NFHA
National Fair Housing Alliance

March 18, 2019

Mr. Alfred Pollard
General Counsel
Federal Housing Finance Agency
400 7th Street SW
9TH Floor
Washington, DC 20219

Re: RIN 2590-AA98 - Validation and Approval of Credit Score Models Proposed Rule

Dear Mr. Pollard:

We appreciate the opportunity to provide comments on the Federal Housing Finance Agency's Proposed Rule regarding Validation and Approval of Credit Score Models. The National Fair Housing Alliance submits the following comments and also supports comments submitted by Consumer Federation of America.

The National Fair Housing Alliance has worked for 30 years to address how the U.S. credit system restricts access to consumers of color. This work includes efforts to reduce discrimination in the extension of credit, expand credit opportunities for under-served groups and improve the financial services market. Our work with industry partners and our network of community- and state-based organizations gives us unique insights into how credit markets function and impact under-served consumers and markets. NFHA works with credit model developers to help lessen the discriminatory impact of scoring systems. We engage with segments of the housing industry who create or utilize algorithmic-based systems to improve their utility for under-served groups. We also provide training and technical assistance to our members who work directly with consumers to advance their fair housing rights, build their credit, counsel them on the homebuying process, and educate them on accessing credit.

Fair Lending Obligation and Fair Lending Assessment

The Federal Housing Finance Agency (FHFA) must ensure that fair lending obligations conferred to the Enterprises by a bevy of laws - including the Fair Housing Act, Equal Credit Opportunity Act, and the Safety and Soundness Act - and their charters are fulfilled. This includes requiring the GSEs to apply a fair lending lens in any credit scoring validation and approval process. Both the **Credit Score Assessment** and the **Enterprise Business Assessment** must include criteria to allow the GSEs to determine if credit score model developers have tested their scoring system according to a fair lending rubric and require the GSEs to perform their own independent fair lending analysis of any credit scoring system they consider. In addition to being tested for accuracy, reliability and integrity, the systems must be tested for fair lending compliance.

FHFA should add a fifth (5th) criteria under the **Credit Score Assessment** section to require *Testing for Fair Lending Compliance*. Credit score models must include an analysis of the independent variables that are used within the model for discriminatory disparities. Additionally, other elements of the model must be tested, including whether variables – or a string of variables – can serve as proxy for a protected class under a fair lending statute and whether the weighting of variables produce discriminatory outcomes. Credit score models must be assessed to determine if any discriminatory effect they might yield can be reduced. Models should also be tested to determine whether they accurately and appropriately predict risk for borrowers who are under-served, living in central cities, living in rural areas, and members of protected classes under fair lending statutes. Models must also be assessed to determine if they include non-traditional credit data, such as rental housing payments, that can both contribute to less discriminatory outcomes and increase the reliability and integrity of the models. **No credit score model should pass the Credit Score Assessment if it cannot meet the Fair Lending Compliance test.**

While both GSEs currently conduct fair lending analyses when making credit policy changes, these have fallen short and this is manifest in the very low performance the GSEs have in lending to borrowers of color and borrowers living in central cities.

Fair lending assessments must go far above and beyond what the GSEs have undertaken thus far to include an analysis of how credit scoring models expand or restrict fair credit access to borrowers of color, persons with disabilities, single female headed households and other protected classes under fair lending laws. These analyses must be performed – not solely within the context of borrowers who already primarily access credit in the financial mainstream but also in consideration of restrictions placed on borrowers who must obtain credit from fringe lenders.

Non-traditional credit providers, like payday lenders, check cashers, buy-here, pay-here lenders, have practices that shield consumers' good behavior while simultaneously amplifying poor behavior. Additionally, these credit providers have policies and practices that push borrowers into delinquency to extract high fees from them. To fulfill their mission of promoting "access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas)"[1] the Enterprises must develop ways to help transport credit-worthy borrowers from the fringe market into the financial mainstream. They cannot do that by performing inadequate fair lending analyses.

