VANTAGESCORE®

Barrett Burns, President & CEO

Friday, July 15, 2011

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
1700 G Street, N.W.
Washington, D.C. 20552

ATTN: Comment on Credit Risk Retention NPR: RIN # 2590-A43

Dear Mr. Pollard:

VantageScore Solutions LLC would like to thank the Federal Housing Finance Agency ("FHFA") and the other Federal agencies with whom you have been working[1] for the opportunity to comment in response to proposed rules implementing the credit risk retention requirements of Section 15G of the Securities Exchange Act of 1934 (15 USC 780-11), as added by section 941 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Public Law 111-203).

Background on VantageScore

Formed in 2006 to offer choice and competition in the credit score marketplace by providing a highly predictive credit score based on the latest analytic methodologies, VantageScore Solutions is a joint venture of the three credit bureaus, Equifax, Experian and TransUnion. Each of the bureaus devoted their top scientists and analytic leaders to the development of our model. Armed with a deep understanding of consumer risk modeling and their respective bureau's database design, team members spent several months building a new consumer credit score model from the ground-up. Fifteen million anonymous consumer files served as the basis for development and testing of the new model. Innovative approaches in the model's development included advanced segmentation techniques that provide more scorecards than many traditional models, including separate segmentation scorecards for full file and thin file consumers.

[1] Office of the Comptroller of the Currency, Treasury ("OCC"); Board of Governors of the Federal Reserve System ("Board"); Federal Deposit Insurance Corporation ("FDIC"); U.S. Securities and Exchange Commission ("Commission"); and, Department of Housing and Urban Development ("HUD").

The VantageScore model rank orders consumers on the likelihood of becoming 90 days or more past due on a credit obligation based on many consumer behaviors and factors, including payment history, utilization, current balances, depth of credit, recent credit and available credit. The VantageScore scale ranges from 501-990. The higher a consumer's score, the less probable the likelihood of becoming 90 days or more past due. The score range approximates the academic grading scale familiar to most consumers. So, in addition to receiving their numerical score, with VantageScore, consumers also get the letter grade that corresponds to their 3-digit score. For example, a score between 900 and 990 is an "A"; between 800 and 899 a “B"; etc.

VantageScore's model is unique. We use the same model across the three bureaus and we use a new modeling approach that looks differently and more deeply into consumer behaviors allowing us to score many individuals who otherwise would not be able to obtain a score.

The Credit Risk Retention Rulemaking

As part of the joint-rulemaking required to implement the credit risk retention requirements of the *Dodd-Frank Act*, the FHFA and other Federal financial regulators have requested comment in response to the Notice of Proposed Rulemaking on "Credit Risk Retention" that was published in the *Federal Register* on April 29, 2011. In its simplest terms this rule, once finalized, will establish whether, and if so, how much "skin-in-the-game" mortgage lenders, servicers and/or securitizers will need to retain when they sell a mortgage. This is a very lengthy proposal and it is our intention to focus our comments on questions 117(a), 117(b) and 159(a) which deal directly with credit scores, since that is the area in which we have recognized expertise.

For reasons set forth in detail below, VantageScore not only agrees with the Agencies but also strongly supports the interagency task force's starting premise as stated in the Notice of Proposed Rulemaking ("NPR"), which states that:

> *In developing the proposal, the Agencies carefully considered how to incorporate a borrower's credit history into the standards for a QRM. The Agencies are aware that credit scores are used often by originators in the loan underwriting process.* ***However, the Agencies do not propose to use a credit score threshold as part of the QRM definition*** *because such a standard would require reliance on credit scoring models developed and maintained by privately owned entities and such models may change materially at the discretion of such entities. There also may be inconsistencies across the various credit scoring models used by consumer reporting agencies, as well as among different scoring models used by a single provider. Consequently, in order to ensure that creditors continue to choose among different credit score providers, the Agencies would have to determine a*

> *cutoff score under multiple scoring models and periodically revise the regulation in response to new scoring models that might arise."*
>
> 76 Federal Register 83 at 24121; emphasis added

With that as a foundational principal, we submit the following responses to specific questions contained in the notice of proposed rulemaking:

I. ***117(a). Should the Agencies include minimum credit score thresholds as an additional or alternative QRM standard?***

As noted above, we strongly agree with the Agencies' approach that a minimum credit score requirement should not be part of the QRM definition. The reasons stated by the Agencies (above) are sound and alone offer enough incentive not to implement a minimum credit score.

However, two additional compelling arguments can be made for why a minimum credit score threshold should not be used as an additional standard for defining QRM:

1. The risk associated with credit scores can change over time; and
2. Using any specific three-digit credit score number or brand as a minimum credit score threshold tacitly endorses a particular vendor's product.

