March 30, 2018

Via FHFA.gov

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

Re: Comments in Response to FHFA Request for Input Regarding Credit Scores

The undersigned consumer and civil rights groups are pleased to submit the following comments in response to the Federal Housing Finance Administration (FHFA)'s Request for Input Regarding Credit Scores. We thank the FHFA for engaging in this longstanding process, which will benefit many consumers once it is completed. Before addressing these issues, we would like to note that the RFI seems to primarily discuss the needs of, and impact on, lenders, investors and other members of the mortgage industry vis a vis updating scoring models. We urge FHFA to equally consider the needs of and impact on consumers.

1. The GSEs should update their scoring models to lessen the impact of medical debt

American consumers desperately need the FHFA to instruct the GSEs to use updated scoring models that lessen the impact of medical debt. Medical debt is a huge issue in this country, with a tremendous impact on credit reports and scores. Research by the Consumer Financial Protection Bureau has found that a stunning 52% of debt collection items on credit reports consist of medical debts.[1] One in five consumers with a credit report – 20% of potential mortgage borrowers – has a medical collection item in their credit report.[2] That is over 40 million Americans.

There is extremely strong evidence that medical debt collection items on credit reports are not an accurate reflection of the creditworthiness of the consumer. The Consumer Bureau study found that consumers whose credit reports show only collection items consisting of medical debts are more reliable payers, owe less, and have more available credit than consumers with other types of collection items.[3] A second study by the Consumer Bureau found that the presence of medical debt on a credit report unfairly penalizes a consumer's credit score, resulting in a credit score that is typically lower by ten points than it should be. For consumers who have medical debt on their credit reports that has been paid off, their scores are up to twenty-two points lower than they should be.[4] Thus, the Consumer Bureau has stated that "[c]redit scoring models which

[1] Consumer Financial Protection Bureau, Consumer Credit Reports: A Study of Medical and Non-Medical Collections 5 (Dec. 11, 2014), available at https://files.consumerfinance.gov/f/201412_cfpb_reports_consumer-credit-medical-and-non-medical-collections.pdf.
[2] *Id.*
[3] *Id.* at 7.
[4] Consumer Financial Protection Bureau, Data Point: Medical Debt and Credit Scores (May 2014), available at https://files.consumerfinance.gov/f/201405_cfpb_report_data-point_medical-debt-credit-scores.pdf.

differentiate medical collections from other collections are likely to more accurately reflect the actual creditworthiness of consumers."[5]

As you know, both FICO 9 and VantageScore 3.0 do improve the treatment of paid medical debts, and paid collection items generally, by not scoring them. In addition, FICO 9 has the advantage in that it gives less weight to *unpaid* medical debts. Consumers whose only negative item is unpaid medical debt can expect their score to increase up to twenty-five points.[6]

Thus, if FHFA wants to make the smallest, most incremental change, it should simply move from Classic FICO to either FICO 9 or VantageScore 3.0. This is the absolute minimum change that FHFA should require. Between the two scoring models, we think FICO 9 is somewhat preferable because of its better treatment of unpaid medical debt.

In the RFI, FHFA states that the GSEs' "empirical findings revealed only marginal benefits to requiring a different credit score than Classic FICO." But that is based on the fact that the GSEs found that the *automated underwriting systems* ("AU systems") more precisely predicted mortgage defaults than using credit scores alone. Comparing the predictiveness of a credit score standing alone against an AU system is not an apples-to-apples comparison. An AU system will of course be more predictive than credit scores alone, since the AU systems take into account factors that scoring does not include, such as income, assets, and debts and expenses not reflected in a credit report.

Furthermore, FHFA does admit that the updated scoring models provide "a slight increase in accuracy, which would ultimately benefit borrowers and investors," as well as incorporating economic changes since the financial crisis. The fact remains that a consumer with paid medical debt will experience a credit score increase - potentially 22 points or more - using an updated model. And if FICO 9 is used, a consumer with unpaid medical debt could experience a score increase as well, of perhaps 10 to 25 points. If that consumer's score is near a cutoff point, this increase can make a huge difference. If the Classic FICO score is slightly below a minimum scoring threshold, using FICO 9 can make the difference between getting a GSE-backed mortgage or not.

The main argument set forth in the RFI against changing to an updated scoring model seems to be the potential cost for the GSEs and industry to adopt a new scoring model. However, investments for the sake of improvement always require resources, but that is no reason to avoid progress. Scoring models built decades ago need to be updated, and the cost to do it is not a good reason to avoid modernization, especially since failure to do so could shut out a significant number of consumers from the mortgage market. In fact, such a move has the potential to broaden the market and help it grow.

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[5] Consumer Financial Protection Bureau, Consumer Credit Reports: A Study of Medical and Non-Medical Collections 5 (Dec. 11, 2014), available at https://files.consumerfinance.gov/f/201412_cfpb_reports_consumer-credit-medical-and-non-medical-collections.pdf.