Any assessment or decision about which credit scoring systems the Enterprises can use, and how they employ credit scores must be undertaken within the context of a comprehensive fair lending analysis and in consideration of the GSEs' mission. This point is critical. Our nation's legacy of race-based housing and lending policies, many created and perpetuated by the federal government and agencies, must be considered in any calculus of what utilities and policies the Enterprises will adopt.

[1] See Federal Home Loan Mortgage Corporation Act - http://www.freddiemac.com/governance/pdf/charter.pdf and Federal National Mortgage Association Charter Act - http://www.fanniemae.com/resources/file/aboutus/pdf/fm-amended-charter.pdf

FHFA's interests should lie not merely in assessing the potential effects of updating the Enterprises credit score requirements but in examining ways the secondary housing finance system can use its resources and amend its standards to adequately serve borrowers who have been unfairly locked out of the financial system. Credit scores have become the gateway to opportunity yet the U.S. dual credit market has resulted in disparate discriminatory outcomes when it comes to credit access. FHFA must keep this in mind when advancing policies for the Enterprises.

Assessment of Borrowers Without Credit Scores

In 2017, both Freddie Mac and Fannie Mae made updates to their AUSs that allowed lenders to originate home loans to borrowers who do not have a credit score, and then sell these loans to the Enterprises[2]. While this development was important, it represented only a first step to expanding credit access for underserved borrowers and has not proven to be a game-changer for underserved borrowers.

As a result of the historical and current systemic disparities in our financial system, people of color and persons with disabilities are disproportionately credit invisible, score insufficient, or have artificially low scores. According to the Consumer Financial Protection Bureau (CFPB), 26 million American consumers – 11% of the adult population - are credit invisible. This does not mean that these consumers do not have credit. It does mean that they do not have credit information that has been reported to the major credit repositories. An additional 8.3% (19 million consumers) don't have enough information on their credit profiles to generate a credit score. An analysis by the CFPB reveals that almost 30% of African American and Hispanic adults are credit invisible or have an unscorable credit profile – compared to about 17% of White adults[3].

One reason people of color have a higher likelihood of being credit invisible is because they are disproportionately represented among those who use non-traditional credit. This disparity is, in part, driven by the lack of mainstream financial institutions like banks and credit unions in communities of color and a simultaneous hyper-concentration of payday lenders, check cashers, and other non-traditional lenders in those same areas. The former reports consumers' positive behavior to the credit repositories, the later systemically does not and this contributes to much of the correlation we see between levels of credit invisibility and certain demographic groups.

Forty-six percent of African Americans, 40% of Latinos, 38% of American Indian and Alaska Natives use alternative or non-traditional financial services. Comparatively, 18% of Whites use these services. In the lead up to the crisis, borrowers of color disproportionately were targeted for and received subprime loans, even when they qualified for prime credit. Moreover, consumers of color are less likely to have a credit card than their White counterparts. One study revealed that 47% of African Americans and 30% of Hispanics did not have access to a credit card as compared to 20% of White consumers[4].

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[2]See Fannie Mae, Selling Guide: Eligibility Requirements for Loans with Nontraditional Credit, https://www.fanniemae.com/content/guide/selling/b3/5.4/01.html See also Mortgages for Borrowers Without Credit Scores, http://www.freddiemac.com/learn/pdfs/uw/mtges4borr_nocreditscores.pdf

[3] Brevoort, Kenneth P., Philipp Grimm, and Michelle Kambara. 2015. *Data Point: Credit Invisibles*, CFPB Office of Research, May, 2015.

[4] "Report on the Economic Well-Being of U.S. Households in 2013," Board of Governors of the Federal Reserve System. Available at: https://www.federalreserve.gov/econresdata/2014-economic-well-being-of-us-households-in-2013-household-credit-behavior.htm#subsection-184-B14E9ACA

Although the GSEs implemented changes that would allow consumers with no credit score to be evaluated through their AUSs, consumers who utilize this process are assessed a higher rate. The Enterprises' delivery fees still apply in these instances and consumers are priced at the same level as a borrower with a 620 Classic FICO score. This can add up to 325 basis points on to the cost of the loan. This significant bump in cost makes the loan unaffordable for many consumers.

