Competition Considerations in Changing Mortgage Finance Credit Score Requirements

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This paper responds to the Credit Score Request for Input issued by the Federal Housing Finance Agency (FHFA).[2] Specifically, it addresses the competitive considerations resulting from potential changes under consideration to the mortgage finance credit score requirements used by Fannie Mae and Freddie Mac (the Enterprises). I am submitting this paper as counsel to Fair Isaac Corporation (FICO); however, it is based on my independent review of the competition issues raised by the RFI.

The Enterprises have long required the use of FICO® Scores in connection with mortgage finance credit applications. FICO Scores are recognized as predictive, independent and reliable. FHFA is now considering the implications of allowing the Enterprises to require the use of VantageScore credit scores. VantageScore is a credit score marketed by VantageScore Solutions, LLC, a joint venture formed and owned by the three national consumer reporting agencies (CRAs) – Equifax, Experian, and TransUnion. Unlike VantageScore, FICO is an independent company that is not owned or controlled by the CRAs.

In making any decision about the use of VantageScore, FHFA should take into account the potential for serious and significant competition consequences. The principal competitive concern, discussed below, is that allowing the use of VantageScore would provide the CRAs both the *incentive* and the *ability* to foreclose FICO as a mortgage credit score provider. In credit information markets, mortgage or otherwise, the CRAs already control the data used to generate credit scores, set the downstream price for credit scores offered by both FICO and VantageScore, and own VantageScore itself. In the mortgage market, however, due to the lack of competition for credit reports caused by the existing tri-merge report requirement, also discussed below, the risk of foreclosure is particularly acute.

The potential for, and likelihood of, an anticompetitive foreclosure strategy is significant should FHFA authorize the use of VantageScores. A successful foreclosure strategy undoubtedly would harm FICO as a competitor as it would drive FICO from the mortgage market, leaving VantageScore as the only provider. Of course, the antitrust laws were enacted for "the protection of ***competition,*** **not** ***competitors***."[3] Here, the resulting harm would affect the marketplace as a whole because a strategy that drives FICO out of the market to the benefit of

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[2] FHFA, "Credit Score Request for Input," Dec. 20, 2017 ("RFI"), *available at* https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/CreditScore_RFI-2017.pdf.

[3] *Brown Shoe Co. v. United States,* 370 U.S. 294, 320 (1962) (emphasis in original). FHFA appropriately recognizes that it is not in the business of picking winners and losers but in ensuring the overall health of the market: "FHFA's objective is not to help any particular company sell more credit scores, but to determine how to appropriately balance the safety and soundness of the Enterprises while maintaining liquidity in the housing finance market." RFI at 19.

the CRAs/VantageScore necessarily would harm both FICO *and* competition. As one court of appeals explained, "The fact that [exclusionary acts] harm competitors does not, however, mean that they do not also harm competition."[4] Indeed, competitors and competition are inextricably linked: "[I]n a concentrated market with very high barriers to entry, competition will not exist without competitors."[5]

That is the case here: FHFA is not considering any credit score provider other than FICO or VantageScore, and no new competitor is likely given the significant entry barriers in this marketplace. If FICO is foreclosed, then there is no independent firm offering credit scores; lenders (and ultimately consumers) would have to turn to the CRAs, which is no option at all. The CRAs already control consumer credit data, set credit score prices, and own VantageScore. Foreclosing FICO would further solidify their dominance in the marketplace, leading to predictably higher prices, lower quality of service and reduced incentives to innovate. These are the quintessential consumer harms associated with enhanced market power.[6] Accordingly, FHFA should proceed with caution and carefully weigh these harms as part of its decision-making process.

I. Framework for Competition Considerations

FHFA recognizes its duty to assess the likely competitive impact of any decision to change the existing credit score requirements. In making such an assessment, FHFA is entitled to – and should – consider the commercial realities associated with the mortgage finance credit marketplace in order to make the necessary judgments. Competition assessments are notoriously fact intensive and are predictive in nature. Indeed, in the seminal explanation of the "Rule of Reason" – the legal framework for conducting most antitrust analyses of marketplace conduct – the Supreme Court stressed the importance of a thorough, fact-based examination of the purpose, scope and effect of the matter at issue: "To determine that question [of competitive effects] the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable."[7]

This examination should "correspond to the commercial realities of the industry" and represent a "pragmatic, factual approach" to the issues at hand.[8] In this regard, the U.S. antitrust enforcement agencies have explained the importance of analyzing each matter "in light of its own facts" and applying the relevant analytical framework "reasonably and flexibly."[9]

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[4] *United States v. Visa USA et al.*, 344 F.3d 229, 243 (2d Cir. 2003).

