

FEDERAL HOUSING FINANCE AGENCY

12 CFR Part 1254

RIN 2590-AA98

Validation and Approval of Credit Score Models

AGENCY: Federal Housing Finance Agency.

ACTION: Final rule.

SUMMARY: The Federal Housing Finance Agency (FHFA) is issuing a final rule on the process for validation and approval of credit score models by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (together, the Enterprises). The final rule defines a four-phase process for an Enterprise to validate and approve credit score models. The process begins with the Credit Score Solicitation (a solicitation by the Enterprises of applications from credit score model developers), followed by the Submission and Initial Review of Applications (an initial review by the Enterprise of submitted applications). The third phase is a Credit Score Assessment by the Enterprise, and the fourth phase is an Enterprise Business Assessment. The final rule establishes criteria for each of the four phases and includes required timing and notices for Enterprise decisions under the process.

DATES: This rule is effective: **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].**

FOR FURTHER INFORMATION CONTACT: Beth Spring, Senior Policy Analyst, Housing & Regulatory Policy, Division of Housing Mission and Goals, at (202) 649-3327, *Elizabeth.Spring@fhfa.gov*, or Kevin Sheehan, Associate General Counsel, (202) 649-3086, *Kevin.Sheehan@fhfa.gov*. These are not toll-free numbers. The telephone number for the Telecommunications Device for the Deaf is (800) 877-8339.

SUPPLEMENTARY INFORMATION:

I. Background

Section 310 of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (Pub. L. 115-174, section 310) amended the Fannie Mae and Freddie Mac charter acts and the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Safety and Soundness Act) to establish requirements for the validation and approval of third-party credit score models by Fannie Mae and Freddie Mac.

Section 310 provides that if an Enterprise elects to condition the purchase of a mortgage loan on the delivery of a borrower's credit score, that credit score must be produced by a model that has been validated and approved by the Enterprise. Section 310 imposes separate requirements on FHFA and the Enterprises. FHFA must first issue a regulation establishing standards and criteria for the validation and approval of credit score models by the Enterprises. Then, each Enterprise must publish a description of its validation and approval process that an Enterprise will use to evaluate applications from credit score model developers, consistent with the FHFA issued regulation.

Section 310 sets forth several factors that must be considered in the validation and approval process, including the credit score model's integrity, reliability, and accuracy,

its historical record of measuring and predicting borrower credit behaviors (such as default rates), and consistency of the credit score model with the safe and sound operation of the Enterprises. The validation and approval process established by the final rule addresses each of the statutory factors, as well as additional standards and criteria consistent with section 310.

On December 21, 2018, FHFA published in the *Federal Register* a notice of proposed rulemaking on the “Validation and Approval of Credit Score Models.” *See* 83 FR 65575. FHFA requested public comment on the proposed rule, including the standards and criteria for the validation and approval of credit score models by the Enterprises. FHFA received 60 comment letters on the proposed rule. FHFA reviewed and considered all comments received in response to the proposed rule. The final rule reflects adoption, clarifications, or changes based on the comments received. A full discussion of the adoption of certain provisions, clarifications, and changes to provisions are in the subsequent sections.

II. Major Provisions of the Final Rule

A. Validation and Approval Process

The final rule generally adopts the validation and approval process set forth in the proposed rule. The validation and approval process outlines how an Enterprise will solicit applications from credit score model developers and assess credit score models for use. An Enterprise must publish a “Credit Score Solicitation” describing the requirements for credit score model developers to submit applications and the criteria under which the Enterprises will evaluate the applications.

Following the “Submission and Initial Review of Applications,” in order for a

credit score model to be approved for use, an Enterprise must complete two separate assessments. The first assessment is a “Credit Score Assessment,” under which an Enterprise will evaluate the credit score model for accuracy, reliability and integrity. During the Credit Score Assessment, an Enterprise will evaluate the credit score model on a standalone basis, outside the Enterprise business systems and processes.

The second assessment is an “Enterprise Business Assessment,” under which an Enterprise will evaluate the potential impact of using the credit score model within the Enterprise’s proprietary business systems and processes. The Enterprise Business Assessment is a comprehensive evaluation of the potential impacts that using each credit score model could have on an Enterprise and the mortgage finance industry. The assessment will consider several factors leading to a decision for use by an Enterprise. Because the Enterprises’ automated underwriting systems (AUS) treat credit scores differently, and because they have different risk tolerances, the Enterprise Business Assessment is designed to consider the credit score model’s impact on an Enterprise’s proprietary business use and risk management needs.

The final rule clarifies that an Enterprise will submit a proposed approve or disapprove determination for each application to FHFA for review, and FHFA will make its determination taking into account the information provided by the Enterprise along with any other factors that FHFA determines appropriate.

B. Certification of Conflicts-of-Interest

The final rule does not adopt the proposed conflict-of-interest certification requirement. The proposed rule would have required credit score model developers to demonstrate, upon applying for consideration, that there was no common ownership with

a consumer data provider that has control over the data used to construct and test the credit score model.

Under the final rule, any credit score model developer is able to submit an application in response to a Credit Score Solicitation, provided it meets the other requirements for applicants set forth in the Credit Score Solicitation.

