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Jamie Gregory, Deputy Chief Lobbyist

500 New Jersey Avenue, N.W.
Washington, DC 20001-2020
202.383.1194 Fax 202.383.7580
www.realtors.org/governmentaffairs

STATEMENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

SUBMITTED FOR THE RECORD TO THE

UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

HEARING TITLED

EXAMINING THE USES OF CONSUMER CREDIT DATA

SEPTEMBER 13, 2012

INTRODUCTION

On behalf of the 1.1 million members of the NATIONAL ASSOCIATION OF REALTORS® (NAR), who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors, and others engaged in all aspects of the real estate industry, thank you for holding this hearing to examine the uses of consumer credit data.

NAR has a long history of involvement in issues concerning the use and disclosure of consumer credit data. Past concerns have focused on consumer credit bureau reporting practices, the calculation and use of credit scores for lending purposes, the introduction of insurance scoring and its impact on access to and the cost of property casualty insurance, and the ability of consumers to access and challenge information contained in the reporting bureaus' files of an individuals credit history.

Most recently, in November 2010, the Board of Directors of the National Association of REALTORS® approved policy that advocates for lenders, FHA, the GSEs, and Federal Regulators to reassess their credit policies to ensure more qualified, creditworthy borrowers have access to the credit they need in order to secure a mortgage. At the time, our members believed that the housing and mortgage markets had over-corrected, and this was one of the major issues holding back the housing recovery - excessively tight credit policy.

Unfortunately, in the two years since NAR adopted this policy, the credit pendulum has moved very little from the overcorrected position of stringent credit policy toward the middle, or a more moderate position. Therefore, to help the committee better understand the issues that REALTORS®, and their clients, face on an on-going basis; NAR will share the findings and recommendations from our members that shaped the organization's credit policy and their concerns with current methods of reporting and assessing credit worthiness.

RECENT CONSUMER CREDIT ACCESS AND DATA CONCERNS

What started as a problem with subprime, predatory loans became a systemic problem affecting all segments of the mortgage and housing markets. This problem had many facets. Lenders made subprime loans to prime borrowers. They also made loans to borrowers who were believed to be prime borrowers without verifying their income or carefully assessing the value of the property. Home values rose far faster than incomes. Mortgage-backed securities received triple A credit ratings based on overly optimistic projections of the performance of their underlying collateral (for example, Alt-A, subprime, and even prime loans). The Nation experienced a serious recession with high unemployment that resulted in less demand for homes and lower home values. Investors were no longer willing to invest in private label securities—mortgage backed securities without a federal guarantee. As a result, many homeowners are unable to afford their mortgages, and are unable to refinance or sell them. A short sale or a foreclosure too often is the only option.

Lenders responded to these problems by refusing to make loans unless they could sell them to Fannie Mae or Freddie Mac (the government sponsored enterprises, or GSEs) or have them insured by FHA. Combined, the GSEs and FHA currently account for more than 90 percent of the mortgage market. For the last several years, lenders have made hardly any non-GSE/non-FHA loans because there is no private label secondary mortgage market and these purely private loans must be held in the lenders' own portfolios. Also in response to these problems, the GSEs and FHA took steps to strengthen their underwriting.

In contrast to the middle years of the previous decade when a very large proportion of potential borrowers were able to qualify for loans with loan-to-value ratios even higher than 100 percent, now it can be very difficult to qualify for 80%+ LTVs without excellent credit. The credit and lending communities and federal regulators should reassess the entire credit structure and look for ways to increase the availability of credit to qualified borrowers who are good credit risks. The inadvertent response to "risk layering" has been "safety layering" where so many safeguards are being imposed that there is little risk to making new loans. NAR believes these "pristine" loans are the result of excessively tight underwriting, not sound business practices. A move toward the middle of the credit pendulum, including more appropriate practices for assessing creditworthiness, will not only help individual, well-qualified potential borrowers, but also the entire housing market which currently suffers from an excess supply of housing and unduly tight underwriting criteria.

In order to facilitate movement away from the overcorrected credit arena, NAR has identified the following concerns, and offered some specific consumer data reporting/scoring recommendations as a starting point for adjusting the current unduly restrictive credit policies.

RECOMMENDATIONS

Impact of Lowering Available Lines of Credit and Increasing Utilization Rates on FICO Scores

A Fair Isaac Corporation's study covering the period of April to October 2009 shows that during that period, 14 percent of consumers experienced a reduction in their lines of credit. While 1/3 of these had their credit lines reduced because of a "risk trigger," the remaining 2/3 had no credit event that caused the reduction. Obviously, throughout this economic crisis, a very large number of consumers have been affected by reductions in their lines of credit.

When a credit card issuer reduces a consumer's line of credit or a mortgage lender reduces a consumer's home equity line of credit (HELOC), there may be an effect on the consumer's credit score. In determining a credit score, specifically the consumers Fair Isaac Corporation (FICO) score, 30 percent is based on "amounts owed," including whether a person is using a high percentage of the available line of credit. FICO research shows that consumers with a high debt load and a high utilization rate pose a greater credit risk.

NAR urges the credit scoring industry to amend its formulas to avoid harming consumers whose utilization rates increase because their available lines of credit are unilaterally reduced without a risk trigger related to the particular consumer. For example, credit scoring models could ignore the utilization rate for such consumers or compute the score as if the available lines of credit had not been reduced. Although the Fair Isaac study shows that the scores of most of those affected stayed within 20 points of the prior score, in today's tight underwriting environment, even one point can mean the difference between qualifying for a loan or not, or qualifying for an FHA down payment of 3.5 percent or 10 percent. With respect to consumers where the lower available lines of credit results in problems with their ability to handle their finances due to an emergency, late payments will very soon result in a lower score so lenders will in most cases be able to take that into account.