The detailed rationale for this important recommendation is set forth in detail below.

A. *Credit Score Values Are Not Static*

Typically, credit scores are three-digit numerical values aligned to a particular level of risk, also known as the "default propensity" rate. "Default propensity" is commonly defined as the risk of a consumer becoming 90 days or more delinquent on a debt, expressed as a percentage. For example, in the case of VantageScore, between June 2008 and June 2010, a consumer with a score from 691-710 had a default propensity of 10%.

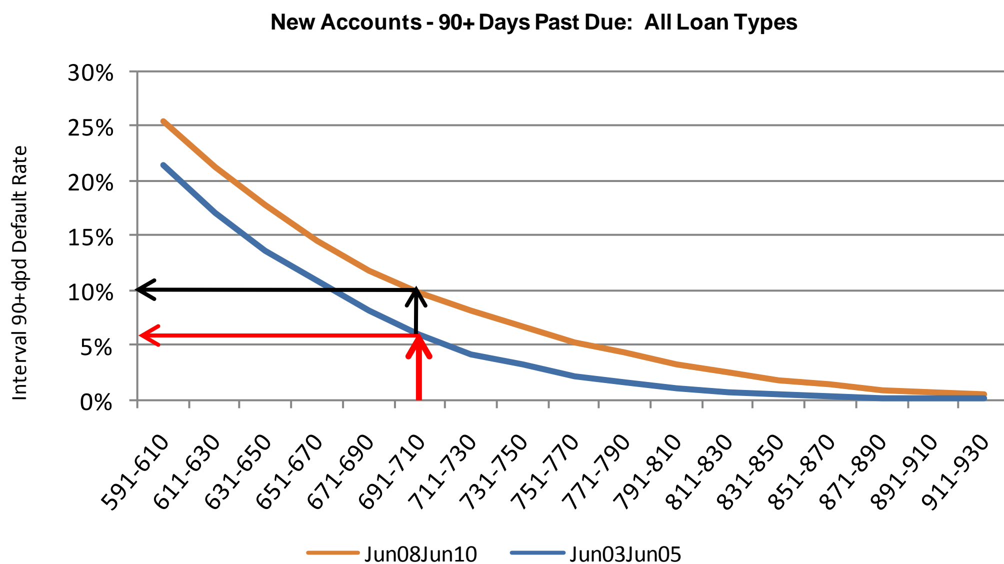
Credit score developers provide performance charts to lenders so that the relationship between the three-digit score value and the propensity for default is understood by the lender. Each lender then uses the performance charts to set cut-off considerations as a component of their loan underwriting process based on their own business strategy for lending risk. This concept is best understood by way of example. Consider a default propensity of .24 percent. What this means from a practical perspective is that for every one consumer whom the lender can expect to go 90 or more days in default, the

lender can expect 416 consumers to not go 90 days or more in default. Mathematically, the default propensity formula is: one divided by .24 percent or (1/.0024 = 417).

However, credit score values are not static numbers that always represent the same probability of default. In fact, the meaning behind a credit score depends on a number of factors unrelated to the borrower or his/her potential risk of default. These factors include: (i) the version of the algorithm used; and (ii) the date that a credit score was pulled for the consumer.

With respect to the version of the algorithm used, consider that there are over 20 versions of FICO – including FICO Classic 95, FICO Classic AU 95, FICO Classic 98, FICO Classic AU 98, FICO NextGen 03 and FICO 08. Given this, we anticipate that no federal regulator can know with any degree of certainty what the true risk is for a loan with a FICO Classic credit score value of "660" versus a loan with a FICO 08 credit score value of "660." This is true because those loans utilize two different credit scoring algorithms, and the 660 value could represent two different levels of risk.

Also, with respect to the date that the credit score was pulled, it is important to bear in mind that risk associated with a score changes over time. Consider the following example.



The graph above illustrates risk levels for consumer loans across two distinct two-year time periods for the most common VantageScore credit tiers: 591-930.[2] The two timeframes were June 2003-June 2005 (blue/bottom line) and June 2008-June 2010 (gold/top line).

The default probability for a VantageScore credit score of 691-710 in the June 2003-June 2005 timeframe was 6 percent (red arrows). The consumer behavioral response seen from the economic volatility in recent years caused the default probability for this score band to rise to 10 percent in the June 2008-June 2010 timeframe (black arrows). This represents a 66% increase in default rate between the June 2003-June 2005 timeframe and the June 2008-June 2010 timeframe.