[6] Ethan Dornhelm, FICO, The Impact of Medical Debt on FICO® Scores, FICO Blog, July 13, 2015, at http://www.fico.com/en/blogs/risk-compliance/impact-medical-debt-fico-scores/.

2. Updating scoring models may reduce disparate impact

Updating the credit scoring model used by the GSEs may also help with the yawning racial divides in mortgage lending, documented by many studies, including a recent one by the Center for Investigative Reporting.[7] This is because denying access to mortgages, or causing them to cost more based on medical debts also has disparate impacts.

Like so many other economic hardships in this country, medical debt does not affect every community equally. For one thing, minority consumers are more likely to be uninsured and thus more likely to have medical debt.[8] Even when they are insured, minority consumers are more likely to incur medical debt. A study of individuals 65 years old or older, who likely had Medicare coverage, found that African Americans had 2.6 times higher odds of medical debt than whites.[9] In addition, African Americans were more likely to be contacted by a collection agency and to borrow money because of medical debt, whereas whites were more likely to use savings.[10]

Thus, using credit scoring models that reduce the impact of medical debt may help reduce racial disparities in mortgage lending and expand access to mortgage credit in communities of color. The simple step of updating credit scoring models could be part of the solution on this thorny, troubling stain on American society.

3. Selection of the four options must take into account the impact on consumers

FHFA has proposed four potential options for updating the scoring models used by the GSEs. Of those, we oppose one option (Option 3 - Lender Choice) and have no preference between the others.

The options proposed by FHFA are:

• **Option 1 – Single Score:** The GSEs would require delivery of a single score – either FICO 9 or VantageScore 3.0 – if available on every loan.

• **Option 2 – Require Both:** The GSEs would require delivery of both scores, FICO 9 and VantageScore 3.0, if available, on every loan.

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[7] Aaron Glantz and Emmanuel Martinez, Center for Investigative Reporting, Kept Out: For people of color, banks are shutting the door to homeownership, Reveal, Feb. 15, 2018, available at https://www.revealnews.org/article/for-people-of-color-banks-are-shutting-the-door-to-homeownership/.
[8] #*See* Kaiser Family Found., Uninsured Rates for the Nonelderly by Race/Ethnicity 2016, at https://www.kff.org/uninsured/state-indicator/rate-by-raceethnicity/?currentTimeframe=0&sortModel=%7B%22colId%22:%22Location%22,%22sort%22:%22asc%22%7D (noting that 8% of whites are uninsured, versus 12% of African Americans and 17% of Latinos.
[9] Jacqueline C. Wiltshire, et al., Medical Debt and Related Financial Consequences Among Older African American and White Adults, American Journal of Public Health 106, no. 6 (June 1, 2016): at 1086-1091.
[10] *Id.*

• **Option 3 – Lender Choice on which Score to Deliver:** The GSEs would allow lenders to deliver loans with either FICO 9 or VantageScore 3.0, when available. Lenders would have to choose one score or the other for a defined period of time (*e.g.*, no less than 12 months).

• Option 4 – Waterfall: The GSEs would allow delivery of multiple score(s) through a waterfall approach that would establish a primary credit score and secondary credit score. Where a borrower does not have a credit score under the primary credit score, a lender would have the option to provide the secondary credit score.

Of these four options, we strongly oppose "Option 3 - Lender Choice" and have no preference amongst the other 3 options. We oppose Option 3 because allowing the lender to choose which scoring model to use would allow for potential abuses to the detriment of consumers, the GSEs, and the broader economy. We note that FHFA did not offer an option of "Consumer's Choice" or even give consumers any measure of input, likely in part due to perceived concerns that they would "game the system." If anything, these concerns should apply more to the "Lender's Choice" option, since lenders have more sophistication and ability to game the system than individual consumers.

We recognize that FHFA's proposal would require the lender to pick one score for a defined period of time, preventing the lender from picking the score for an individual consumer. But one of the lessons of the 2008 mortgage meltdown is that mortgage lenders and brokers are unlimited in their creativity to develop schemes that benefit themselves at the expense of consumers and others. Exploding adjustable rate mortgages, no-income no-assets loans, phony appraisals – the list goes on. We can easily imagine a lender using one scoring model, but telling consumers the score from the other model if it benefits them - for example, telling consumers the other score if it is lower in order to upsell the rate on the loan. As we have learned all too well, even a written disclosure on credit score usage could not overcome oral misrepresentations. Thus, Option 3 should definitely be ruled out for the protection of consumers, the GSEs and the broader mortgage market.