Need to Change Reporting and Treatment of Loan Modifications/Payment Plans

Lenders sometimes agree to approve a loan modification or a payment plan for a borrower. The benefit to lenders is they may avoid a foreclosure and minimize their loss, and the benefit to borrowers is they may be able to keep their home. While the borrower's credit is damaged, sometimes they can rebuild it by meeting their new payment obligations. This is only possible, however, if a lender reports the loan modification as the same loan with changes. Some lenders report loan modifications with a Code ("AC") that indicates "partial payment—not paid as originally agreed." In November 2009, the credit reporting agencies (the CRAs, Equifax, Experian, and TransUnion) started to allow a new code ("CN") that means "loan modified under a Federal government plan." Credit scoring companies need to ensure that their formulas recognize this code, and lenders need to utilize it when a loan modification is granted. Furthermore, NAR urges the credit scoring industry to study the credit risk performance of consumers whose loans are modified under a Federal government plan and modify the credit scoring formulas accordingly.

Fair Isaac Corporation has advised NAR that its research shows that borrowers not paying as originally agreed are more likely to become seriously delinquent in the near future. NAR questions the assumption that borrowers who agree to a loan modification or a payment plan for credit obligations they can no longer afford but who then demonstrate their ability to handle the modified payments are higher credit risks, especially given the now longer history, experience and ongoing modification of these types of loan modification programs. NAR has urged FICO to study the credit risk performance of these consumers and modify the FICO formula accordingly.

NAR urges the credit and lending communities and federal regulators to adopt reasonable, uniform reporting of loan modifications so if borrowers make on-time payments for a reasonable period their payments are reported as "paid as agreed." This recognizes that both parties agreed to the loan modification, that it has, in effect, replaced the prior loan, and that the consumer is working to restore good credit. Continuing to report payments indefinitely as "not paid as originally agreed" makes it difficult, if not impossible, for the borrower to begin to reestablish good credit until the loan is fully repaid. Refinancing will be practically impossible. The borrower may never be able to move to another home because the borrower's credit will never be good enough to qualify for another mortgage. The current variations in reporting means consumers are treated inconsistently and, accordingly, the system is viewed as being unfair. All of these effects are against the interest of every party involved and the housing market itself.

Establish Standards to Address Strategic Defaults

Press reports indicate that a significant number of borrowers who owe more on their mortgages than their homes are now worth, but who can afford to pay their mortgages, are nevertheless opting to default, sometimes after first buying another home. This action is usually referred to as a strategic default.

NAR believes that borrowers who have the financial ability to meet their mortgage obligations should do so. It is appropriate for a borrower whose default is not due to extenuating circumstances to be required to take more time to repair their credit history and qualify for new credit.

However, NAR urges the lending industry (including the FHA, the GSEs, and lenders) to adopt or retain, as appropriate, underwriting policies that take into consideration extenuating circumstances of the borrower. For example, it should be possible for a borrower to qualify for a new mortgage more easily and faster if extenuating circumstances, as determined pursuant to underwriting policies of the lender, occurred that led to the borrower's loan default.

Need for Research on the Impact of Credit Policies on Underserved Groups

NAR also believes that the industry must assess if there is a need for additional research on the impact of current credit policies on underserved groups. Not all groups have the same "culture" with respect to the use of credit. Some have thin files because they are not aware of their credit options, choose not to use credit to avoid potential misuse, are young and do not have a long credit history, or only have payment history related to cell phone and utility bills and rent. Others live in extended families where the household has a very high joint capacity to handle its financial needs and obligations, but find it difficult to qualify for a loan.

NAR continues to urge lenders to rely on non-traditional credit histories in underwriting loans for potential borrowers with thin credit files to determine if they are good credit risks. In addition, NAR urges credit score providers and the lending industry to amend their policies to avoid denying credit to borrowers who are good credit risks, but don't otherwise fit a traditional model.

Ensure Consumers Access to their Credit Scores

Section 1100F of the Dodd-Frank Act gives consumers the right to a free copy of their credit scores if a creditor takes an adverse action based on information contained in a consumer credit report. Previously, consumers only had the right to a free copy of their credit report in the case of an adverse action—and annually, if they requested a copy—but not the credit score in either case.

NAR, whenever an opportunity to amend the Fair Credit Reporting Act arises, has and will continue to support legislation to give all consumers the right to receive a free copy of their credit score from each national credit reporting agencies at the same time they receive a free copy of their credit report provided on request. Giving all consumers a right to receive a free copy of their credit score will avoid confusion and increase transparency with respect to consumer credit. Many consumers think they already have this right. Others are misled by sites that promise a free credit score but entice consumers into agreeing to monthly charges. Avoiding the need to distinguish between two classes of consumers—those that qualify for a free report and those that do not—will also make administration of the statutory free disclosure requirements easier for the credit reporting agencies.

CONCLUSION

REALTORS® understand well the impact that credit reports and the use of the data contained therein have on American households. They also believe that one of the biggest issues impacting the housing economy is the lack of available credit for potential homebuyers. If the housing finance industry, both private and government-backed, can move away from its overcorrected position of stringent underwriting requirements and move toward a middle ground, more moderate underwriting posture, a housing robust recovery will occur. And when housing recovers, so does the American economy.

NAR thanks you for this opportunity to share our thoughts on consumer credit data and its impact on the housing recovery. As always, the National Association of REALTORS® is at the call of Congress, and our industry partners, to help continue the housing and national economic recovery.