[5] *Spirit Airlines, Inc. v. Nw. Airlines, Inc.,* 431 F.3d 917, 951 (6th Cir. 2005).

[6] For example, the U.S. antitrust agencies explained that competitor collaborations that increase market power "may harm competition and consumers by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement." U.S. Dep't of Justice and the Federal Trade Comm'n, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS, § 2.2 (2000) ("Competitor Collaboration Guidelines"), *available at* https://www.ftc.gov/sites/default/files/documents/public_events/joint-venture-hearings-antitrust-guidelines-collaboration-among-competitors/ftcdojguidelines-2.pdf.

[7] *Chicago Board of Trade v. United States*, 246 U.S. 231, 238 (1918) (setting forth standards for "rule of reason" antitrust inquiry).

[8] *Brown Shoe, Inc. v. United States*, 370 U.S. 294, 336-37 (1962) (conducting market definition test).

[9] Competitor Collaboration Guidelines at § 1.

The competition issues associated with the use of VantageScore are similar to those that frequently arise in connection with vertical mergers or vertical integration. "Vertical" refers to companies operating at different levels of production. Here, the CRAs control the data on which credit scores are based. In creating VantageScore, they formed an entity designed to operate at a different level of production, namely the design and marketing of scoring algorithms that are applied to the underlying CRA data to determine individual credit scores.

Not all instances of vertical integration or vertical transactions raise competition concerns; indeed, many are procompetitive. But, concerns arise when firms – either individually or collectively – are able to extend market power.[10] Harm to the competitive process results when vertical transactions "create opportunities and incentives for firms to handicap rivals, and such actions can harm competition if they weaken the constraint that rivals impose on the merged firm's market power (or, in some cases, the combined market power of a collection of firms that can coordinate on a higher price, lower output, or other non-competitive result)."[11] Vertically-integrated firms can use anticompetitive strategies to keep competitors "below the critical level necessary . . . to pose a real threat."[12]

One of the principal concerns with vertical restraints and vertical mergers is that they may result in anticompetitive foreclosure that raises rivals' costs in such a way that consumers will ultimately be harmed. For example, a firm may be able to deny its rivals access to the marketplace through "customer" foreclosure, which involves the vertically-integrated firm (or group of firms) reducing or stopping purchases from rivals. Foreclosure can cause rivals to exit the market or reduce investment, thereby enhancing the vertically integrated firm's power to raise prices and potentially reduce innovation, all to the detriment of consumers.[13] Similar concerns exist for denying a rival access to a critical input (such as the consumer credit data that is an input to credit scores), thereby raising the rival's costs and leading it to reduce output or raise prices.[14]

The antitrust enforcement agencies take these vertical concerns seriously. As noted in the Justice Department's *Policy Guide to Merger Remedies,* although a "purely vertical merger does not itself change the number of firms competing to produce a particular product or service…vertical mergers can create changed incentives and enhance the ability of the merged

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[10] *See, e.g.*, *McWane v. FTC*, 783 F.3d 814, 832 (11th Cir. 2015) (explaining harm to competition that can occur when a firm – or group of firms – with market power uses exclusive dealing arrangements to prevent a rival from offering meaningful competition).

[11] Jon Sallet, Deputy Assistant Attorney General, Department of Justice, Antitrust Division, "The Interesting Case of the Vertical Merger," Nov. 17, 2016, at 6 ("Sallet").

[12] *United States v. Microsoft Corp.*, 253 F.3d 34, 71 (D.C. Cir. 2001) (en banc) (per curiam) (explaining allegations of use of exclusive dealing to keep competitors from threatening defendant's market power).

[13] For example, the Department of Justice in the *Comcast/NBCU* transaction sought in its remedy not only to protect existing video rivals from foreclosure should the merged firm withhold content, but also to "prevent the merged firm from foreclosing or raising the costs of developing business models with which online entrants would attack long-prevailing incumbent market power." Sallet at 7.

[14] For example, a vertical merger may reduce competition by "foreclosing competitors of the purchasing firm in the merger from access to a potential source of supply, or from access on competitive terms." *Yankee Entm't & Sports Network, LLC v. Cablevision Sys. Corp.*, 224 F. Supp. 2d 657, 673 (S.D.N.Y. 2002).

firm to impair the competitive process."[15] As a Federal Trade Commission enforcement official recently observed, vertical transactions merit antitrust scrutiny: "Contrary to a popular view in the business press (especially prior to the Department of Justice's recent challenge to the AT&T/TimeWarner acquisition), vertical merger review has been and continues to be a meaningful and important part of FTC (and DOJ) merger enforcement."[16]

II. The Dominant Role of the CRAs in the Marketplace

The CRAs already play a dominant role – and have substantial power – in the marketplace given their control over credit data, their ability to set the downstream price for credit scores offered by both FICO and VantageScore, and their joint ownership of VantageScore.