4. *FHFA must think more broadly than simply using updated versions of the traditional scoring models*

As FHFA knows, there has been great concern over the past few years regarding "credit invisibility." A May 2015 by the Consumer Bureau found that 26 million Americans (or about 1 in 10) do not have a credit history, and another 18 million are unscorable because their histories are too scant ("thin") or old. The CFPB study also found that African American, Hispanic, and low-income consumers are more likely to have no credit history or to be unscorable.

Policymakers, advocates, and industry members have proposed solutions to credit invisibility, most particularly promoting the use of alternative sources of data. In general, some of us have urged a cautious, 'go slow' approach toward alternative data. For an in-depth analysis of this approach, attached are consumer groups comments to the CFPB's RFI on alternative data.

One "alternative data" score that we do think could show promise is FICO's XD score. The fact that it is a second chance or fallback score is useful, especially since it scores data not included

in the files of the Big Three nationwide credit reporting agencies (NCRAs). Instead, it uses data from specialty consumer reporting agencies such as the National Consumer Telecom and Utilities Exchange, which we understand overwhelmingly (over 90%) consists of payment information from telecommunication companies.

Using data not in the NCRA files to create special scores for otherwise unscoreable consumers is preferable to the wholesale addition of the same data to traditional credit reports, where it might damage consumers who already have a credit score. Thus, an effort such as FICO XD, which currently uses alternate data only when a consumer has a thin file or no file, is preferable to a situation where the information in NCTUE is added to the main credit reporting files of the nationwide CRAs.

Thus, we urge FHFA to study this issue and consider implementing a limited pilot on the use of FICO XD. It is worth researching whether FICO XD can be used as a second chance or "waterfall" score in mortgage lending to address the issue of credit invisibility.

We noted that simply switching to VantageScore will not fully address the issue of credit invisibility. While VantageScore states that it scores 30-35 million more consumers than FICO, it does so by using the same data as FICO but scoring a file even if there has been no activity recently (FICO requires activity within the last 6 months but VantageScore will produce a score if there is activity within the last 2 years). Thus, the use of VantageScore will not benefit "no files" or many of the "thin files" who have solely negative records (such as only debt collection tradelines). It could provide scores for consumers who previously had good credit records but have dropped out of the credit market. This is a more limited set of consumers, some of whom are likely to be older consumers who have paid off their previous mortgage and do not need new mortgage credit. VantageScore itself has stated it will help 2 to 3 million consumers. Of those, the number who are applying for a mortgage is uncertain.

5. We favor requiring only two credit reports to promote competition

FHFA has asked whether it should consider changing the requirement to obtain credit reporting data from all three NCRAs, and replacing it with the flexibility to obtain data from just two NCRAs or even one NCRA. We would strongly favor such a proposal, and believe it would benefit both consumers and lenders.

First, only requiring two credit reports would introduce a small but useful amount of competition into the credit reporting market. We have frequently noted that the credit reporting industry is an oligopoly, given that there are only three companies that control the entire market. But in the mortgage market, it is actually a functional monopoly – there is no competition – due to the requirement that mortgage lenders use credit reports from all three NCRAs. There may be secondary players, such as the tri-merge resellers, but the fundamental critical data is held by the three NCRAs. Requiring reports from only two of the three NCRAs will at least move the market from a functional monopoly. It might compel the NCRAs to improve their practices. For example, if the GSEs or lenders are upset enough about Equifax's data breach, they might decide to choose Experian and TransUnion reports.

Second, only requiring two credit reports could help in the situation where a consumer has managed to correct an error in his or her credit report with two of the NCRAs but the third NCRA has been incompetent in fixing it. For example, there is one NCRA that appears to be more prone to “mixed file” errors than the other two because of the way in which it matches data. Of course, FHFA will need to develop guidelines regarding how to decide which NCRAs the reports will be obtained from, and what entity is empowered to make the decision. We urge FHFA to allow for consumer input into the decision, and to have protections in place to avoid abuses by lenders if they are allowed to make the decision.

On a related note, we could like to reiterate that the GSEs should not penalize consumers for credit reporting disputes in their automated underwriting systems. We continue to believe that this treatment constitutes a violation of the Equal Credit Opportunity Act.[11]

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Thank you for the opportunity to submit these comments and for your efforts to update the credit scoring model used by the GSEs. If you have questions about these comments, please contact Chi Chi Wu (cwu@nclc.org or 617-542-8010).

Respectfully submitted,

National Consumers Law Center
(on behalf of its low income clients)
NAACP
National Association of Consumer Advocates
U.S. PIRG
World Privacy Forum

Connecticut Fair Housing Center
Tennessee Citizen Action
Woodstock Institute (Illinois)

[11] For a complete discussion of this issue, see our November 2014 letter to FHFA at https://www.nclc.org/images/pdf/credit_reports/fhfa-letter-treatment-of-credit-reporting-disputes_11142014.pdf