Credit Score Model Developer Independence and Conflict of Interest Certification

The proposed requirement that each credit score model developer applicant certify that no entity owning consumer data required to construct the credit score model is related to the credit score model developer is impractical, untenable, and will lead to less competition in the marketplace. If FHFA is concerned about price manipulation, it can set controls (some of which are already included in the proposed rule) to mitigate against any perceived unfairness. FHFA could also require data mining companies that are affiliated with credit model developers to sell the same data to entities that pass the Credit Score and Enterprise Business Assessments at a fair price point.

The limitation FHFA proposes would prevent credit modeling agencies from being able to procure consumer data owned by a related entity yet companies that own proprietary consumer data provide that data to an affiliated entity for the purpose of building scoring models. Moreover, many companies that have their own proprietary data use that information to build proprietary scoring systems. For example, insurance companies often use their proprietary consumer data to construct scoring systems for the purposes of both underwriting consumers to determine eligibility for certain products and to price consumers. This has not led to conflicts of interest, unfairness, or a debilitation of services for consumers. Rather, the competition has compelled insurance companies to improve their systems to offer the best delivery and service to consumers.

In fact, the GSEs themselves have proprietary data that they use in their automated underwriting systems which are updated regularly. The fact that each GSE uses data they each respectively own in their AUSs has not contributed to any conflict of interest but rather has helped drive competition within the secondary housing finance market. The fact that the GSEs continually update their systems – based on new data and technologies – underscores the need for this process to be available in the credit scoring space as well.

The two largest players in the mortgage credit scoring space are FICO and VantageScore. We have ample evidence that VantageScore's entrée into the mortgage credit scoring space and the competition it has brought has compelled both companies to improve their products and make changes that provide more fair outcomes for consumers. For example, after considerable testing VantageScore determined that paid medical debt collections had a de minimis effect on borrower behavior. This change was critically important since underserved borrowers, who are more likely to be uninsured or under-insured and live in health deserts, are more gravely impacted by the actions and policies of medical debt collection agencies. FICO later made the same change, very likely due to its desire to be competitive and because it too found diminished importance of medical debt collections on borrower behavior. It is important to note that civil rights and consumer protection advocates had been pushing for years for medical debt collection information to be removed from consideration in credit scoring and automated underwriting systems.

The restriction FHFA is proposing in the rule would not only limit competition but might well prevent credit modeling agencies from having access to new data sets that could improve performance and/or contribute to the development of scoring systems that have a less discriminatory outcome.

Transparency in the Credit Score Assessment Process

FHFA must provide the public with as much information as possible regarding which credit scoring systems the GSEs will use and how the determination was made to approve any particular score. Additionally, FHFA must provide more confidential information regarding the Credit Score Assessment Process to academics, including academics with fair lending and civil rights expertise. The process must be transparent particularly because FHFA has not greenlighted live pilots that have been requested by civil rights and consumer protection groups despite fully understanding how lending discrimination has restricted market access.

Moreover, when FHFA conducted an empirical evaluation of FICO 9 and Vantage Score 3.0, it did so with a limited data set – loan applications the Enterprises received from lenders. The analysis of credit score accuracy was based on loans acquired by the Enterprises. In other words, the Enterprises' analyses were conducted based on borrowers already in the traditional financing system. Narrowing the borrower pool in this fashion tilted the outcome. The analyses did not consider borrowers who operate outside of the financial mainstream. Yet, these are precisely the borrowers upon which more focus is needed. An analysis that excludes the very universe of borrowers that would be most impacted by the expanded use of credit scoring mechanisms is wholly insufficient.

For this reason, FHFA must make the Credit Score Assessment Process as transparent as possible to allow experts and the public to better determine if the systems being adopted by the GSEs are fair.

Sincerely,

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