The RFI provides extensive background information about how credit scores are used in the mortgage industry. The CRAs play a central role in the overall mortgage credit finance system. They are the entities that collect, store, and sell the relevant data on individual consumers that is critical to the mortgage review process.[17] There are three key factors – *i.e.*, commercial realities – relating to the power of the CRAs that greatly affect the competitive dynamic in this marketplace:

1. The CRAs Control the Data Used for Credit Scores.

Companies such as FICO have developed algorithms for credit scoring models that are applied to each CRA's data in order to generate a consumer's credit score based on that particular data. A consumer, therefore, typically has three different credit scores for each type of credit scoring model. The CRAs license the credit scoring model in order to calculate and sell credit scores.

As FHFA describes in the RFI, the CRAs have a lock on consumer data for the mortgage finance industry. They are "the exclusive providers of consumer credit data and credit scores to the Enterprises;" the "sole source" of data for the credit score models under consideration by FHFA and the Enterprises;" and none of those models consider data obtained from outside of the CRAs.[18] Moreover, there are significant barriers for any new firm to attempt to enter the consumer credit data business, and, as a result, there is currently no other realistic provider of consumer data.

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[15] U.S. Justice Dept., Antitrust Division, *Policy Guide to Merger Remedies,* at 5 (2011), *available at* www.justice.gov/atr/public/guidelines/272350.pdf.

[16] D. Bruce Hoffman, Acting Director, Bureau of Competition, "Vertical Merger Enforcement at the FTC," at 1 (Jan. 10, 2018); *see generally* Complaint, *United States v. AT&T Inc. et al.* (17-cv-2511) (D.D.C. filed Nov. 20, 2017) at ¶ 10 (providing framework for analysis of potentially anticompetitive vertical merger under Section 7 of the Clayton Act).

[17] They obtain their underlying data from "furnishers" (entities such as banks, credit card companies, and state or local governments that interact with consumers); and they sell data files and scores to resellers, who ultimately provide them to lenders. *See* RFI at 3-11.

[18] RFI at 7, 8 & 13.

2. *The CRAs Set the Prices for Credit Scores and Reports*

The CRAs control pricing for the credit scores and reports. "[I]t is the CRAs, not FICO and Vantage, that sell and negotiate the price of these scores to lenders and other end-users."[19] In the mortgage finance industry, the CRAs then sell consumer credit reports and scores to "resellers," which are separate entities that purchase information from the CRAs. The resellers assemble reports for lenders on mortgage applicants that include each applicant's credit report and a FICO Score from each CRA. Accordingly, the CRAs control the downstream relationship with the resellers.

3. *The CRAs Do Not Compete Against Each Other Given the "Tri-Merge" Report Requirement*

In the context of mortgage lending, the Enterprises require a borrower's credit report and score from each of the three national CRAs, which, collectively, is called a "tri-merge credit report." The resellers aggregate consumer credit data from the three CRAs and package it into a single mortgage credit report.[20] Accordingly, there is no competition between or among the CRAs. In other credit areas outside of mortgage, a lender may only require one credit report and score. In those circumstances, a reseller or other entity could negotiate pricing and other terms with each CRA and use the one that provided the most competitive offer. Given the tri-merge requirement, however, each CRA recognizes that its data will be required for the ultimate report and therefore each CRA's data is a necessary element for the mortgage application.

III. The CRAs' Incentive and Ability to Direct Use of VantageScore

In addition to their power over credit data, the CRAs have aligned their interests through their joint ownership in VantageScore. This alignment of interests and incentives is an important consideration in assessing whether to endorse the use of VantageScore. As the RFI states, "It is important for FHFA to consider the incentive structures at the credit scoring companies and the CRAs that price and sell credit reports and scores."[21] The interests of VantageScore are intextricably linked to those of the CRAs, and vice-versa. FICO, on the other hand, is independent.

The VantageScore joint venture provides the CRAs the *incentive* to steer credit score use toward VantageScore and away from FICO. While the underlying organizational and operational relationship between VantageScore and the CRAs is not a matter of public record, it is understood that the three CRAs equally co-own the venture and have a financial interest in its success. Each time a lender uses VantageScore over FICO, the CRAs earn revenues from the sale of the VantageScore credit report and FICO – VantageScore's competitor – is denied its own sale.