While the final rule permits credit score model developers that meet solicitation requirements to submit applications, the Enterprises will consider market and competition impacts as part of the Enterprise Business Assessment. This may include market or competition impacts related to the ownership structure of the credit score model developer and its relationship to other market participants. The Enterprise's consideration of market and competition impacts is consistent with the normal risk assessment and evaluation that an Enterprise would conduct with respect to other potential third-party providers or counterparties.

C. No Required Use of Credit Scores

The final rule provides that an Enterprise is not required to use third-party credit scores for any business purpose. Section 310 does not require an Enterprise to use a third-party credit score model for any part of its business operations or purchase decisions. However, if an Enterprise conditions its purchase of mortgages on the provision of a credit score, section 310 requires that the score must be derived from a model that has been validated and approved in accordance with section 310 and this final rule. The validated and approved credit score must be used in all of the Enterprise's purchase-related systems and procedures that use a credit score.

The final rule contemplates that if in the future an Enterprise no longer uses third-

party credit scores in any purchase-related systems or procedures, the Enterprise would not be subject to the requirements in the final rule. Conversely, if an Enterprise uses credit scores as a consideration in setting the price for loans it purchases, for example by using Loan Level Price Adjustments (LLPAs) or Delivery Fees based on credit score and loan-to-value (LTV) ratios, the Enterprise is subject to the requirements of the final rule, even if the Enterprise no longer uses credit scores in any other manner.

If a new credit score model is approved, the final rule permits an Enterprise to replace the existing credit score model or to continue to use the existing credit score model in addition to a newly approved credit score model. Section 310 expressly permits replacement of one validated and approved credit score model with another validated and approved credit score model, and does not establish any standard for replacement, other than the models must be validated and approved. Neither section 310 nor the final rule creates any right to or expectation of continued, future, or permanent use of any credit score model by an Enterprise, even if the model has been validated and approved.

D. Current Credit Score Model in Use

Fannie Mae and Freddie Mac currently require lenders to provide credit scores derived from the Classic FICO credit score model for each loan delivered to the Enterprises.¹ The final rule clarifies how Classic FICO will be evaluated under the validation and approval process. The final rule establishes criteria for the initial Credit Score Assessment that permit an Enterprise to evaluate Classic FICO on an expedited basis, if necessary, to meet statutory timeframes. This approach allows an Enterprise to

¹ The Enterprises require delivery of FICO 5 from Equifax, FICO 4 from TransUnion, and FICO Score 2 from Experian, which are collectively referred to as “Classic FICO.”

complete the validation and approval process for the credit score model currently in use by the Enterprises and the mortgage finance industry (Classic FICO). This evaluation may occur prior to a determination on any other application(s) received in response to the initial Credit Score Solicitation.

While the final rule makes no predetermination of which applications will be approved, FHFA expects that Classic FICO is likely to meet the applicable testing criteria based on its history of use. However, FHFA acknowledges that approving a credit score model in use for the past decade would not satisfy the intent of section 310 that the Enterprises consider credit score models developed after Classic FICO. FHFA expects that the Enterprises will also evaluate applications received in response to the initial Credit Score Solicitation and that the Enterprises may submit to FHFA a proposed determination to approve one or more of those credit score models for use, either to replace Classic FICO or in addition to Classic FICO.

III. Summary of Comments Received and FHFA Responses

In response to the proposed rule, FHFA received 60 comment letters during the 90-day comment period.² Comments were received from all segments of the mortgage industry, including: mortgage insurers, mortgage originators, Mortgage Backed Securities (MBS) and Credit Risk Transfer (CRT) investors, technology vendors, housing advocates, industry trade groups, Congressional members, and other interested stakeholders. FHFA considered all comments received in response to the proposed rule. While the final rule adopts most of the provisions from the proposed rule, FHFA has

² <https://www.fhfa.gov/SupervisionRegulation/Rules/Pages/Validation-and-Approval-of-Credit-Score-Models.aspx>.

incorporated a number of changes. A discussion of FHFA's rationale for all components of the final rule, including responses to significant issues raised by comment letters, is set forth below.

A. Validation and Approval Process and Timelines

FHFA proposed that the validation and approval process have four phases, with the first phase being a solicitation for applications from credit score model developers, the second phase being the submission and initial review of applications, the third phase being a Credit Score Assessment, and the last phase being an Enterprise Business Assessment. The final rule adopts these four phases as proposed and establishes minimum standards and criteria for each phase. Consistent with section 310 and the proposed rule, the final rule permits an Enterprise to add to the standards and criteria for all four phases of the process. In general, comments received on the four phases in the proposed rule were supportive of this approach.

The proposed rule also set out timelines for the completion of each phase of the validation and approval process. Section 310 requires that an Enterprise provide notice of a "determination" to an applicant within 180 days from receipt of a complete application, with two possible 30-day extensions. While recognizing that statutory provision, the proposed rule set forth timelines that reflect the length of time FHFA believes, based on similar analysis conducted in 2015, is necessary for an Enterprise to complete the acquisition of consumer credit data for testing of each credit score model and the empirical and business analysis of each credit score. FHFA received a few comment letters that supported the need to separate the Credit Score Assessment from the Enterprise Business Assessment. Commenters were split on the length of time proposed

for each phase. Some commenters stated that the maximum total time allowed for completion of the process was too long.

The final rule adopts the four phases and the associated timeframes as proposed. Specifics of the four phases are explained in more detail below.

