for future changes, should extract the benefits of competition in credit score modeling;
- 4) The regulatory system governing credit scoring models should be structured to encourage ongoing efforts to improve predictive capacity and reliability throughout the credit cycle; other objectives, such as expanded consumer access to credit, should also be pursued so long as they do not compromise predictive capacity and reliability;
- 5) Current efforts that are focused on data provided by the national consumer reporting agencies—Equifax, Experian, and TransUnion—should not displace or otherwise discourage efforts focused on the use of additional data sources, such as telecommunications, rent, or utility payments; and
- 6) FHFA and the Enterprises should abide by transparent processes for maintaining and/or changing the Enterprise credit score requirements; such processes should include regular communication with a wide variety of mortgage market participants.

Use of Credit Scores

MBA supports the concept that the proposed rule does not require particular uses of third party credit scores by the Enterprises. It is difficult to account for future innovation in underwriting or pricing for credit risk in a proposed rule, so the Enterprises should not be locked into specific uses of certain factors or inputs. For

⁴ FHFA, “Credit Score Request for Input,” December 20, 2017. Available at: https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/CreditScore_RFI-2017.pdf.

⁵ MBA, “RE: Credit Score Request for Input,” March 30, 2018. Available at: https://www.mba.org/Documents/MBA_FHFA_CreditScoreRFI_March2017.pdf.

example, in recent years the Enterprises have updated their automated underwriting systems to allow evaluation of loans for which the borrower does not have a Classic FICO score.⁶ Such advances should not be discouraged by the regulations governing the use of credit scores.

Similarly, MBA supports the requirement that, upon an Enterprise conditioning its purchase of loans on an approved credit score, it must use that approved credit score in all of its systems and procedures that feature credit scores as a factor or input. For example, an Enterprise should not be permitted to use one credit score as a minimum eligibility requirement for a particular product and use a different credit score for purposes of loan pricing. Such a construct would create significant confusion and operational challenges in the market.

Validation and Approval Timeline

The proposed rule clearly describes the expected timeline of the validation and approval process, including the timelines associated with each of the four phases of this process. Similarly, the proposed rule provides guidance on the frequency with which the validation and approval process will take place. A predictable and well-defined system is preferable to the ad hoc reviews currently undertaken by FHFA and the Enterprises.

With respect to the frequency of the validation and approval process, the proposed rule contemplates FHFA requiring Enterprise solicitation of new credit score models every seven years. This cycle allows sufficient time for the completion of each validation and approval process, though it may not allow the Enterprises to be as responsive as possible when new technologies or data sources emerge. The proposed rule does, however, allow FHFA the flexibility to require solicitations on a different schedule if it deems it appropriate to do so. MBA recommends that FHFA more frequently evaluate whether a new solicitation would provide significant benefits to the market, such that it is prepared to begin the process earlier than the seven-year threshold if warranted. At no point should the cycle be extended beyond seven years. If FHFA elects to begin a new solicitation earlier than seven years from the prior solicitation, it should be required to explain its basis for doing so in the solicitation.

With respect to the timeline for each validation and approval process, the proposed rule indicates that the full period from the Enterprises' submission of their initial solicitations for regulatory review to the final approval determination is expected to last approximately 24-30 months. This timeline is lengthy, reflecting the complexity of

⁶ A Classic FICO score references the collective use of Equifax's FICO 5, Experian's FICO 2, and TransUnion's FICO 4.

credit score modeling and the need for thorough review to understand the numerous implications of the approval of new models.

MBA believes, however, that there are sensible options for shortening this timeline in a manner that does not jeopardize safety and soundness. In particular, the Credit Score Assessment Phase and the Enterprise Business Assessment Phase entail the two processes by which the Enterprises evaluate whether new credit score models are suitable for future use. The former phase lasts 180-240 days, and the latter phase lasts 240 days. While these evaluations are expected to be difficult and complex, it seems that a 14-16 month period is longer than is likely to be necessary, particularly if these evaluations are undertaken simultaneously. FHFA and the Enterprises should also build on their existing empirical evaluations of models produced by FICO and VantageScore Solutions to shorten this timeline during the initial validation and approval process. Further, while the proposed rule does not prohibit the Enterprises from conducting the Credit Score Assessment and the Enterprise Business Assessment simultaneously, the timeline that is provided clearly seems to imply that they will occur sequentially. MBA believes these evaluations should be undertaken simultaneously over a period of approximately ten months.