This shift in risk levels for credit score values is inherent in all credit score models. Using a credit score value from all credit score developers will result in a default or risk probability that is not constant, but will fluctuate with changing consumer behavior.

As a result, should the Agencies decide to incorporate a minimum credit score value as part of the definition of QRM, then that value would be based only on the corresponding risk level present at the time the regulation is drafted. To remain accurate, the risk level would need to be revalidated every year. The results of the revalidation are likely to reveal the shift in risk and thereby require that the regulation be rewritten every year to inform the market about the new credit score minimum.

Should the Agencies decide that it is necessary to include a specific level of risk as part of the definition of a QRM, a solution is to avoid naming a credit score value, and rather, name a maximum propensity for default. While lenders' appetites for risk often fluctuates with market conditions, this maximum propensity for default can be written into the regulation today and remain constant over time.

Under that scenario, lenders can use their credit score model of choice to measure compliance with the maximum propensity of default for loans designated "qualified residential mortgage" provided that the credit scoring methodology meets already established federal requirements to qualify as a sound credit score model. This solution avoids the issues regarding multiple credit score providers cited above by the Agencies, while also avoiding the need to revisit the regulation every year because of shifting levels of risk associated with those values.

[2] The full VantageScore range is from 501-990, where a higher number indicates lower risk.

B. *Avoid Brand Endorsement*

In recent years a number of the federal banking regulators have wisely chosen to eliminate from newly-promulgated rules references to specific credit score brands. Below are examples demonstrating that the Federal Reserve Board (the "Board"), the Federal Housing Finance Agency ("FHFA") and the Federal Housing Administration ("FHA") recognize that brand endorsements are not appropriate in the context of federal rulemakings:

- **Federal Reserve Board/HOEPA Rulemaking/July 2008.** "For example, it is common to distinguish borrowers by credit score, with lower-scoring borrowers generally considered to be at higher risk of injury in the mortgage market. Defining the protected field as lower-scoring consumers would fail to protect higher-scoring consumers ''steered'' to loans meant for lower-scoring consumers. Moreover, the market uses different commercial scores, and *choosing a particular score as the benchmark for a regulation could give unfair advantage to the company that provides that score*."[3]

- **FHFA/2009 Enterprise Transition Affordable Housing Goals/August 2009.** "The proposed rule provided a market analysis to support the proposed adjustment of the housing goals levels for 2009, and discussed the effect of tighter underwriting standards of private mortgage insurers and the reduction in mortgage insurance availability for borrowers with low credit scores. A credit reporting corporation and a credit scoring corporation commented that FHFA's analysis should not specifically reference 'FICO' credit scores, stating that the reference implies endorsement of the Fair Isaac Corporation product and creates an unfair advantage. *FHFA did not intend to endorse a specific product. Accordingly the market analysis in the final rule refers generally to credit scores rather than to a specific product*."[4]

- **FEDERAL HOUSING ADMINISTRATION, "Risk Management Initiatives: Reduction of Seller Concessions and New Loan-to-Value and Credit Score Requirements."**
"While FHA's historical data and analysis is derived from the "FICO-based" decision credit score, *it is not FHA's intent to prohibit the use of other credit scoring models to assess an FHA borrower's credit profile*. In this notice, FHA seeks comment on the best means for FHA to provide guidance to the industry

[3] 73 Federal Register 147 at 44,532 – 44,533 (July 30, 2008) (emphasis added).

[4] 74 Federal Register 152 at 39,888 (Aug. 10, 2009) (emphasis added).

> on acceptable score ranges for other scoring models, to ensure that the scales used for all scoring systems are consistent and appropriate for an FHA borrower."[5]

We applaud the Federal Reserve's, the Federal Housing Finance Agency's and the Federal Housing Administration's decisions to avoid endorsement of one credit score brand by avoiding codifying a particular brand name as part of a federal regulation and we urge you and your colleagues to likewise omit from the definition of "qualified residential mortgage" reference to any specific credit score brand name.

Accordingly, we urge the following:

1. That the Agencies refrain from using any specific three-digit credit score number as part of the definition of "qualified residential mortgage".

2. Should the Agencies decide there is a need to utilize standards that reflect borrower credit history data in the definition of a QRM, we recommend the use of a "maximum propensity of default" in place of a minimum credit score.

3. Finally, we further urge the Agencies not to name any specific credit score brand for purposes of tracking or reporting by lenders regarding QRM loans, eliminating any thought that the federal government endorses or requires a particular vendor's product in a competitive marketplace.