1. Proposed and Final Rule

Under both the proposed rule and the final rule, each Enterprise must publish a Credit Score Solicitation as part of the solicitation phase of the process. The Credit Score Solicitation will specify the opening and closing dates of the solicitation time period during which the Enterprise will accept applications from credit score model developers. FHFA expects that the Credit Score Solicitation will include a description of the information that must be submitted with the application; instructions for submitting the application; a description of the Enterprise process for obtaining data for testing; a description of the Enterprise's process/criteria for conducting the Credit Score Assessment and the Enterprise Business Assessment; and other requirements established by the Enterprise consistent with section 310.

In the Submission and Initial Review of Applications phase, the Enterprise will determine whether each application submitted by a credit score model developer is complete. An application would be complete only after the Enterprise has received all required fees and information from the applicant as well as any data that must be obtained from a third party. If an application is not complete, the Enterprise must notify the applicant and provide an opportunity for the applicant to submit any information that the Enterprise determines necessary for the evaluation of the application.

During the Credit Score Assessment phase of the process, each credit score model will be assessed for accuracy, reliability, and integrity, independent of the use of the credit score in the Enterprise's systems. The Credit Score Assessment will also include any other requirements established by the Enterprise.

During the Enterprise Business Assessment phase, which is the fourth and final phase of the process, an Enterprise will assess the credit score model in conjunction with the Enterprise's business systems and processes. The Enterprise must assess the accuracy and reliability of credit scores when used within the Enterprise's systems. The Enterprise must assess possible impacts on fair lending and on the Enterprise's operations and risk management. An Enterprise also must consider impacts on the mortgage finance industry, assess competitive effects, conduct a third-party provider review, and perform any other evaluations established by the Enterprise as part of the Enterprise Business Assessment.

2. Comments Received and Final Rule Rationale

Commenters were generally supportive of the proposed four phases, and the final rule adopts this approach. Based on the comments received and prior work related to analyzing credit score models, the four-phase approach is operationally practical. The four-phase approach is also consistent with the statutory requirements of section 310.

Some commenters stated that the proposed timeline for the solicitation, review and assessment of applications was too long. One commenter stated that the "long, drawn out process does not encourage the competition contemplated by Sec. 310." On the other hand, the Enterprises commented that they support the four-phased approach, and the timelines outlined in the proposed rule. The timelines in the proposed rule were

informed by the work related to assessing credit score models conducted by FHFA and the Enterprises from 2015 to 2018 pursuant to FHFA's Conservatorship Scorecards. The final rule adopts the proposed timelines associated with completion of each phase of the process because they appropriately allow for completion of the provisions required by section 310. The timelines allow the Enterprises an appropriate amount of time to process applications, and they reasonably reflect prior FHFA and Enterprise experience regarding the amount of time needed to test and evaluate credit score models. The timelines adopted in the final rule reflect the maximum number of days allowable to complete the entire process, and in FHFA's judgment, are necessary to reasonably achieve the objectives of the statute.

The timeframes set out in the final rule do not address the time it will take the industry to prepare for a change in credit score requirements. One commenter stated consideration of any credit score model should include "the time, effort, complexity, uncertainty, and costs (direct and indirect) to the mortgage industry of alternative decisions." As discussed in the proposed rule, implementation timing is not addressed in section 310. Implementation of any change to existing credit score requirements will have significant operational and cost implications for the Enterprises and the mortgage finance industry. FHFA expects that full implementation of any change to the Enterprise credit score requirements will take the industry as long as 24 months after a new credit score model is approved. The final rule does not address how an Enterprise's credit score requirements might change following the approval of a new credit score model. How an approved credit score model(s) is implemented, including the timeframe for the Enterprises to transition from one credit score to another score or scores, is best

addressed outside of the final rule. FHFA will provide direction to the Enterprises on implementation issues consistent with applicable law.

Some comment letters stated that the validation and approval phases should be done simultaneously. Under the final rule, the Credit Score Assessment and Enterprise Business Assessment phases may be conducted sequentially, or in unusual or unique circumstances such as the initial solicitation, simultaneously. In some cases, an Enterprise may want to have the results of the Credit Score Assessment before initiating the Enterprise Business Assessment. In other cases, an Enterprise may conduct some or all of the Enterprise Business Assessment at the same time it is conducting the Credit Score Assessment. In all cases, in order for a credit score model to be approved for use, the credit score model would have to pass both a Credit Score Assessment and an Enterprise Business Assessment. As discussed in more detail below, the final rule clarifies that FHFA's review of a proposed determination by an Enterprise must include a decision by FHFA to either approve or disapprove the proposed determination. Under the final rule, if an Enterprise finds that an application should be approved, the Enterprise must submit a proposed determination recommending approval of a credit score model to FHFA at the conclusion of the Enterprise Business Assessment phase. However, the credit score model will only be considered validated and approved for purposes of the regulation and section 310 if an Enterprise makes a final determination to approve the credit score model after FHFA has completed its review.

With regard to communication with applicants during the Enterprise review process, one commenter noted the possible need for additional interaction with applicants concerning issues in their applications. As noted above, the final rule provides for an

Enterprise to request supplemental information from the applicant if necessary, which will allow the Enterprises to have those additional interactions.

