Suggestion Summary

In order to meet FHFA’s stated objectives (plus provide additional benefits via future state AUS), the GSEs don’t need to change credit scores. They just need to update the score selection rule: ***Continue to base the LLPAs (Loan-Level Price Adjustments) on the lowest-middle credit score, but loosen and base the AUS eligibility decision on the highest -middle credit score.***

Current State

Since AUS went live in 1994, the credit score selection rule has always been “lowest of each borrower’s middle credit score”. As we know, each borrower typically has three scores, and many/most loans have two borrowers, so many/most loans have six credit scores. Call them B1 hi-mid-lo and B2 hi-mid-lo. Both GSE’s AUS first identify the “mid” for each borrower, then identify the lowest of the multiple mids. This rule was chosen by looking backward at which score provided the best “model fit” relative to actual past loan defaults. But in real-life, three major changes have occurred since then that justify a change.

1. Looking backward from 1994 meant that mortgages were approved in a 28/36 max HTI/DTI regime. Today, AUS approves loans up to 50 DTI. And published AUS scoring factors do not include HTI at all (in part, in order to avoid inadvertently putting an arbitrary limit on the price of a home for which a borrower might qualify).

2. LLPAs didn’t exist in 1994. In effect, the AUS decision applied to both eligibility and price (g-fee). Today, LLPAs allow for a more nuanced and bifurcated AUS decision making process.

3. One important unintended consequence of the current rule is that the borrower with the lower credit score is deleted from the loan application in real life. Doing so then understates the household income, which overstates the DTI. The result over time is that the reliability of the DTI as a predictive factor goes down, and the ceiling for the DTI must be raised (e.g. from 36 to 50) in order to maintain a tolerable AUS approval rate. We’ve just started seeing pmi companies push back on high DTIs (> 45). And the sensitive “sole borrower” credit risk factor is likely overstated to some degree as well, due to deleting borrowers from loan applications.

Expected Outcomes/Benefits

Changing the score selection rule as suggested above will:

* increase the AUS approval rate for creditworthy borrowers
* continue to provide risk-based LLPA pricing
* provide more product approval options for creditworthy borrowers
* improve the data integrity of the AUS data over time, especially DTI and credit score
* be relatively easy to implement from an IT perspective, as AUS already identifies all mid-scores, including high-mid
* improve the bifurcated AUS decision (approval and LLPA price) and create more flexibilities for future loan product development and credit policy development