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National Association of Federally-Insured Credit Unions

March 29, 2018

Federal Housing Finance Agency
Office of Housing and Regulatory Policy
400 7th St., SW, 9th Floor
Washington, D.C. 20219

RE: Credit Score Request for Input

Dear Sir or Madam:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally-insured credit unions, I am writing to you in regard to the Federal Housing Finance Agency's (FHFA) Request for Input (RFI) on credit score models. NAFCU and its member credit unions have long advocated for the use of alternative models that more accurately capture creditworthy borrowers and permit them to access affordable credit. Therefore, NAFCU is pleased that the FHFA is beginning to gather information and feedback from stakeholders regarding the adoption of new models at Fannie Mae and Freddie Mac (the GSEs) and urges the agency to move swiftly through the rulemaking process.

Credit unions have unique relationships with their members and should be permitted to choose the credit score model that best accommodates their members. This should be adopted at little or no cost to credit unions – the GSEs should absorb the vast majority of expenses associated with the transition to the use of new credit score models. Nonetheless, NAFCU and its member credit unions would appreciate the opportunity to meet with the FHFA to learn more about the GSEs' assessment of FICO 9 and VantageScore 3.0 before the adoption of any of the four options listed in the RFI. Additionally, significant consumer education must accompany the adoption of new credit score models, so NAFCU urges the FHFA to instruct the GSEs to provide materials for lenders to offer to borrowers before or concurrently with the adoption of one of the four potential credit score options.

General Comments

The *Housing and Economic Recovery Act of 2008* established the FHFA to supervise, regulate, and provide oversight of the GSEs and the Federal Home Loan Bank System. Since 2008, the

FHFA has served as conservator of the GSEs. The FHFA's *2015 and 2016 Scorecards for Fannie Mae, Freddie Mac, and Common Securitization Solutions* required the GSEs to assess the potential impact of updating the GSE credit score requirement from Classic FICO to another score or scores. The GSEs analyzed the scores from three credit score models – Classic FICO, FICO 9, and VantageScore 3.0 – and evaluated the impact of a new credit score model on access to credit, operations in the mortgage finance industry, and competition in the credit score market. Although the FHFA has not publically released the GSEs' empirical analysis, the study apparently shows there is only a marginal benefit to requiring a score other than Classic FICO. Fortunately, the FHFA recognizes there are overriding potential benefits to updating the current credit score requirements.

The FHFA is using this RFI to gather feedback from stakeholders on various credit score model options. Currently, industry practice requires lenders to use a borrower's credit report and credit score from each of the three national credit reporting agencies (CRAs) (commonly referred to as a "tri-merger credit report") and the FHFA is evaluating whether to instead require lenders to obtain only one or two reports and scores from the CRAs for each mortgage application. The FHFA is considering adopting one of the following four options: (1) require delivery of a single score – either FICO 9 or VantageScore 3.0 – if available, on every loan; (2) require delivery of both scores, if available, on every loan; (3) allow lenders to deliver loans with either score, when available, with certain constraints such as using one score or the other for a defined period of time; and (4) allow delivery of multiple scores through a waterfall approach that would establish a primary credit score and secondary credit score.

NAFCU and its member credit unions support flexibility in the use of credit scores and the opportunity for a credit union to decide, based on its unique membership, which credit score works best. Therefore, the FHFA should implement Option 3, even if it does impose certain constraints to prevent adverse selection. Competition between credit score models is likely to lead to more accurate and inclusive models that provide a broader population of borrowers with access to affordable credit. It is nonetheless important that the majority of costs associated with transitioning to the use of new models (excluding those relating to the credit union's adoption and incorporation of a model) as well as educating consumers are absorbed by the GSEs and not passed on to lenders in the form of pricing based on the model used.