Several comments were in favor of the Enterprises conducting a joint Credit Score Assessment. The comments that supported a joint assessment indicated that it is likely to lead to a more efficient process. The final rule does not prohibit the Enterprises from conducting a joint Credit Score Solicitation and/or Credit Score Assessment. The Enterprises may choose to issue a joint Credit Score Solicitation and to collaborate on the Credit Score Assessment of credit score models outside of their automated underwriting systems. A joint approach may minimize costs and operational burdens with these phases. However, the Enterprises will have to consider each credit score model that passes the Credit Score Assessment in an independent Enterprise Business Assessment because of differences in their respective business systems and processes.

B. Alignment of Enterprises

The preamble to the proposed rule stated that FHFA may direct the Enterprises to align their assessment processes or their decisions on which credit score models to approve. The final rule includes three separate provisions that FHFA may use to direct the Enterprises at different stages of the validation and approval process. The final rule does not itself require the Enterprises to align their processes or outcome decisions. This approach is consistent with the proposed rule in providing flexibility for FHFA and the Enterprises to ensure that the Enterprises are able to respond appropriately to the primary market and to their own business requirements and objectives, as well as to manage their operations in a manner that is safe and sound.

1. Proposed Rule

The proposed rule provided for FHFA review at two points in the validation and approval process. First, the proposed rule required each Enterprise to submit its Credit Score Solicitation for FHFA review before making it publicly available. The proposed rule stated that FHFA could approve or disapprove the Credit Score Solicitation, and may impose any appropriate terms, conditions, or limitations on its approval. Second, the proposed rule would have required each Enterprise to notify FHFA of any decision to approve or disapprove a credit score model application prior to an Enterprise's notification to the applicant or the public. The preamble to the proposed rule indicated that this notice requirement would provide FHFA with an opportunity to make any determinations or take any steps appropriate in FHFA's capacity as conservator or as safety and soundness regulator with respect to changes, updates to, or replacement of any credit score model, including alignment of outcomes.

2. Comments Received

FHFA received several comments that either supported alignment of the Enterprises or expressed concern that the rule would permit the Enterprises to approve for use different credit score models. For example, one commenter stated that it is necessary and appropriate for FHFA to align Enterprise usage of credit scores to ensure that Fannie Mae and Freddie Mac securities are as homogeneous as possible. Other commenters emphasized the potential cost and operational impacts if the Enterprises do not align on which credit scores they require.

FHFA also received comments on the impact that alignment of the Enterprise credit score requirements could have on FHFA regulations such as the Enterprise capital requirements (Conservatorship Capital Framework) and other Enterprise policies, such as

the Private Mortgage Insurer Eligibility Requirements (PMIERS). For example, one commenter noted that credit scores are used by the mortgage insurance industry “in a variety of ways, including to determine borrower eligibility, pricing, and to calculate the amount of capital required to comply with the Enterprises’ capital and operational standards for [private mortgage insurers].” Two commenters raised a concern about the Enterprises using different credit score models to assess the creditworthiness of borrowers, which they stated could raise the risk of a divergence in the performance of loans collateralizing their mortgage backed securities, potentially causing prepayment speeds to differ in the Uniform Mortgage Backed Security (UMBS). Commenters also noted that any change in the credit score model would require other policies and requirements such as PMIERS and the Enterprise capital requirements to be recalibrated based on the new credit score model.

3. Rationale for Final Rule

While the final rule does not require the Enterprises to align on processes or outcomes related to validation and approval of credit score models, the final rule permits FHFA to require alignment of the Enterprises on any aspects of the validation and approval process, including which credit score model or models would be approved for use. Based on the comments received and FHFA’s own assessment of potential impacts, it is likely that FHFA would have to consider whether the Enterprises should align their credit score requirements, whether the Enterprises remain in conservatorship or not. The final rule expands on the proposed rule provisions for FHFA review at different stages of the validation and approval process to provide clarity for applicants and the Enterprises on how FHFA, as conservator or regulator, may require alignment of the Enterprises.

As stated above, the final rule expands on three provisions FHFA may use to direct the Enterprises at different stages of the validation and approval process to address alignment. First, the final rule maintains the proposed provision for FHFA review of the Enterprise Credit Score Solicitation. As in the proposed rule, the final rule states explicitly that FHFA may approve or disapprove the Credit Score Solicitation and may impose any terms, conditions, or limitations on its approval. This will allow FHFA to require an Enterprise to make any changes that FHFA determines appropriate, including any changes that may be necessary to align the respective Enterprise processes.

Second, the final rule adds a new provision for FHFA to undertake an evaluation concurrent with the 240-day Enterprise Business Assessment phase. FHFA's evaluation during the Enterprise Business Assessment phase will focus on potential impacts on other regulations and aligned Enterprise policies. This evaluation could include how the Enterprise use of credit scores may impact the PMIERS, the UMBS regulation, CRT transactions, and the Enterprise capital requirements. For example, under the PMIERS, the risk-based required asset amounts for mortgage insurers are based on factors including the original LTV ratio of the insured loan, the original credit score for the loan, the loan vintage, and other factors. A change to the credit score requirements of the Enterprises would require an update to the PMIERS requirements to reflect a new credit score model.

FHFA's evaluation during the Enterprise Business Assessment will provide an opportunity for FHFA to determine the feasibility of implementing multiple credit score models. FHFA may make this decision in its capacity as conservator under existing FHFA authorities or as safety and soundness regulator under the approval authority

provided by this final rule. For example, FHFA may consider the impact on Enterprise loan pricing if the Enterprises permit the use of more than one credit score model by lenders. FHFA may require the Enterprises to maintain a single credit score model if the secondary market liquidity were expected to decline if multiple credit score models were permitted, or if FHFA determines there are other policies or regulations that require alignment on credit score model requirements.