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[19] RFI at 11.
[20] RFI at 8; *see also* RFI at 9 ("For borrowers with a traditional credit history, lenders must try to obtain a tri-merge credit report for each borrower on the loan application.").
[21] RFI at 19.

Moreover, the VantageScore joint venture itself reflects an agreement among the three CRAs, each of which is a horizontal competitor to the others. In the most recent case analyzing antitrust issues associated with joint ventures, the Supreme Court reiterated its long-standing doctrine that "concerted behavior" – *i.e.*, agreements between competitors – should be treated "more strictly" from an antitrust perspective than "unilateral behavior" by a single company.[22] The Court explained that, unlike independent action, "[c]oncerted activity inherently is fraught with anticompetitive risk" insofar as it "deprives the marketplace of independent centers of decisionmaking that competition assumes and demands."[23] Indeed, the U.S. antitrust agencies recognize the potential risks from competitor collaborations that increase incentives to raise price above or reduce output or innovation below what would prevail in the absence of the venture.[24]

Should FHFA allow the use of VantageScore credit scores, then the CRAs also would have the *ability* to steer mortgage lenders toward their use.[25] The CRAs can employ a wide variety of tools to do so as the CRAs control the underlying data used in credit scores, determine the downstream pricing of both VantageScores and FICO® Scores, and are the single point of sale and distribution for credit reports and scores. The CRAs have direct relationships with the resellers who will be purchasing credit scores; Fair Isaac does not.

IV. Potential for Competitive Harm

As discussed above, the CRAs, both individually and jointly, control major aspects of the credit reporting marketplace. The question, therefore, is whether FHFA should endorse the use of VantageScore, which has the potential to result in the CRAs extending their current control over credit data into credit scoring. Doing so would provide the CRAs both the *incentive* and *ability* to favor their own score provider (VantageScore) over FICO, resulting in substantial foreclosure concerns.

Of immediate concern, the CRAs could engage in a customer foreclosure strategy. The CRAs collectively share their financial interest in VantageScore, thereby providing the incentive to align with VantageScore instead of FICO. As discussed above, the CRAs could readily take actions to steer resellers and lenders toward VantageScore and away from FICO, thus foreclosing FICO from competitive access to mortgage origination lenders who would buy FICO® Scores. Importantly, unlike in other credit markets, the tri-merge mortgage requirement means that resellers and lenders must deal with all three CRAs (and the price terms the CRAs choose to impose with respect to VantageScore and FICO) for each mortgage credit report and score, giving each CRA an even greater *ability* than in other credit markets to favor VantageScore over

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[22] *American Needle Inc. v. NFL*, 560 U.S. 183, 190 (2010) (*quoting Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 768 (1984)).

[23] *Id.* (*quoting Copperweld*, 467 U.S. at 768-69).

[24] "The central question is whether the relevant agreement likely harms competition by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement." *Competitor Collaboration Guidelines* § 3.3.

[25] In discussing the potential for marketplace foreclosure from vertical mergers, a leading antitrust treatise states that "one should simply presume that when a vertical merger occurs, self-dealing will occur as well." Philip E. Areeda and Herbert Hovenkamp, ANTITRUST LAW, IV.A., ¶ 1004 at 165 (4th ed. 2016). Here, like the interests of firms in a vertical merger, one should presume that the CRAs will have the incentive and the means to direct lenders to VantageScore over FICO.

FICO. Resellers and lenders are forced to accept the terms imposed by each CRA because they must buy a credit report and score from each CRA to form the required tri-merge report. This foreclosure risk should be given careful consideration by FHFA.

Input foreclosure concerns also exist. By withholding the necessary consumer credit data or distribution access from FICO, or by raising their price for such data or access, the CRAs could foreclose important inputs necessary for FICO to continue to innovate and compete. FICO would not be able to turn to other sources of supply given that the existing CRAs control the necessary data and there are substantial barriers to any new firm compiling the data needed to compete with the three existing CRAs.

The resulting competitive harm from a foreclosure strategy can manifest itself in numerous ways. The CRAs could increase Fair Isaac's costs, which can ultimately lead to higher prices. Indeed, a "raising rivals' costs" concern is one of the principal harms from anticompetitive vertical transactions.[26] The CRAs could also block or limit FICO's access to data, thereby diminishing the quality of FICO's product and reducing innovation as consumer financial data is a key ingredient to continued development of advanced credit scoring models.