Credit Unions Support Lender Flexibility

Credit unions utilize credit scores throughout the mortgage life cycle, from (1) before application to determine if a borrower is pre-qualified; (2) during the application process for eligibility and pricing purposes; (3) prior to a decision on financing as a quality control measure; and (4) in servicing the mortgage for a variety of reasons. Sometimes credit unions may use several

different models in addition to the tri-merger credit report for various lending business lines. Some credit unions also use non-traditional credit scoring factors such as income and education as well as other behavioral patterns to provide valuable data points for underwriting and pricing products. Consequently, the lender choice option would best account for differences in the way credit unions currently use credit scores to evaluate their members' creditworthiness and allow the institution to decide which model would best serve its members.

Although NAFCU and its member credit unions support flexibility and choice with respect to the credit score models, the GSEs should adopt a policy of requiring a single credit score model, of the lender's choosing, to be used throughout the entire loan life cycle (from origination through servicing). Despite the fact that some credit unions may have the capacity to support multiple scores throughout the life cycle, a single score policy from origination through servicing would create the most simple and transparent process for lenders and consumers alike. Additionally, it is important that government guarantee programs in the primary mortgage market, such as those of the Federal Housing Administration (FHA), United States Department of Veterans Affairs (VA), and United States Department of Agriculture (USDA) Rural Development follow the same credit score requirements as the GSEs to create consistency across the board and make it easier for credit unions to adopt a new credit score model and use it uniformly for member loans.

Some credit unions have noted that the single score option may be preferable because it would be easier for both the credit union and the GSEs to manage and less expensive overall; however, Option 3 (lender choice with constraints) would likely generate the same cost-savings so long as the GSEs do not require lenders to test both credit score models before deciding which one to use for a specified period of time. The potential constraints for Option 3, as outlined in the RFI, would make it no more difficult to implement than the single score option (Option 1). Both options would require changes to infrastructure, operating policies and procedures, and an initial transition and implementation cost. No additional, ongoing costs would be associated with Option 3 that are not already present in Option 1 because both contemplate the use of one of two possible credit score models. Unless a credit union chooses, at the onset, to evaluate both possible credit score models (FICO 9 and VantageScore 3.0) before deciding, the options are essentially the same, with Option 3 carrying the added bonus of flexibility based on a credit union's individualized preference.

Credit unions should be permitted to exercise their preference in credit score models based on the highest benefit provided to their members. The FHFA should not be handing this authority to the GSEs to decide what is best for the industry as a whole – a one-size-fits all approach to regulation is never the right answer. Credit unions deserve to have the flexibility to decide which model would best serve their members and be least burdensome and disruptive in terms of transitioning from the existing Classic FICO model to a new model. The fact that the FHFA

would have to exercise greater oversight in this area, implement a couple new rules regarding the constraints associated with giving lenders a choice in which credit score model they use, and update its systems and pricing grids does not detract from the significant benefits Option 3 would likely provide to the industry overall. In particular, even though the FHFA would have to manage multiple credit scores across all players in the mortgage industry, this competition among models would likely lead to fairer, more accurate models in the long run in terms of predictive power, consistency, inclusion, and consumer-friendliness.

Furthermore, the FHFA should no longer require financial institutions to pull a tri-merger credit report, but rather use just one credit report and score from the CRA of their choice. The current tri-merger credit report requirement introduces confusion and unnecessary cost, which is mostly passed on to the borrower in the form of pass through closing costs. Credit unions have expressed that they see little value in the use of the tri-merger report because the vast majority of the time the data reported is exactly the same; so credit unions simply experience a huge expense in the mortgage lending process that is not easily recouped from the borrower and provides virtually no benefit.

The increased accuracy and consistency among new credit score models also calls into question the use of three separate scores for a single loan. NAFCU and its member credit unions urge the FHFA to drop this tri-merger credit report requirement. Allowing credit unions to use just one CRA would allow them to shop around in terms of price, service, and innovation, choose their preferred CRA, and then leverage their direct relationship with that CRA to benefit their institution and members. Consumers are also consistently bewildered as to why three separate reports are required and why the middle credit score is the one that must be used for the loan. Eliminating the tri-merger credit report requirement would remove this confusion as well as the great redundancy and cost burden that this requirement has created. In addition to reducing costs overall, it would also facilitate a common credit union practice of providing members with their monthly credit score for free, which is a great consumer benefit that has positive economic effects even outside of the mortgage market.