Finally, the final rule revises the proposed provision regarding prior notice to FHFA of an Enterprise determination based on the Enterprise Business Assessment. The proposed rule provided for 45-day prior notice to FHFA of any determination by an Enterprise on an application. This would have required an Enterprise to make an approval determination and submit that approval determination to FHFA for review. The preamble to the proposed rule indicated that FHFA could take appropriate steps in FHFA's capacity as conservator or as safety and soundness regulator in response to the prior notice, but the proposed rule did not explicitly state that FHFA could approve or disapprove the Enterprise determination at this stage.

The final rule provides that an Enterprise must submit a proposed determination to FHFA. FHFA will review the Enterprise proposal and either approve it or disapprove the proposed determination. The final rule provides that FHFA must approve or disapprove the Enterprise's proposed determination during the 45-day prior notice period. The requirement for FHFA approval or disapproval will provide a mechanism for FHFA to ensure that the Enterprises reach aligned decisions on which credit score model or models to approve, if FHFA determines that alignment of the Enterprises is appropriate.

FHFA acknowledges the concerns raised by commenters about the potential costs and complexity that may arise if the Enterprises follow different processes, apply different criteria, or reach different decisions on which credit score model(s) to use and how they would be used. However, the final rule is flexible enough to allow FHFA to require alignment in areas where FHFA determines alignment is appropriate, and to allow the Enterprises to be different in other areas. For example, Fannie Mae and Freddie Mac currently treat credit scores in different ways in their respective AUSs. Fannie Mae uses credit scores as an eligibility threshold for its AUS, while Freddie Mac uses credit scores as one factor in the risk assessment for its AUS. As a result, in implementing the final rule, the Enterprises may consider different factors in their respective Enterprise Business Assessments based on how they each use credit scores in their own business systems.

The final rule does not require the Enterprises to use identical processes for evaluating credit score models, and the final rule does not require the Enterprises to reach identical decisions on which credit score models to approve through the validation and approval process.

However, the final rule provides for several points at which FHFA may consider whether a greater or lesser degree of alignment is needed to address the needs of the mortgage market or the statutory mission of the Enterprises, including to promote access to mortgage credit throughout the Nation. For example, FHFA may exercise this discretion to enhance processing efficiency in the mortgage market, to enhance the safety and soundness of the Enterprises, or to reduce costs for lenders, borrowers, and others.

C. No Requirement for Conflicts-of-Interest Certification

The proposed rule would have required each applicant to provide a certification regarding conflicts of interest as part of its application. The final rule does not adopt this requirement and instead permits credit score model developers to submit applications to the Enterprises in response to a Credit Score Solicitation, regardless of the ownership structure of the credit score model developer. However, the final rule permits consideration of conflicts of interests as part of a comprehensive Enterprise Business Assessment.

1. Proposed Rule

The proposed rule required that a credit score model developer certify in its application that the credit score model developer has no common ownership or affiliation with the owner of data used to construct the credit score model. This conflicts-of-interest certification was proposed to address concerns about vertical integration of the nationwide consumer reporting agencies (CRAs), and to address current and potential future affiliations between data providers and analytic companies that own algorithms used to generate credit scores. For example, VantageScore Solutions, LLC is jointly owned by the three nationwide CRAs. The CRAs also own, price, and distribute consumer credit data and credit scores. This type of common ownership could in theory negatively impact competition in the marketplace.

The proposed rule discussed concerns that the CRAs could potentially use their position in the marketplace in a manner that favors VantageScore Solutions, LLC over its current and future competitors. The proposed rule would have addressed these concerns by prohibiting common ownership or control of a credit score model developer and the

owner of the consumer credit data that is needed to construct the model and to generate the credit scores.

The proposed rule also required each applicant to provide information about its market experience and financial capacity. Such information included a detailed description of the credit score model developer's corporate structure and business relationships, governance structure, and past financial performance, including audited financial statements for the preceding three years.

2. Comments Received

FHFA received numerous comments on the proposed conflicts-of-interest certification, both supporting the proposed restriction and opposing the proposed restriction. Commenters against the proposed conflicts-of-interest certification raised three main arguments. First, several commenters stated that the proposed conflicts-of-interest certification requirement was not consistent with the spirit or letter of section 310. One commenter stated that “the Proposed Rule directly conflicts with the spirit and intent of the Credit Score Competition provisions within the Economic Recovery, Regulatory Relief and Consumer Protection Act (S.2155); where Congress recognized that competition is vital in commercial markets and therefore required that the FHFA allow existing credit scoring models to compete with the incumbent scoring company.”

Second, some commenters stated that open competition among credit score model developers would lead to improved credit score models and would benefit borrowers. One commenter stated that “[f]or over a decade, VantageScore LLC has competed and provided demonstrable value in other lending markets without any tangible harm to its

rivals, and most importantly, consumers have benefitted from greater access to financial opportunity.”

