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March 28, 2018

Melvin L. Watt
Director
Federal Housing Finance Agency
Constitution Center
400 7th Street SW
Washington, DC 20219
https://www.fhfa.gov/AboutUs/Contact/Pages/Request-for-Information-Form.aspx

Dear Director Watt:

On behalf of the 1.3 million members of the National Association of REALTORS® (NAR), I submit this letter in response to the Federal Housing Finance Agency's (FHFA) *Credit Scoring Request for Input*. NAR has long advocated for the credit and lending communities, as well as federal regulators, to reassess the entire credit structure and to look for ways to increase the availability of credit to qualified borrowers who are good credit risks. NAR appreciates the FHFA's efforts to introduce new credit models to the government sponsored enterprises (GSEs), but views this as a first step and looks forward to the GSEs' adoption of additional modeling and data innovations in credit scoring.

The National Association of REALTORS® is America's largest trade association, including NAR's five commercial real estate institutes and its societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,200 local associations or boards, and 54 state and territory associations of REALTORS®. NAR represents a wide variety of housing industry professionals, including approximately 25,000 licensed and certified appraisers, committed to the development and preservation of the nation's housing stock and making it available to the widest range of potential homebuyers.

REALTORS® believe that homeownership is an integral part of the American Dream that should not be out of reach for individuals and families that lack a deep borrowing history and consequently, access to traditional forms of credit. By assessing ways to increase the availability of credit to qualified borrowers who are good credit risks, as well as the potential risks involved with doing so, credit and lending institutions could restructure credit opportunity for millions of borrowers.

Importance of Credit Scores

The availability of mortgage credit at a fair and reasonable cost is central to the home purchase transaction that, in turn, is central to the businesses of REALTORS®. Critical to the extension of credit is the credit score. REALTORS® see firsthand the negative impacts on consumers who are buying, selling, leasing, or renting properties when flawed or lacking credit scores make it hard or impossible for their clients to purchase homes.

Credit scoring is built on the credit history patterns of groups of individuals using consumer reporting agency (credit bureau) records. These comparative patterns translate into statistics used as the basis for estimating the likelihood of an individual to default in the future. Thus, credit scoring innovations are driven by changes in both modeling of credit data and by changes in the credit data itself.

While the GSEs performed empirical analyses of credit scores for the request for input, those analyses have not been released to the public. The details of the analysis provided in the request for input indicate that analysts examined applications to the GSEs. This method does not take into account borrowers diverted to other agencies (Federal Housing Administration, Rural Housing Service, or the Veterans Administration) due to lender overlays or dissuaded from applying all together in the post-crisis environment, i.e. precisely the group that expanded credit is intended to address. Worse, the analysis did not take into account innovations in data such as telecommunications, rental, and utility payments available in newer models of both the Fair Isaac Corporation (FICO) and VantageScore credit score models. In the future, any analysis used to evaluate whether an innovation can be used in credit scoring by the agencies should be made public.

Different Models

The FICO Corporation is one of several private companies that provide credit scores based on their proprietary model to lenders, insurers, investors, and other users. However, the GSEs currently only accept "classic" FICO scores, which are derived from an older credit model built on data that existed prior to the financial crisis. Furthermore, each credit bureau generates a different FICO score based on a modified version of the "classic" FICO model that is tailored to the data unique to each credit reporting agency (CRA). Thus, "classic" FICO refers to FICO 5 from Equifax, FICO 4 from TransUnion, and FICO Score 2 from Experian. VantageScore has one model used across the CRAs. The request for input seeks to determine whether the GSEs should rely on classic FICO scores or to allow newer scores based on more advanced modeling including FICO 9 or VantageScore 3.0 or a combination of the scores. REALTORS® view competition as critical to the adoption of innovations that will meet the expanding needs of American homeowners and option three under the request for input best satisfies this need.

Accuracy and transparency of the credit scores, both modeling and the data they rely upon, is important to REALTORS®. For years, some consumers were denied access to homeownership based on inquiries for credit while shopping—one of the very behaviors that an open market should encourage. It took decades for the FICO Corporation to remedy this problem and while the pace of change within credit modeling has increased dramatically since the housing crisis, it appears those innovations were driven in part by competition. REALTORS® do not support one model over the other, but recognize the need for competition to stimulate needed changes.

