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Priscilla Almodovar
Chief Executive Officer, Fannie Mae
1100 15th St NW
Washington, DC 20005

Michael DeVito
Chief Executive Officer, Freddie Mac
1551 Park Run Dr
McLean, VA 22102

ATTN: Comments on the Enterprise Credit Score and Credit Reports Initiative – Partnership Playbook

Ms. Almodovar and Mr. DeVito,

The Housing Policy Council ("HPC")[1] appreciates the opportunity to submit this comment letter in response to the Federal Housing Finance Agency's ("FHFA") announcement on March 23, 2023[2] of an implementation plan[3] for the adoption of the FICO 10T and VantageScore 4.0 credit score models, as well as the bi-merge credit reporting policy. HPC member companies have substantial engagement with the Enterprises as originators and servicers of residential mortgages that are securitized by the Enterprises, as counterparties to the Enterprises in credit risk transfer structures, as vendors that provide technology solutions to mortgage market participants, liquidity providers and purchasers of correspondent loans, and as private mortgage insurers that provide loan-level credit enhancement on certain Enterprise mortgages. As such, the members of HPC have a direct interest in the impact of the credit score policy business decisions of the Enterprises, as well as the manner in which the credit score policies contribute to a competitive, equitable, and sound housing finance system.

We appreciate FHFA's intent to recalibrate the credit scoring framework. However, due to the far-reaching impacts of the proposed changes, which include significant costs and operational complexity, a timeline that fails to provide sufficient time for a disciplined review and validation process, and a process that doesn't have scheduled ways to incorporate feedback from key stakeholders', the proposed implementation plan poses a risk to the stability of the housing finance system.

We endorse the position expressed in Director Thompson's testimony before the House Financial Services Committee that the credit score model "transition timeline must be flexible enough to incorporate testing and unexpected events, but also efficient enough to incorporate testing and

[1] The Housing Policy Council is a trade association comprised of the leading national mortgage lenders and servicers; mortgage, hazard, and title insurers; and technology and data companies. Our interest is in the safety and soundness of the housing finance system, the equitable and consistent regulatory treatment of all market participants, and the promotion of lending practices that create sustainable homeownership opportunities in support of vibrant communities and long-term wealth-building for families. For more information, visit www.housingpolicycouncil.org

[2] FHFA news release on credit score policy requirements from March 23, 2023.

[3] Fannie Mae and Freddie Mac Joint Implementation Plan

unexpected events…"[4] Based upon our review of the current proposed timeline we are concerned that the plan doesn't include sufficient time, flexibility, or detail to execute this extraordinary effort effectively. Further, the plan does not reflect an agile and iterative process to incorporate stakeholder feedback. To address this, we believe that the credit score policy implementation plan should be adjusted to include:

- Robust data transparency to analyze the impacts of the changes and design new models to support the wide array of business functions that will be affected;
- A comprehensive and iterative stakeholder engagement process; and
- A realistic timeline that accommodates data analysis and modeling, policy determinations, systems development and testing, as well as unexpected setbacks.

If FHFA were to adopt these three recommendations and adjust the implementation process accordingly, we believe that this policy change will still be very difficult for market participants, but could be adopted with reduced disruption to the housing finance system. However, without a commitment to making these adjustments, we have significant concerns about the current plan's risks to the housing finance system.

Recommendation 1- *Stakeholders need data transparency to analyze the impacts of the changes.*

We are mindful that FHFA and the Enterprises have been analyzing these credit score models and policy changes for years and have no doubt accumulated significant data on how the various models might perform in different scenarios. Other market participants, however, have not yet had the opportunity to review that data and perform their own testing and analysis. Market participants will need a significant amount of information regarding, among other things: how new model(s) relate to Classic FICO, how FICO 10T compares with VantageScore 4.0, how Enterprise policies and procedures will change (including effects on pricing and borrower eligibility), potential impacts in the To-Be-Announced ("TBA") and Credit Risk Transfer ("CRT") markets and any countermeasures to address these impacts by FHFA or the Enterprises, impacts on affordable housing programs, and the expectations for lenders and insurers under a new framework. To address these and other issues, we think it is essential that stakeholders be provided extensive datasets as quickly as possible. Specifically, the data releases need to contain the following elements:

1) Classic FICO scores for all borrowers from all three credit bureaus back to 1999.[5]

2) FICO 10T and VantageScore 4.0 scores[6] for each loan application from each of the three bureaus as far back in time as possible (preferably back to 1999 as well). Getting this data for the pre-Great Financial Crisis loan cohorts would be highly desirable to determine how the new models actually perform in a significant economic downturn relative to Classic FICO.[7] If it is not possible to provide this full set of historical data, at a minimum we would request that the Enterprises provide the raw credit bureau attributes on loans back to 1999 (or provide some other proxy value for the new scoring algorithms).