Third, commenters argued that the proposed conflicts-of-interest certification is unnecessary because antitrust laws already prohibit the types of anti-competitive behavior that the conflicts-of-interest certification was intended to prevent. One commenter stated that “[t]he antitrust statutes are very clearly designed to prevent exactly the type of anticompetitive behavior the FHFA is concerned about and if necessary, those statutes may be readily invoked to provide relief.”

FHFA also received comments supporting the proposed conflicts-of-interest certification. These comments expressed concerns about the potential negative effects on competition that may result if the owner of consumer credit data needed to develop competing credit score models and distribute credit scores into the marketplace also owns or controls a credit score model developer. One comment stated that “[t]he Enterprises must be required and allowed to judge competing scoring approaches and their effects on reliability and performance based solely on the merits, without the inevitable distortions brought about by data owners’ simultaneous control of the data, the credit score model, and the means of credit score distribution.”

Another commenter indicated that the proposed independence requirement is needed to promote open and fair competition among credit score developers, stating that the proposed certification requirement “shows serious consideration for ensuring open and fair competition in the submission and evaluation of new credit scoring models that is welcome and needed.” Another commenter suggested that the competitive concerns about common ownership could be mitigated if the CRAs transferred their contractual

control of the credit score distribution channel and pricing. Commenters supporting independence of credit score model developers also argued that there is the potential for competitive harm resulting from vertical integration of credit score model developers and the CRAs that own the data used to construct and test such models.

Although not addressed in the proposed rule, some commenters expressed support for other changes that could foster competition. For example, some commenters supported an approach that would allow lenders to choose among multiple validated and approved credit scores. Opposing this view were commenters expressing concerns about adverse selection and impact on investors if lenders were permitted to select the credit score used to underwrite a borrower's mortgage.

A number of commenters also noted that increased competition and improvements to credit score models may result from adopting newer data types and sources. For example, some commenters supported the use of data outside of the CRAs, such as rental and telecommunications data. While FHFA believes there are other consumer data sources that could potentially be useful, the proposed and final rule do not address, or create any provision related to, required use of alternative data consistent with section 310.

3. Rationale for Final Rule

The final rule does not include the proposed conflicts-of-interest certification requirement. Instead, the final rule permits credit score model developers to submit applications for consideration by the Enterprises, without having to demonstrate that there is no affiliation or common ownership of the credit score model developer with data provider(s). The independence requirement was intended to encourage additional credit

score developers to enter the mortgage marketplace. The proposed rule reflected concerns that the CRAs lacked an incentive to support new entrants because of their ownership of VantageScore Solutions, LLC. However, FHFA recognizes that there are many other factors that may affect the potential entrance of new credit scoring companies into the industry.

Despite the concerns raised by some commenters about potential impacts on competition, FHFA has concluded that allowing all credit score model developers to submit applications is more consistent with section 310, which does not prevent any credit score model from being considered for potential use in the mortgage market. Therefore, the final rule does not require a credit score model developer to provide a conflicts-of-interest certification with its application.

While all credit score model developers are permitted to apply for consideration regardless of ownership structure, the final rule adopts the proposed requirement that a credit score model developer provide all information necessary for an Enterprise to evaluate the credit score model developer. Such information may include relevant experience of the applicant and financial capacity of the applicant. The final rule requires, as part of the Enterprise Business Assessment, evaluating whether use of a credit score model could have an impact on competition in the industry. The Enterprise must consider whether such impact is due to any ownership or other business relationship between the credit score model developer and any other institution. The assessment of competitive effects is discussed in more detail below.

D. Frequency of Solicitation of Applications

The proposed rule provided that FHFA would require the Enterprises to solicit applications from credit score model developers at a minimum once every seven years, unless FHFA determined that a solicitation should occur more or less frequently. The proposed minimum frequency for solicitations was based on prior feedback from the industry on the significant cost and operational complexity of updating the credit score required by the Enterprises. For example, responding to FHFA's December 2017 Request for Information (RFI), representatives from the mortgage insurance industry requested 24 months to transition from the current credit score to a new credit score.³ However, several comments on the proposed rule stated that seven years is too long, and that the seven years would not align with the rate of innovation or advances in technology and data.

The final rule provides that FHFA will require the Enterprises to open a solicitation period as FHFA determines necessary. FHFA may require a new solicitation on its own initiative or in response to a request from any party, including an Enterprise. The final rule requires FHFA to make a determination on whether it is necessary for the Enterprises to open a solicitation for credit score model developers to apply for consideration.

1. Proposed Rule

The proposed rule stated that FHFA would require the Enterprises to solicit applications from credit score model developers at least once every seven years, unless FHFA determined that a solicitation should occur more or less frequently. FHFA would establish the solicitation requirement by notice to the Enterprises, which would include:

³ <https://www.fhfa.gov/PolicyProgramsResearch/Policy/Pages/Credit-Scores.aspx>.

(1) a requirement for the Enterprises to submit a Credit Score Solicitation to FHFA for review; (2) a deadline for submission of the Credit Score Solicitation to FHFA; and (3) a timeframe for the solicitation period in which the Enterprises would accept applications.

In connection with each required solicitation, the proposed rule would have required an Enterprise to submit to FHFA a Credit Score Solicitation including: (1) the opening and closing dates of the solicitation time period during which the Enterprise will accept applications from credit score model developers; (2) a description of the information that must be submitted with an application; (3) a description of the process by which the Enterprise would obtain data for the assessment of the credit score model; (4) a description of the process for the Credit Score Assessment and the Enterprise Business Assessment; and (5) any other requirements as determined by the Enterprise.