One might argue that competition is not prudent in credit modeling and that differences in models are based on cutting corners leading to a race to the bottom. However, the credit score is not used in solitude in the underwriting at Freddie Mac and it is simply a threshold for underwriting and pricing at Fannie Mae. Furthermore, all interested parties, lenders, private mortgage insurers, investors, and the GSEs, can test the veracity of these models over time. Lenders relied heavily on credit scores in the post-crisis environment to protect against elevated risks as evidenced by wide spread use of credit overlays. If the reliability of a score declines, lenders' risks will rise and they will migrate to a more reliable score.

For these reasons, NAR supports the adoption of option three, the use of a single credit model for all mortgages originated by a lender for a defined period to prevent gaming of the score. However, there should be an "off ramp" if the quality of the measure is found to degrade. In this sense, lenders would be incentivized to regularly check the veracity of the model they chose, while the credit modeling companies would be incentivized to maintain quality. Lenders may choose to pull multiple scores to share with investors for comparison when reporting, but the pre-selected score must be used in underwriting. Multiple scores may create confusion for investors and homebuyers, but as the Consumer Financial

Protection Bureau (CFPB) demonstrated in their 2012 research on the topic, a reference measure can be constructed for comparison. [1]

The status quo (option #1) is not a desirable option as it does not address the growing need for innovative credit options in the housing market. Other options that require pulling both scores simultaneously (option #2) or by way of a pre-approved waterfall (option #4) limit competition and the process of adapting innovations necessary to fill the credit void.

Tri-merge Score

Under the current system, an applicant for a mortgage pulls a tri-merge score, which displays the individual's credit score from all three CRAs and the middle score is used for underwriting. With the tri-merge report, the credit bureaus are not incentivized to improve the data in their repository, as each CRA's score is considered regardless of the overall quality of the data and analysis.

By allowing lenders to choose a score, lenders are likely to gravitate towards the score of the bureau with the best data. This in turn would incentivize the credit bureaus to improve their data, fix errors, and extend partnerships with other data vendors in order to integrate other sources of consumers' financial life such as telecom, utilities, and even bank statements. Thus, competition and a framework for the FHFA and GSEs to review and then adapt to credit innovations is critical to adopting the next breakthrough in credit scoring: alternative credit data.

Benefits of Alternative Credit

A borrower's credit score is crucial for entrance to the housing market; with a poor score, or none at all, a borrower stands little to no chance of obtaining a loan. Yet millions of Americans – particularly minorities, immigrants, and people with modest incomes – come from backgrounds that avoid debt, leading many to have little to no credit history.

As noted by the CFPB in its *Request for Information Regarding Use of Alternative Data and Modeling Techniques in the Credit Process* (2017), nearly 45 million Americans are underserved and have trouble accessing affordable credit. With new credit scoring models that incorporate additional predictive metrics and payment history, many of these "thin file" individuals would be able to obtain credit and enter the housing market.

Utility, telecomm, and rental histories should be incorporated into credit scores used by the GSEs. Doing so would bolster credit profiles of those individuals lacking more traditional borrowing histories. These advances could provide powerful insights, not just into groups historically left out of mainstream credit, but to borrowers who fall out of good standing through fewer trade lines during recessions or as they age. As the demographics of our country change to include a larger minority and elderly population, these advances will become critical to extending housing credit. Furthermore, more accurate credit scores may improve pricing for some borrowers.

New Demographic Paradigm Requires New Credit Scoring Paradigm

Expanding the system to incorporate innovations in credit scoring will necessitate an expense. That cost must be balanced against the benefits reaped from the change. REALTORS® believe that expanded credit scoring can create a new rung on the housing ladder, extending ownership to millions of credit worthy Americans. Furthermore, the Enterprises are currently earning billions of dollars every quarter that are passed to the Treasury. Those profits should be used by the GSEs in part to fund the expense of reviewing and adapting to new credit models.

Conclusion

[1] CFPB. "Analysis of Differences between Consumer- and Creditor-Purchased Credit Scores". September 2012

Adoption of innovations in credit scoring will help many more families achieve the American Dream by responsibly boosting consumer access to mortgage credit. NAR is encouraged by the FHFA's focus on reviewing new credit models. However, establishing a review process for new models and further exploration of alternative credit data and models are necessary improvements to such an integral part of the housing finance system. NAR appreciates the opportunity to provide input and look forward to continuing to work together on these important issues. If you have any questions, please contact me or NAR Senior Policy Representative, Ken Fears, at 202-383-1066 or kfears@REALTORS.org.

Sincerely,

Elizabeth J. Mendenhall

Elizabeth Mendenhall
2018 President, National Association of REALTORS®