In the proposed rule, FHFA notes that feedback from the RFI indicated that the mortgage industry would require approximately 18-24 months to adopt any new credit score model. Given the operational changes that would be necessary, along with the appropriate testing and analysis, MBA believes this is a reasonable expectation following approval of a new model. While the proposed rule does not specifically address industry adoption timelines, FHFA should consult with the Enterprises to ensure that sufficient time is granted. FHFA should also direct the Enterprises to clearly articulate the timeline for delivery of loans featuring the new credit score well in advance of any such changes.

Evaluation of Credit Score Model Accuracy

The proposed rule describes four potential options by which the Enterprises would evaluate the results of their credit score model accuracy testing. Among these options, MBA recommends use of an approach that allows the Enterprises to assess the accuracy of a particular model in a relative manner through comparisons to other models that have already been approved. Such an approach would allow the Enterprises sufficient flexibility in making a determination based on this assessment, rather than requiring the use of a bright-line test. In concert with this approach, which would be used on an ongoing basis, MBA recommends that FHFA immediately approve use of the Classic FICO model.

Other options, such as the use of an approach based on a particular benchmark, raise concerns regarding models that are specifically calibrated to “beat” that

benchmark, which could skew the design of the model in important and difficult-to-recognize ways. As there are several benchmarks that could be used to test a model's accuracy, reliance on a single benchmark could prove problematic. This approach also requires the use of a minimum threshold that models must exceed. This threshold, however, could effectively serve as an anchor on the accuracy of future models. That is, rather than spurring credit score model providers to continually improve the accuracy of their models, this approach may cause model providers simply to invest enough to ensure they exceed the minimum accepted level of accuracy. The approaches that feature relative comparisons of models better encourage ongoing improvements in predictive capacity.

Any accepted approach should also ensure the continued eligibility of previously-approved models where appropriate. If the Enterprises were required to institute a bright-line test that effectively forced them to replace previously-approved models with newer models, the operational costs to market participants could be quite significant. For example, if Classic FICO was already approved and in use at the Enterprises and a new model (developed by a different provider) was determined at a later date to be slightly more predictive, the Enterprises should not be forced to stop accepting Classic FICO if they determine it is still acceptable for their loan purchase conditions. Likewise, in such a scenario, market participants should not be forced to switch to a new model, and should instead be given the option to determine whether they prefer the use of the new model or Classic FICO.

Similarly, regardless of the option that is adopted in the final rule, FHFA and the Enterprises should validate and approve Classic FICO immediately rather than require the model to undergo the lengthy process envisioned in the proposed rule. Such a step would significantly reduce transition uncertainty for market participants and ensure that there are no market disruptions prior to the approval of any new models (including new models developed by FICO).

Interaction with Credit Score Model Applicants

A critical factor determining the likelihood of competition and innovation from new credit score model providers is the perceived fairness of the validation and approval process. That is, if potential model providers feel that the design of the process tilts toward rejection of new models, these institutions are unlikely to invest the time or resources to enter the market.

To better ensure that the process is not unnecessarily skewed toward rejection of new models, the proposed rule should provide a more flexible treatment of models (or providers) for which potential issues are identified. As currently constructed, the process in the proposed rule features dozens of requirements across numerous

dimensions, and failure with respect to any single requirement would lead to rejection of the entire model.

A more practical approach would provide applicants with opportunities for interaction with the Enterprises (and FHFA) when potential issues are identified. For example, if the Enterprises have concerns regarding the data used to determine the integrity standard in the Credit Score Assessment or regarding fair lending compliance in the Enterprise Business Assessment, they should not reject the model outright, but instead engage in more detailed dialogue with the model provider. If this dialogue, along with any new information that is supplied, does not alleviate the Enterprises' concerns, the model would still be rejected. If the issue is clarified or resolved, though, the model should remain in the validation and approval process.

