



FACT SHEET: VALIDATION AND APPROVAL OF CREDIT SCORE MODELS BY THE ENTERPRISES

FHFA PROPOSED RULE ON THE VALIDATION AND APPROVAL OF CREDIT SCORE MODELS BY FANNIE MAE AND FREDDIE MAC

BACKGROUND

Section 310 of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (PL-115-174) (the Act) amended Fannie Mae and Freddie Mac (the Enterprises) charter acts and the Federal Housing Enterprises Financial Safety and Soundness Act (Safety and Soundness Act) to establish new requirements for the validation and approval of credit score models by the Enterprises.

The Act does not require the Enterprises to use a credit score; however, if an Enterprise conditions the purchase of a mortgage loan on a borrower's credit score, that credit score must be produced by a model that has been validated and approved by the Enterprise based on the standards and criteria in the Act and FHFA regulations.

The Act requires FHFA to issue regulations establishing standards and criteria for the validation and approval of credit score models by the Enterprises.

SUMMARY OF THE PROPOSED RULE

The proposed rule would establish a four-phase process for an Enterprise to validate and approve credit score models:

- Solicitation of applications from credit score model providers
- Review of submitted applications
- Credit score assessment
- Enterprise business assessment

Solicitation of applications from credit score model developers

During this phase each Enterprise would publish a credit score solicitation. The solicitation would include dates for the solicitation period, a description of the information that must be submitted with the application, a description of the Enterprise process for obtaining data for testing, a description of the Enterprise's process and criteria for conducting their validation and approval, and additional information required by the Enterprise, subject to FHFA review and approval.

Each Enterprise would be required to submit its initial credit score solicitation to FHFA within 60 days of the effective date of the final rule. FHFA would review and approve each Enterprise's solicitation within 45 days. The Enterprise would then publish its solicitation for at least 90 days prior to the start of the solicitation period. This is to ensure that applicants have sufficient time to understand the Enterprise application requirements and validation and approval process prior to submitting their application. Finally, the initial solicitation period for application submission would be open for 120 days.

HIGHLIGHTS

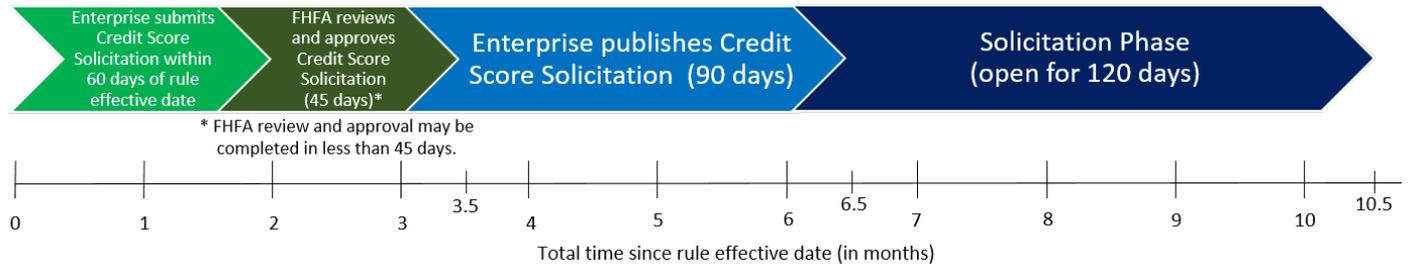
- The Act establishes new requirements for the validation and approval of credit score models by the Enterprises.
- This proposed rule seeks comments on FHFA's four-phase process for the validation and approval of credit score models by the Enterprises.
- The proposed rule would establish reasonable deadlines for the Enterprises to solicit applications and evaluate any applications received.
- Interested parties will have 90 days to comment on the proposed rule via FHFA.gov.



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The proposed rule would require the Enterprises to solicit new applications from credit score model developers every seven years unless FHFA determines otherwise.