II. ***117(b). If so, how might the rules incorporate privately developed credit scoring models in a manner that (i) ensures that borrowers, originators, and investors have adequate notice, and an opportunity to comment on, changes to scoring methodologies that may affect a borrower's eligibility for a QRM, (ii) maintains a level competitive playing field for providers and developers of credit scores, and (iii) ensures that any credit scoring methodology used for QRM purposes is an remains predictive of a borrower's default risk?***

As noted above, we do not believe that a minimum credit score should be used as part of the definition of a QRM. However, in the event the Agencies require use of credit history as part of the standard, we would like to be certain that the Agencies understand that by using "maximum propensity for default" instead of "minimum credit

[5] 75 Federal Register 135, (July 15, 2010) at 41,220-41,221(emphasis added).

score", all of the issues itemized in the question above are rendered moot. "Maximum propensity for default" addresses each concern:

(i) Because there is no reliance on any credit score model, there is no need to revisit regulations if/when private developers change those models.

(ii) Lenders and credit score developers already work with propensity for default in the implementation of credit score models. Use of "maximum propensity for default" in fact levels the playing field.

(iii) Just as is the case today, lenders are responsible for demonstrating that the models in use meet already established regulations. The Agencies can cite Regulation B Sec 202.2 (p) as the standard. This regulation already identifies what is considered an *empirically derived, demonstrably and statistically sound, credit scoring system.*

III. 159(a). Are* the *proposed requirements for a qualifying automobile loan appropriate?

Although unstated in the Notice of Proposed rulemaking, VantageScore can only assume that logical consistency would imply that the principles that led the Agencies to r*eject* the use of a credit score threshold as part of the QRM definition equally apply to the definition of a "Qualifying Automobile Loan."[6] Nevertheless, we note that at least one and perhaps more than one of the comments submitted in response the Notice of Proposed Rulemaking not only recommends the use of credit scores in determining whether a loan meets criteria to be classified as a "Qualifying Automobile Loan" but also goes so far as to recommend that a specific brand of credit score be used.[7] VantageScore urges the Agencies to reject any approach toward defining a "Qualifying Automobile Loan" by using a credit score for that purpose for the same reasons the Agencies considered and rejected using a credit score threshold as part of the QRM definition.

[6] "The Agencies are aware that credit scores are used often by originators in the loan underwriting process. However, the Agencies do not propose to use a credit score threshold as part of the QRM definition because such a standard would require reliance on credit scoring models developed and maintained by privately owned entities and such models may change materially at the discretion of such entities. There also may be inconsistencies across the various credit scoring models used by consumer reporting agencies, as well as among different scoring models used by a single provider. Consequently, in order to ensure that creditors continue to choose among different credit score providers, the Agencies would have to determine a cutoff score under multiple scoring models and periodically revise the regulation in response to new scoring models that might arise." 76 Federal Register 83 at 24121

[7] For example, see comments filed by the American Securitization Forum dated June 10, 2011 at page 82: "The Auto Sponsors propose that the material characteristics to be compared are FICO score, outstanding principal balance and remaining term."

In regard to the definition of a "Qualifying Automobile Loan" we respectfully suggest the following:

1. That the Agencies refrain from using any specific three-digit credit score number as part of the definition of "Qualifying Automobile Loan".

2. Should the Agencies decide there is a need to utilize standards that reflect borrower credit history data in the definition of a Qualifying Automobile Loan, we recommend the use of a "maximum propensity of default" in place of a minimum credit score.

3. Finally, we further urge the Agencies not to name any specific credit score brand for purposes of tracking or reporting by lenders regarding Qualifying Automobile Loan, eliminating any thought that the federal government endorses or requires a particular vendor's product in a competitive marketplace.

Conclusion

For the reasons set forth above, VantageScore Solutions, LLC strongly urges you and the other Federal regulators charged with promulgating the final rule implementing the credit risk retention requirements of the *Dodd-Frank Act* to incorporate into the final rule the well-reasoned premise reflected in the Notice of Proposed Rulemaking and refrain from using a credit score threshold as part of the required QRM definition and in the definition of a Qualifying Automobile Loan. Consistent with recent rulemakings of the Federal Reserve Board, the Federal Housing Administration and the Federal Housing Finance Administration, we conclude by urging the Agencies to avoid endorsement of one credit score brand by avoiding codifying a particular brand name as part of this or any other federal regulation.

Thank you for considering our thoughts as you move forward with this important rulemaking proceeding. If you or others working on this Notice of Proposed Rulemaking have any questions or would like additional information please don't hesitate to contact me at (203) 363-2161 or by email at BarrettBurns@vantagescore.com.

Sincerely,

President & CEO