Should the foreclosure be successful, the marketplace harm would be even more acute. Foreclosing FICO eliminates a firm independent of the CRAs, leaving the CRA-controlled VantageScore as the only provider of mortgage finance credit scores. The consumer harm resulting from this vertically-integrated monopolist would be clear in terms of higher prices and reduced quality, but also, especially, decreased innovation: "A vertically integrated monopoly is less likely to spur innovation and efficiency than competition between vertically integrated firms, and a vertically integrated monopoly is unlikely to pass the benefits of innovation and efficiency on to consumers."[27]

Importantly, while the potential competitive harm from an effective foreclosure strategy is clear when it results in one firm (or a coordinated group of firms) controlling the stages of production, such a dramatic outcome does not have to happen right away to still have a competitive impact. As the Department of Justice set forth in its recent *AT&T/Time Warner* complaint, the foreclosure disruption "need not occur immediately;" instead, the effects may come over time as competition is slowly lost.[28] Ultimately, however, a successful foreclosure strategy would eliminate FICO from mortgage finance credit scores, thereby depriving the market of a voice that is independent of the CRAs.

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[26] *See* Thomas Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals; Costs to Gain Power Over Price*, 96 YALE L.J. 209 (1986).
[27] Competitive Impact Statement, *United States, et al. v. Ticketmaster Event Entertainment, et al.* (2010), *available at* https://www.justice.gov/atr/case-document/competitive-impact-statement-209.
[28] Complaint, *AT&T* at ¶¶ 3-4.

V. Prior Antitrust Litigation Demonstrates Reasons For Concern

In 2006, Fair Isaac filed antitrust claims in federal court relating to the CRAs' initial formation of VantageScore.[29] The district court specifically noted the ability for the CRAs – through VantageScore – to cause significant competitive concerns:

> [The CRAs'] combined dominance in the aggregated credit data market and control of the sales of bundles of aggregated credit data and credit scores could create a dangerous probability that [the CRAs] can install VantageScore as a monopoly in the credit scoring market if they agree to take anticompetitive measures such as manipulating the prices of credit scores and denying Fair Isaac [FICO] access to aggregated credit data.[30]

The court subsequently found that, on the specific marketplace issue before it, Fair Isaac could "take action to protect itself" by, for example, striking a data deal with one of the CRAs.[31] Therefore, there was no real immediate threat of antitrust injury to Fair Isaac. The claims eventually were dismissed on "antitrust standing" and "injury" grounds, *not* on the actual merits themselves.[32] In essence, the court found that FICO – as a competitor to VantageScore – was not the proper plaintiff at that time to pursue the claims.

The mortgage finance credit market at issue here, however, is not comparable to the marketplace that the court was considering in *Fair Isaac.* In the mortgage market, *FICO has to work with all three CRAs given the tri-merge report requirement*. There is no opportunity for FICO to "strike a deal" with just one or play the CRAs off each other, as the court found in *Fair Isaac*. Instead, the interests of the CRAs here are aligned and each has power as an essential component of a tri-merge report and score. In short, while the court in 2011 dismissed the antitrust claims on procedural grounds, here and now, FHFA should ensure that the merits are properly considered and that competition is properly protected.

VI. Conclusion

FHFA noted in the RFI how the very conditions present in the mortgage finance credit score marketplace give rise to the potential for competitive concerns:

> As stated earlier, the three CRAs jointly and equally own VantageScore. Each CRA controls the data used to generate credit scores. The CRAs also control the price for end-users of VantageScore and FICO scores. The CRAs' ability to control the data and pricing of both VantageScore and FICO scores, while maintaining a financial interest in VantageScore, could create concerns about competition.[33]

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[29] *See Fair Isaac Corp. v. Experian Information Solutions, Inc.,* 645 F. Supp. 2d 734 (D. Minn. 2009), *aff'd,* 650 F.3d 1139 (8th Cir. 2011).

[30] *Fair Isaac Corp. v. Equifax Inc.*, 2008 WL 623120 at *8 (D. Minn. March 4, 2008).

[31] *Fair Isaac*, 645 F. Supp. 2d at 755 (discussing Fair Isaac's preferred partnership agreement with Equifax).

[32] *See Fair Isaac*, 650 F.3d at 1144-47.

[33] RFI at 19.

FHFA is right to be concerned. The market structure and commercial realities strongly suggest that allowing the use of VantageScore in the mortgage credit market will provide the CRAs both the *incentive* and *ability* to foreclose competition. The resulting harm to competition has the potential to be significant. FHFA should take these concerns into account before endorsing such an outcome.