2. Comments Received

FHFA received comments expressing a range of views on the appropriate frequency for solicitation of new credit score models. One commenter stated that “[w]ith respect to the frequency of the validation and approval process, the proposed rule contemplates FHFA requiring Enterprise solicitation of new credit score models every seven years. This cycle allows sufficient time for the completion of each validation and approval process, though it may not allow the Enterprises to be as responsive as possible when new technologies or data sources emerge.” The commenter therefore recommended that “FHFA more frequently evaluate whether a new solicitation would provide significant benefits to the market, such that it is prepared to begin the process earlier than the seven year threshold if warranted.” However, another commenter

cautioned that “frequent and radical changes to credit score models may raise the cost and complicate implementation even more...”

3. Rationale for Final Rule

The final rule provides that FHFA will determine the frequency of credit score solicitations in its discretion. FHFA may initiate a solicitation at its own initiative or in response to a request submitted to FHFA by any person, including an Enterprise. While the final rule does not include the proposed baseline frequency of once every seven years, the final rule approach is consistent with the proposed rule, which would have allowed FHFA to require a solicitation either more or less frequently.

Recognizing that comments on the proposed rule encouraged FHFA to consider opening solicitations more frequently, the final rule does not include a seven-year solicitation cycle. Instead, the final rule allows FHFA to establish the frequency of the solicitation in response to the need and justification from either the industry or an Enterprise. FHFA can open the solicitation window as frequently or as infrequently as necessary, assuming there is reasonable justification to do so.

The final rule strikes a balance between the comments concerned about the potential cost and impact of frequent solicitations and the comments concerned that infrequent solicitations would not be responsive to advances in technology and data. The validation and approval process is potentially time-consuming and costly, and the implementation of any changes to the credit score model in use by the Enterprise and the industry would entail substantial time, cost, and effort by many parties. For that reason, it would be impractical and too costly to require the Enterprise to solicit applications on a rolling or annual basis. At the same time, FHFA recognizes that a seven-year cycle may

be too long to take into account innovations and advances in technology and data. FHFA may initiate solicitations more or less frequently depending on technology, improved data, or other compelling reasons to do so.

E. Fair Lending Compliance and Certification

The proposed rule included fair lending compliance provisions in two phases of the credit score model validation and approval process. First, the proposed rule would have required a certification by the credit score model developer in the application phase. Second, the proposed rule would have required the Enterprises to assess fair lending impacts during the Enterprise Business Assessment. The final rule retains both of these fair lending provisions. The final rule also adds a requirement that the Enterprises evaluate the potential impact of using a particular credit score model on access to credit.

1. Proposed Rule

The proposed rule included two provisions related to fair lending. First, in the application phase, the credit score model developer would have been required to certify that no characteristic that is based directly on or is highly correlated solely with a classification prohibited under the Equal Credit Opportunity Act (15 U.S.C. 1691(a)(1)), the Fair Housing Act (42 U.S.C. 3605(a)), and the Safety and Soundness Act (12 U.S.C. 4545(1)) was used in the development of the credit score model or was used as a factor in the credit score model to produce credit scores. The proposed rule would have required the credit score model developer to provide information in its application on any fair lending testing and evaluation of the model conducted. Second, in the Enterprise Business Assessment phase, the Enterprises would have been required to evaluate the fair

lending risk and fair lending impact of the credit score model and credit scores produced by it in accordance with standards and requirements related to federal fair lending laws.

2. Comments Received and Final Rule Rationale

Comments on the proposed fair lending provisions were generally supportive of both the proposed certification requirement in the application phase and the proposed fair lending assessment in the Enterprise Business Assessment. Some commenters recommended that FHFA expand the fair lending requirements to include additional requirements for fair lending testing. Commenters also supported adding as part of the Enterprise Business Assessment a requirement to assess potential impacts on access to credit from any change to the credit score model requirements of the Enterprises.

The final rule retains fair lending compliance provisions in both the application and Enterprise Business Assessment phases and adds a requirement that the Enterprises consider potential impacts on access to credit in response to feedback received in the comments.

The compliance and certification requirements in the application phase of the final rule are the same as the proposed rule. Some commenters suggested requiring fair lending testing by the credit score model developer in the application's fair lending certification.

The final rule requires each application to include a certification that no characteristic used in the development of the credit score model or as a factor in the credit score model to produce credit scores is based directly on or is highly correlated solely with a prohibited classification. In the final rule, each application must address compliance of the credit score model and credit scores produced by it with federal fair

lending requirements and provide information on any fair lending testing and evaluation of the model conducted. FHFA expects credit score model developers to have a sufficient basis for making the certification and addressing the application requirement, but the final rule does not prescribe or require any particular method of evaluation or testing.

Some commenters proposed inserting “current” before “federal fair lending requirements” out of a concern that federal fair lending requirements may change due to rulemakings, acts of Congress, and court decisions. FHFA recognizes that applicable legal standards, including the Fair Housing Act, Equal Credit Opportunity Act, and Safety and Soundness Act, may change over time. The proposed rule was not limited to federal fair lending requirements as of a particular date, and the final rule does not include any change on this point.

