



Validation and Approval of Credit Score Models

Webinar on Proposed Rule | January 9, 2019

Contact: Beth Spring, DHMG

WELCOME



Elizabeth Spring

*Sr. Policy Analyst, Division
of Housing Mission & Goals*



Robert Dunsky

*Principal Economist, Office of Policy
Analysis & Research*



Proposed Rule Overview

The proposed rule would establish a four-phase process for the validation and approval of credit score models:

- 1) Solicitation of Applications from Credit Score Model Developers;
- 2) Initial Review of Submitted Applications;
- 3) Credit Score Assessment; and
- 4) Enterprise Business Assessment

Statutory Requirements

SEC. 310. Credit Score Competition.

“(B) Use of Credit Scores.--The corporation shall condition purchase of a residential mortgage by the corporation under this subsection on the provision of a credit score for the borrower only if—

- (i) the credit score is derived from any credit scoring model that has been validated and approved by the corporation under this paragraph; and
- (ii) the corporation provides for the use of the credit score by all of the automated underwriting systems of the corporation and any other procedures and systems used by the corporation to purchase residential mortgages that use a credit score.”

Statutory Requirements

SEC. 310. Credit Score Competition.

“(C) Validation and Approval Process.—The corporation shall establish a validation and approval for the use of credit score models, under which the corporation may not validate and approve a credit score model unless the credit score model—

- (i) satisfies minimum requirements of integrity, reliability, and accuracy;
- (ii) has a historical record of measuring and predicating default rates and other credit behaviors;
- (iii) is consistent with the safe and sound operation of the corporation;
- (iv) complies with any standards and criteria established by the Director of the Federal Housing Finance Agency under section 1328(1) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992; and
- (v) satisfies any other requirements, as determined by the corporation.”

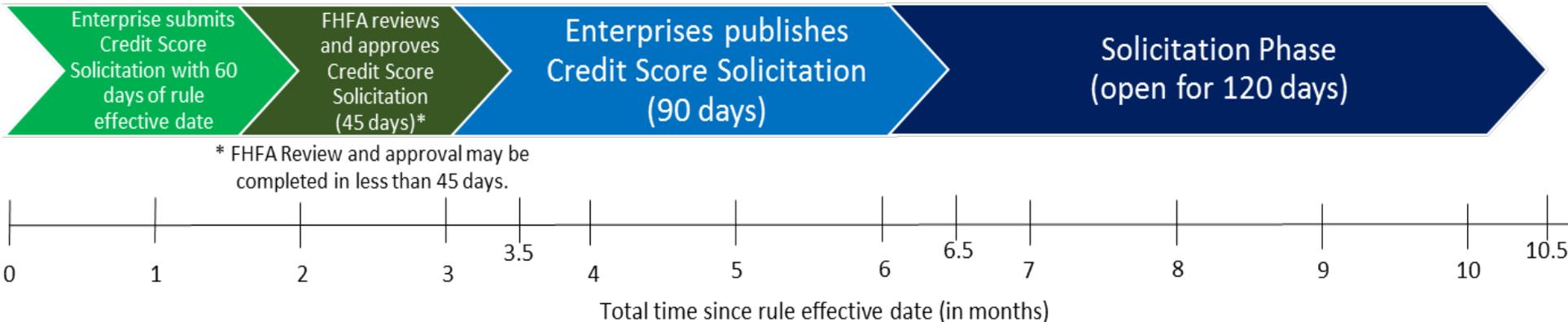
Validation and Approval Process



Phase 1: Solicitation of Applications

- FHFA would periodically require the Enterprises to solicit applications.
- FHFA reviews and approves each Enterprise “Credit Score Solicitation.”
- Enterprise make publicly available their Credit Score Solicitation.
- Initial Solicitation period will extend 120 days.

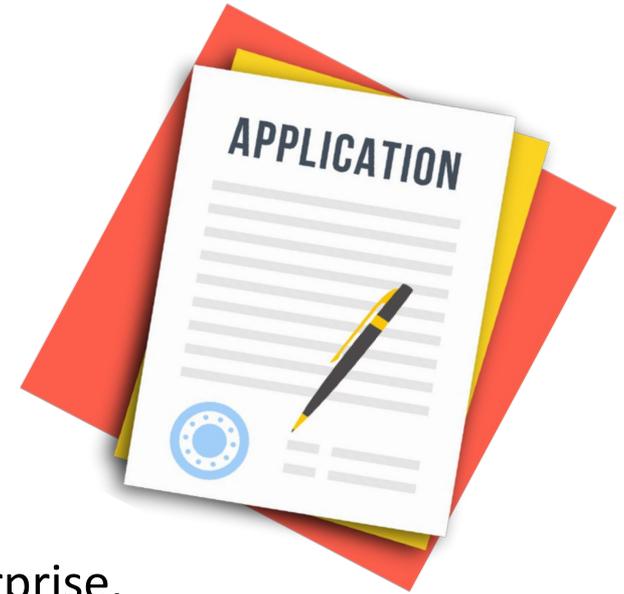
Figure 1: Illustration of Initial Solicitation Maximum Timeframe



Phase 2: Initial Review of Submitted Applications

Components of a Complete Application:

1. Application fee;
2. A fair lending certification;
3. Demonstrated use by industry;
4. Conflicts of interest certification; and
5. Any other information required by an Enterprise.