Figure 1: Illustration of Initial Solicitation Timeframe



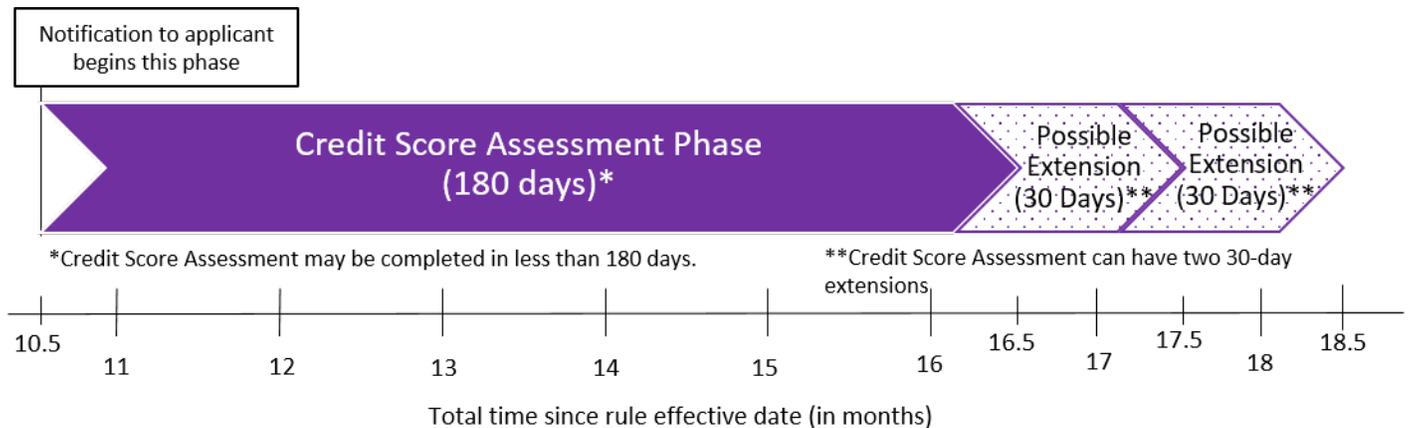
Review of submitted applications

The proposed rule would require the Enterprises to determine whether each application submitted is complete and includes all required fees. Each applicant would be required to submit an application fee, fair lending certification, information to demonstrate its use by an industry, a conflicts of interest certification, and any other information required by an Enterprise. The Enterprise also would obtain any data necessary for testing. Applicants would be responsible for the cost of an Enterprise obtaining the data, and an application would not be complete until the third-party data has been received.

Credit score assessment

This phase would test each credit score for accuracy, reliability and integrity outside of the Enterprise’s business systems. This phase must be completed within 180 days of notification to the applicant, with two possible 30-day extensions. In assessing accuracy, the proposed rule seeks comment on four different approaches: comparison-based approach, champion-challenger based approach, benchmark-based approach, and transitional approach. All applicants that meet the requirements of this phase begin the Enterprise business assessment phase.

Figure 2: Illustration of Initial Credit Score Assessment Maximum Timeframe



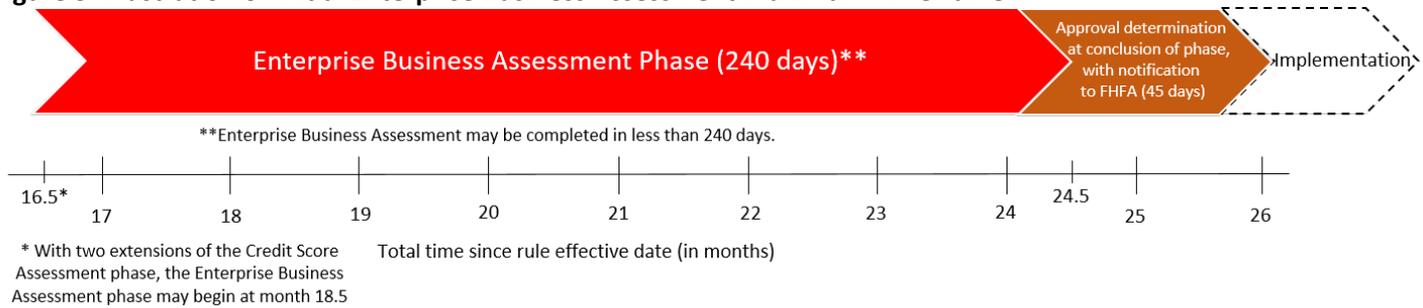


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Enterprise business assessment

This phase would assess the credit score model in conjunction with the Enterprise’s business systems that use borrower’s credit scores as part of criteria for the purchase of mortgage loans. The Enterprise business assessment would evaluate accuracy and reliability within the Enterprise systems, impacts on fair lending, possible competitive effects from using a particular model, an assessment of the model provider as a potential vendor, the impact to the mortgage finance industry, and the impact on the Enterprise’s operations and risk management. This phase must be completed within 240 days. A credit score model may be approved by an Enterprise during this phase, subject to FHFA review and approval. If an application is approved, the credit score model will be implemented by the Enterprise in its systems. Any approval of a new credit score model will be publicly announced.

Figure 3: Illustration of Initial Enterprise Business Assessment Maximum Timeframe



KEY FEATURES

Credit score model developer independence

The proposed rule would prohibit an Enterprise from approving any credit score model developed by a company that is related to a consumer data provider through any common ownership or control. The proposed rule also would require an Enterprise to consider potential conflicts of interest and competitive effects in assessing the costs and benefits of approving any credit score model.

In 2017, FHFA issued a request for input on potential changes to the Enterprise credit score requirements and sought feedback on credit score competition and consolidation in the credit score marketplace. Competition concerns may arise if a credit score model developer is owned by or affiliated with an institution that may have a conflict of interest. For example, this could include a credit score model developed by an institution that controls the data used to develop the credit score model, or it could include a credit score model developed by a lender for use in its own systems.

Timeframes and Implementation

The proposed rule would establish reasonable time periods for each phase of the process. The proposed rule does not address the timeframe for industry adoption and implementation of a new credit score model(s) which would be in addition to the time for validation and approval. Based on feedback received through the request for input, FHFA believes that it will take the industry approximately 18-24 months to adopt and implement a new credit score model after a model has been approved by an Enterprise. The proposed rule invites comments on this topic.