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[4] Written Testimony of Sandra L. Thompson, before the House Committee on Financial Services
[5] As of the date the credit scores were pulled for each loan transaction.
[6] As of the application or note date for each loan transaction.
[7] This older (pre-Great Financial Crisis era) data is critical because during the COVID recession, the CARES Act suppressed derogatory credit, and thus is less reliable for these testing purposes.

3) Provide this historical dataset in a manner that links it to the Enterprise loan performance datasets. This data could be used by all industry participants to:

- Evaluate the fair lending risk and loan performance of FICO 10T and VantageScore 4.0, compared to classic FICO for the historical loan dataset over long periods of time with varying economic cycles;
- Analyze the move from the tri-merge to the bi-merge using classic FICO (once the calculation for a bi-merge FICO has been determined);
- Develop policy recommendations for the GSE instructions for lender selection of two CRAs; and
- Recalibrate models that support pricing and investment systems, to accommodate the new methodology and scores.

In addition to this data, we request that the Enterprises publish a public version of the Business Assessment that was conducted in accordance with 12 CFR § 1254.8, for each scoring model that the GSEs recommended to FHFA for approval. Release of the information associated with this statutorily required process would help stakeholders to understand the Enterprise perspective on the following key elements: the accuracy and reliability of the model; the fair lending impacts; impacts on Enterprise operations and risk management, and impact on the industry; and competitive effects. Publication of this Business Assessment would provide participants in all other market segments, specifically including portfolio, private label securities, and government insurers to assess the approved models using similar methodologies and information.

Recommendation 2- *We request a transparent, delineated, and continuous stakeholder engagement process.*

We endorse Director Thompson's testimony that "the public engagement process will allow stakeholders to provide critical feedback and input on the implementation process and to work with FHFA and the Enterprises to further refine the proposed implementation plan."[8] Unfortunately, the current public engagement process identified in the Joint Implementation Plan does not satisfy this objective. For this policy change to succeed, the implementation plan should be revised to include a holistic, defined engagement process that includes comprehensive discussions with market participants as well as targeted stakeholder outreach to key market segments.

Models for this type of holistic engagement process include the FHFA development and execution of the Single Security Initiative/Common Securitization platform and the LIBOR Transition LIBOR Transition Project, which incorporated comprehensive stakeholder outreach, as well as progress reports, requests for information, revisions to the credit policy to account for the stakeholder input, and a testing process. To supplement this best practice, we recommend the following specific engagement recommendations:

- Targeted outreach focused on the potential impacts on borrowers and investors (CRT, MSR, and MBS investor communities).
- Targeted outreach focused on consumer education and messaging to consumers on costs and outcomes (with direct engagement with consumer advocacy organizations).
- Outreach to representatives from the credit report production and delivery supply chain.

[8] Id.

- Collaboration with the MISMO organization and the related Communities of Practice (CoP) to establish the MISMO Standards and consideration of the lead-time needed for any new scoring methodology including any changes to the bi-merge logic and subsequent loan representative score methodology.
- Dedicated policy engagement on the development of credit policy to address gaming/adverse selection/fair lending issues. This should include discussions of how to avoid credit score shopping by borrowers, loan officers, brokers, lenders, etc. Also, discussion about how the representative score can be chosen to address fair lending concerns. Lastly, the process should include discussion about how Fair Credit Reporting Act declination credit factors will be determined and messaged to applicants in light of averaged credit bureau scores.
- Dedicated engagement to align the government insurers with the policy decisions and timing for the use of both the bi-merge classic FICO and ultimately the FICO 10T and VantageScore 4.0 credit score models.

If FHFA and the GSEs were to adopt a holistic engagement plan like this, the likelihood of a successful transition will be significantly increased.

Recommendation 3- *The Implementation Timeline needs significant adjustments.*

Director Thompson's testimony that the credit score model transition process "must be flexible enough to incorporate testing and unexpected events"[9] does not align with the agency's currently proposed timeline. In fact, the timeline proposed as part of the Enterprise Joint Implementation Plan doesn't include any time for testing, policy iteration, or unexpected events, or an effective stakeholder engagement process, and we are concerned that this is inadequate for the scale and complexity that the policy change poses. Candidly, the proposed timeline is both too aggressive and is missing key milestones that are needed for the project to succeed. Specifically, we recommend the following changes (at a minimum) to the timeline:

- There needs to be significantly more time between the publication of historical data and the expected implementation of the new policy (both the tri-merge to bi-merge milestones and the incorporation of FICO 10T and VantageScore 4.0). The timeline should provide no less than 18-24 months between the publication of data and any implementation milestone, to provide time for model development, testing, policy discussions and finalization, and unexpected events.
- The timeline needs to include the critical milestones that will make the transition possible, such as identifying when the GSE credit policy framework will be published and what data will need to be submitted to the Enterprises (we recommend that the credit policy framework be released at the same time as the data delivery policy).
- The timeline needs to include a clear transitional framework and identification of any processes and procedures required during periods where both 'old' and 'new' score calculations and submissions may be acceptable.
- The timeline should establish distinct, defined phases for solicitation of input, to provide the opportunity for stakeholders to provide a wide array of important insight for consideration, including analysis of the historical data. This approach would permit the GSEs to adjust credit policy decisions based on stakeholder feedback.