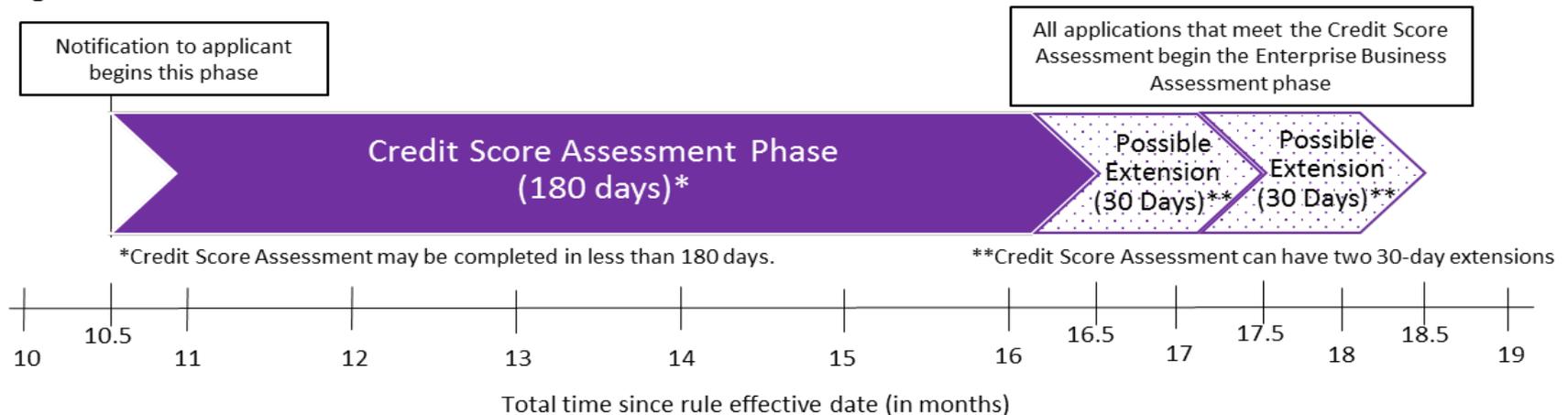


** Data Acquisition: An Enterprise may acquire data from a third party to conduct a credit score assessment. This data may be acquired after the end of the solicitation period.*

Phase 3: Credit Score Assessment

- Each Enterprise would conduct a Credit Score Assessment for all complete applications.
- The assessment would include tests of accuracy, reliability and integrity.
- Applicants must meet minimum requirements of the Credit Score Assessment to move on to the Enterprise Business Assessment.
- Applicants will receive notice of the outcome of the Credit Score Assessment.

Figure 2: Illustration of Initial Credit Score Assessment Maximum Timeframe



Phase 3: Options for Evaluating Test Results

Approaches for Assessing Accuracy:

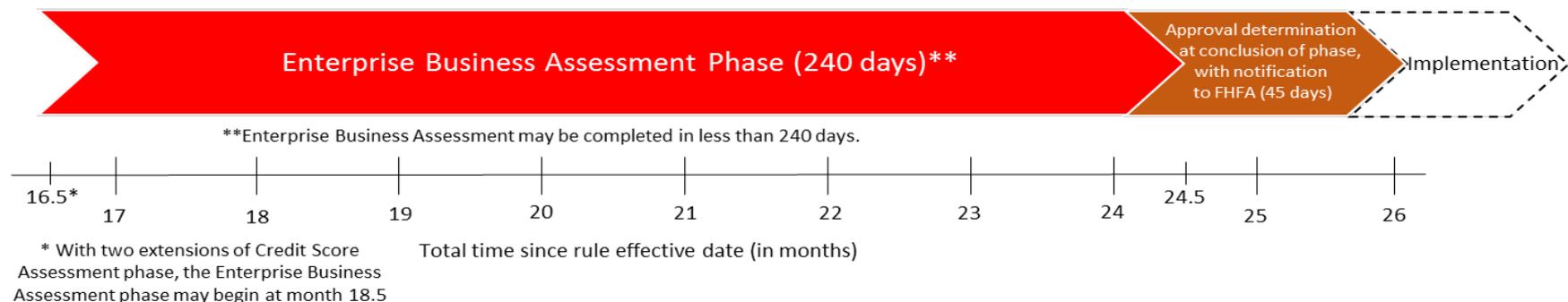
1. Comparison-Based Approach
2. Champion-Challenger Approach
3. Benchmark-Based Approach
4. Transitional Approach



Phase 4: Enterprise Business Assessment

1. Assessment of accuracy and reliability of credit scores within Enterprise systems;
2. Possible fair lending impacts;
3. Impact on Enterprise risk management/impact on industry;
4. Competitive effects;
5. Third party vendor review; and
6. Any other criteria established by an Enterprise.

Figure 3: Illustration of Initial Enterprise Business Assessment Maximum Timeframe



Applicant Notices

The proposed rule would require the Enterprises to notify applicants at each stage of the process, to include:

1. An Application Status notice;
2. Notice of complete application;
3. Notice when Enterprise begins Credit Score Assessment phase;
4. Notice if application has passed the Credit Score Assessment phase; and
5. Notice of final Enterprise Business Assessment determination (approval)





QUESTIONS?



COMMENTS

COMMENTS ARE DUE BY:

March 21, 2019

Comment at:

<https://www.fhfa.gov/SupervisionRegulation/Rules/Pages/Validation-and-Approval-of-Credit-Score-Models.aspx>