Because the validation and approval process occurs infrequently under the proposed rule (potentially every seven years), the consequences for rejection are significant, as the provider would need to wait a lengthy period of time before being given the chance to re-submit. MBA therefore recommends that the process require the Enterprises to seek remediation for, or clarification of, potential issues before rejecting a model.

Implementation of a Multi-Score Approach

The RFI issued by FHFA in late 2017 included numerous questions regarding the ability of the Enterprises (and the market) to transition to a system featuring multiple approved credit score models. Three of the four options proposed for consideration by FHFA were multi-score approaches, with varying conditions that sought to address consumer access to credit, operational costs for the industry, market liquidity, and safety and soundness of the Enterprises.

Despite FHFA receiving numerous comments from the public in response to these options, the proposed rule does not include any guidance or requirements regarding how multiple credit score models would be implemented. Instead, the proposed rule simply notes that “these decisions could be handled through FHFA’s authority as regulator or as conservator.”⁷

The manner in which a multi-score approach is implemented, however, will have a significant impact on the factors listed above—consumer access to credit, operational costs for the industry, market liquidity, and safety and soundness of the Enterprises. As such, it is impossible to fully and accurately evaluate the proposed rule without an understanding of the ways in which multiple models will be used.

⁷ 83 FR 65579.

For example, an approach in which all approved credit scores are required on every loan delivered to the Enterprises would shift more of the operational burden to lenders, whereas an approach that allows lender choice of single credit score would shift more of the operational burden to investors. The use of multiple models for loan pricing or minimum product eligibility standards would have direct, tangible effects on consumer access to credit as well.

Further, it is unclear from the proposed rule whether the Enterprises would make the determination regarding how to adopt a multi-score approach, subject to FHFA approval, or instead whether FHFA would direct the Enterprises to adopt a particular approach.

Simply deferring to FHFA's future, unspecified actions—whether as regulator or as conservator—is an insufficient substitute for a detailed explanation as to how multiple credit score models will be used in the context of the proposed rule. MBA recommends that FHFA clearly articulate which of the proposed options from the RFI will be adopted, along with the terms and timelines by which it will be implemented.

Assessment of Industry Impact

During the Enterprise Business Assessment Phase outlined in the proposed rule, the Enterprises are required to evaluate (and make a determination regarding) the effects of new credit score models on competition, market liquidity, and cost and availability of credit, as well as the costs and benefits to various market participants, including lenders, mortgage insurers, and investors. This requirement represents a broad mandate for the Enterprises—one that extends well beyond their typical business considerations.

Despite the ongoing conservatorship of the Enterprises, these institutions should be considered privately-owned entities for the purposes of the future state envisioned in the proposed rule. By placing the responsibility for evaluating competition, liquidity, credit availability, and other market conditions on the Enterprises, FHFA is ceding substantial authority to non-governmental entities. It is far from clear that the Enterprises, particularly once removed from conservatorship, should be granted this authority to make determinations concerning the public interest. MBA believes it is much more appropriate for FHFA, in consultation with market participants, to make any determinations that credit score models could adversely affect market conditions. FHFA can and should consult with the Enterprises when doing so, but the Enterprises' role should be confined to providing data and relevant analysis to allow FHFA to make an informed determination.

MBA therefore recommends that the impact of credit score models on competition, liquidity, credit availability, and market conditions be removed as a factor upon which

the Enterprises can reject a credit score model, and that this responsibility instead be placed with FHFA.

Competition in the Market

The primary impetus for the legislation⁸ that serves as the basis for the proposed rule is the desire to facilitate competition in the market. The title of this legislative provision, “Credit Score Competition,” confirms this view. As is noted in the principles described above, MBA believes that competitive forces typically produce better results in the market by stimulating innovation and lowering costs. The use of a multi-score approach is not without costs for market participants, though, so competition must be structured in a manner that minimizes these costs while maximizing the opportunities that are presented.