[9] Id.

- The timeline should identify milestones for engagement with, and technical assistance to, FHA, VA, RHS, and Ginnie Mae, as well as non-agency markets to analyze the published data and provide feedback, as most lenders rely on Fannie and Freddie's AUS system to underwrite government and non-agency loans. It is quite important that government insurers be in alignment on both the bi-merge report and modern score (FICO 10T/VantageScore 4.0) adoption. Failure to do so would cause lenders to absorb the cost and complexity of running multiple different credit models and potential borrower confusion that their scores (which must be disclosed to them per FCRA regs) differ across the loan products they are evaluated under by their lender (e.g. FHA vs GSE). Additionally, a failure to align policy raises a real risk that the government loan products could be adversely selected, with marginal loans that may not fare well under the new models; the vast majority of government loans are run through GSE automated underwriting systems (DU and LP), which will be utilizing the new credit score models.

While this specific set of timeline requests highlights areas of concern that should be included as milestones and/or action items in the multi-year timetable, we also have serious concerns that the timeline does not acknowledge the full array of stakeholder business-related activities that each company will need to undertake. Obviously, each type of market participant will have a unique set of responsibilities, but all will begin with a basic assessment of the implications of the new credit scores on a variety of functions. An extraordinary level of attention and resources will be required for each company to make the transition, as the number of business activities affected is extensive.

While the list is long and varied, here is a sample of the types of critical functions that will require substantial time for development, testing, and deployment. First and foremost, every company involved in origination will need to rework significant portions of the origination process, from prequalification through underwriting through closing. This will include new disclosures and form updates for borrowers and investors. Behind these operational changes will be new and comprehensive modeling to recalibrate the use of new credit score models with corporate risk appetite, pricing, and portfolio valuations. These will all require changes to existing technology capabilities and resources. Further, each of these will need alternative or dual processes for investors not adopting the same policies as the GSEs. Each vendor that will be transitioning will also need to establish and test integration and capabilities, which will result in new contract negotiations between a multitude of counterparties. The new credit score system will have an impact on all credit determinations, product availability, and pricing, while companies adapt and determine how entirely new methodologies affect volume, customer mix, performance, and capital requirements. Of course, the flow of information from origination through servicing and loss mitigation will be affected, requiring policy and process retooling. In addition, the quality control and quality assurance capabilities of every company will need to be adjusted, and again, tested for effectiveness prior to implementation. Again, this is a representative, rather than all-inclusive list, reflecting merely a small subset of the work that will need to be performed to adopt the new credit score framework.

In other words, this is a *massive* undertaking that will require re-specification of virtually every procedure and protocol that uses credit scores, across the broad spectrum of businesses that perform some role in the housing finance system. The work will touch thousands of operations and thousands of entities, and unfortunately, the current timeline is unrealistic, providing insufficient time for most of these critical tasks.

Lastly, our members believe that the plan should eliminate the proposed move to a bi-merge credit report utilizing Classic FICO as a first phase of the credit score implementation plan. Instead, we recommend a one-step conversion (i.e., introduce FICO 10T/VantageScore 4.0 and bi-merged scoring at the same time instead of in phases). This could minimize the expense, time, and resources required to perform multiple analyses and, more importantly, could shorten the overall timeline for adoption.

The development and calibration of risk models is a time-consuming and costly effort that requires processing of extensive amounts of loan-level historical data to properly assess how the new performance information will affect the various business functions, such as eligibility and pricing. The same tasks for model development and calibration would then need to be duplicated for the subsequent transition to FICO 10T and VantageScore 4.0. In our view, any prior efforts to develop models, and establish new functionality, including eligibility and pricing, based on bi-merge Classic FICO would provide little or no value toward the overall transition, nor would bi-merge Classic FICO processing provide any interim benefit toward the goals of improved precision or reliability. Therefore, we recommend that the implementation plan remove the proposed shift to bi-merge Classic FICO and incorporate the transition to bi-merge processing with the transition to modern scores to lower the costs and the operational risks.

Conclusion:

While we are highlighting our grave concerns with the announced timeline and milestones, we do believe that adoption of our three recommendations could make the transition a more successful experience and would certainly help to minimize disruption and risk to the system. Thank you for your consideration.

Yours truly,

Edward J. DeMarco
President
Housing Policy Council