Potential Benefits for Credit Unions

An update to the GSEs' credit scoring requirement is long overdue. On a broad scale, the current system has created a monopoly in the credit scores market and has introduced a level of risk that is associated with reliance on just a single vendor for input on such a crucial aspect of the mortgage process. For many credit unions, the current Classic FICO model often results in significant inaccuracies in terms of risk-based pricing adjustments, either through loan-level pricing adjustments or delivery fees. The adoption of new models would create substantial benefits for both credit unions and their member/borrowers. For borrowers, it would allow for

more accurate pricing, increased access to credit, scoring transparency throughout the process, and reduced costs in the long run. Credit unions would also experience cost savings in addition to enhanced risk management in lending operations, and the knowledge and experience that comes with adopting emerging financial services technologies.

Credit unions are excited about the opportunity to utilize modern credit score models in their underwriting processes. NAFCU encourages the FHFA to act swiftly in the adoption of new credit score requirements for the GSEs because the minor disruption that would likely be caused by accepting new models would be drastically outweighed by the benefit to credit union members. As a result, these members would achieve more accurate risk ratings, which would lead to more loan approvals for creditworthy borrowers and more fair and accurate risk-adjusted pricing on loan products. With the ability to use either FICO 9 or VantageScore 3.0, credit unions would be able to use the same modern credit score model for all of their loan products, which would also create efficiencies and cost savings. Above all else, consistent with the credit union mission, credit unions would be able to provide more opportunities for their members to access affordable credit and achieve their dreams of homeownership.

Costs to Credit Unions Must be Minimal

Any change to the GSEs credit score requirements would necessarily come with initial operational and transition costs, which would likely be passed on to credit unions and ultimately consumers. The introduction of competition into the credit scores aspect of the GSE loan purchase process would combat this initial increase by steadily driving down prices as FICO and VantageScore battle for market share through the creation of more and more accurate models. There would likely be very little impact on pricing in the To-Be-Announced and mortgage-backed securities markets because competition would drive the participants to continually improve their models and gradually approach scoring in increasingly similar ways, providing even more certainty to the entire mortgage market. By allowing the GSEs to accept multiple credit score models, ultimately any costs would be offset by cost savings and increased efficiencies.

Nevertheless, there are steps the FHFA and the GSEs should take to minimize some of the disruptions and initial costs associated with the adoption of new models. NAFCU encourages the FHFA to direct the GSEs to release their internal test results and analyses of the new models in addition to publishing historical data and score translation tables to help offset implementation costs for other parties, such as mortgage insurers and private investors. This cost offset would carry over to the lender side and credit unions would likely see lower initial and ongoing costs with the adoption of new credit score models. This would also help to provide increased

confidence and certainty in the varying credit score models, potentially fueling further efficiencies.

Moreover, in terms of consumer education, the GSEs should be required to provide resources to lenders to help them understand the different credit score models so they may then harness this knowledge to develop useful materials for their consumers. In addition to score translation tables so that consumers can clearly understand the different scoring metrics for FICO and VantageScore, consumers should receive a more detailed explanation of how their credit score is used to determine pricing on their loan. This would help to ameliorate some of the cost burden credit unions face in providing financial education resources and would give consumers reassurance and confidence in the mortgage process.

Conclusion

Keeping up with innovations in credit score models should be a priority for the GSEs. NAFCU and its member credit unions are pleased that the FHFA is taking steps to adopt new credit score models and are confident that the minor, temporary disruption caused by the adoption of new models will be worth the benefit to consumers. NAFCU appreciates the opportunity to provide its comments regarding the FHFA's RFI on credit scores. If you have any questions or concerns, please do not hesitate to contact me at (703) 842-2212 or akossachev@nafcu.org.

Sincerely,

Ann Kossachev
Regulatory Affairs Counsel