Importantly, the validation and approval process in the proposed rule allows for applications by developers of credit score models that rely on information beyond that which is obtained through the national consumer reporting agencies. This information, such as utility and telecommunications payment history, presents an important opportunity to better evaluate consumers who are historically underserved, such as low-income or minority households. While historically underserved consumers may have less experience using financial products such as credit cards or unsecured personal loans, the inclusion of “alternative” sources could add valuable data to their credit histories. Rental payments, another lesser-used source of data, are also likely to show a strong positive relationship to future mortgage payments.

This development represents a significant improvement from the current system, as well as the options presented in the RFI, which in each case only considered models that rely on “traditional” data. Opening the market to models that use differing sources of data is an important and underappreciated benefit of the competition facilitated by the proposed rule.

The proposed rule also addresses concerns regarding the independence of credit score model providers from consumer reporting agencies by prohibiting any common ownership or control across these institutions. From a practical standpoint, the strict limitation that allows for no common ownership may cause operational problems associated with de minimis equity holdings. More broadly, these provisions in the proposed rule may raise important questions with respect to the full ownership of model developers by the consumer reporting agencies.

As is noted in the proposed rule, VantageScore Solutions is jointly owned by Equifax, Experian, and TransUnion. MBA believes the potential concerns noted in the RFI, as

⁸ Public Law 115-174, Section 310.

well as some of the public responses to the RFI, merit further evaluation and analysis by FHFA. Such evaluation and analysis should not be based solely on feedback from respondents to the RFI, but instead should include the examination of other consumer lending markets and potential options for addressing and mitigating competitive concerns other than an outright prohibition. Given the significance of this provision to the practical implementation of the proposed rule, MBA believes a more thorough level of evaluation and analysis is warranted before any final decisions are reached.

Pilot Programs

MBA supports the inclusion of a process by which pilot programs can be implemented to develop and analyze performance history of a relatively new credit score model. Pilot programs, if undertaken appropriately, should foster increased competition and innovation among model providers. Absent the ability to participate in pilot programs, model developers may never be able to adequately satisfy the “demonstrated use” requirement in the Enterprise review of submitted applications. This problem is particularly relevant for models that are developed expressly for use in the mortgage market (and as such, would not be able to show demonstrated use in other consumer lending markets, such as those supporting credit cards or automobile loans).

As MBA has noted in prior communications with FHFA,⁹ any pilot programs that are implemented should feature transparent terms that do not confer excessive advantages on certain market participants. The proposed rule states that pilot programs should be limited in duration and scope. MBA believes that these limits on duration and scope should be made publicly available. FHFA and the Enterprises should also provide the public with information regarding the types of institutions participating in the pilot program, as well as the metrics (quantitative or qualitative) by which the program will be evaluated. Finally, FHFA should provide clear guidance regarding how a credit score model would transition from a pilot program to the full validation and approval process to ultimate implementation by the Enterprises.

The proposed rule as currently drafted does not require the appropriate levels of transparency or program limits. MBA recognizes and supports the use of pilot programs in the context of credit score models, but as with other areas of the Enterprises’ businesses, the outsized role and influence of the Enterprises necessitates terms and practices that better serve the public interest.

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⁹ See, for example: MBA, “RE: Regulatory Review,” June 4, 2018. Available at: [https://www.mba.org/Documents/MBA_FHFA_Regulatory_Review\(0\).pdf](https://www.mba.org/Documents/MBA_FHFA_Regulatory_Review(0).pdf).

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Thank you in advance for your consideration of these comments. Should you have questions or wish to discuss further, please contact Dan Fichtler, Director of Housing Finance Policy, at (202) 557-2780 and dfichtler@mba.org.

Sincerely,

A handwritten signature in black ink, appearing to read "R. Broeksmit", with a stylized flourish at the end.

Robert D. Broeksmit, CMB
President and Chief Executive Officer
Mortgage Bankers Association