The final rule includes the proposed fair lending assessment requirements in the Enterprise Business Assessment phase. Commenters supported the fair lending compliance component in the Enterprise Business Assessment. One commenter recommended including disparate impact testing in the fair lending assessment. The final rule refers to the standards and requirements of applicable fair lending authorities. The final rule itself does not describe the compliance standards for those authorities. However, the rule does require an evaluation of the fair lending risk and fair lending impact associated with those fair lending authorities, including identification of potential impact, comparison of the new credit score model with any credit score model currently in use, and consideration of potential methods of using the new credit score model.

The proposed rule also requested comments on whether the Enterprise Business Assessment should consider whether the credit score model may have any impact on access to mortgage credit. Commenters were supportive of requiring this analysis. Some commenters stated that access to mortgage credit is a critical component of building wealth that has historically been limited on the basis of protected factors. The final rule requires an Enterprise to consider possible impacts on access to credit as part of the Enterprise Business Assessment.

F. Qualifications of Credit Score Model Developer

The proposed rule would have required that the Enterprises review, in accordance with their third-party provider management policies and procedures, the corporate structure, governance structure, and past financial performance of the credit score model developer, including three years of audited financial statements to demonstrate financial strength of the credit score model developer. As discussed previously, the final rule includes the proposed requirements on the evaluation of the financial strength of the credit score model developer, but the final rule does not include the proposed application requirement for three years of audited financial statements. FHFA expects that the Enterprises will consider any guidance that FHFA has issued in its supervisory capacity to the regulated entities on the oversight of third-party provider relationships.

1. Proposed Rule

The proposed rule would have required that each application include any information that an Enterprise may require to evaluate the credit score model developer (*i.e.*, relevant experience and financial capacity). Such information would include a detailed description of the credit score model developer's: (i) corporate structure,

including any business relationship to any other person through any degree of common ownership or control; (ii) governance structure; and (iii) past financial performance, including audited financial statements for the preceding three years.

2. Comments Received

Several commenters opposed the proposed requirement that applicants provide audited financial statements for the preceding three years, stating that such a requirement was arbitrary or unreasonable and the Enterprises should manage their vendor risk through their existing third-party management process. Several commenters raised concerns about the burden associated with providing three years of audited financial statements. One commenter stated that “since credit score model developers are not counterparties, there is no need to require an assessment of developers at the rigorous level proposed.”

3. Rationale for Final Rule

The final rule does not adopt the proposed three year audited financial statements requirement. The final rule is less prescriptive than the proposed rule in establishing criteria for assessing the financial strength of credit score model developers. The final rule requires an applicant to submit information related to its organization and financial strength in its application, and the final rule requires an Enterprise to assess the financial strength of the credit score model developer as part of the Enterprise Business Assessment. However, the final rule does not include the proposed requirement that a credit score model developer provide three years of audited financial statements. This change will provide more flexibility for an Enterprise to determine what information is

necessary for its review and potentially more flexibility to applicants submitting such information.

FHFA has provided supervisory guidance to the Enterprises on managing risks associated with third-party providers. The guidance describes FHFA's supervisory expectations, including that an Enterprise review audited financial statements, equivalent financial information, or other evidence of creditworthiness and financial viability. This review should consider whether the third-party provider will be able to continue to perform its role for the foreseeable future. The level of review, and documentation required, will vary depending on the financial risk to an Enterprise and/or the viable alternatives to the third-party provider.

Effective risk management of third-party provider relationships is essential to the safe and sound operations of the Enterprises. It is not necessary for the final rule to reference guidance that is already applicable to the Enterprises or to impose specific requirements related to third-party provider financial information. FHFA expects the Enterprises to consider applicants in accordance with any applicable FHFA guidance on the financial strength of third-party providers that is in effect at the time of the relevant Credit Score Solicitation.

The final rule also permits the Enterprises to establish additional requirements for qualifications of credit score model developers. The Enterprises are required to include any such additional requirements in the Credit Score Solicitation, and those requirements are subject to FHFA review and approval as discussed above.

G. Demonstrated Use

The proposed rule would have required an applicant to demonstrate use of the credit score by creditors to make lending decisions. The proposed rule would not have established a standard for meeting the demonstrated use component, but permits an Enterprise to address criteria for demonstrating use in its Credit Score Solicitation. The final rule adopts the same approach.

1. Proposed Rule

The proposed rule would have required the applicant to demonstrate use of its credit score model by creditors to make credit decisions. The requirement was designed to ensure that all credit score models considered by an Enterprise are used or employed by lenders. The proposed rule discussed various options for how an applicant might demonstrate use (*e.g.*, testimonials by non-mortgage and/or mortgage lenders).

2. Comments Received

Most commenters supported the proposed requirement that applicants demonstrate use of the credit score by creditors to make credit decisions. One commenter suggested that this requirement could be expanded to require “substantial use in originating and securitizing consumer credit products of the same credit quality as the conventional, conforming mortgage loans that the Enterprises purchase and securitize.” In addition, commenters encouraged FHFA to include in the final rule an “objective and quantifiable standard of substantial use.” One commenter stated that while the demonstrated use requirement “may impede innovation,” the Enterprise pilot programs could engage “untested” credit scores.

3. Rationale for Final Rule

The final rule requires an applicant to demonstrate use of the credit score by creditors to make credit decisions. The final rule does not establish a standard for meeting the demonstrated use component, but permits an Enterprise to address criteria for demonstrating use in its Credit Score Solicitation. FHFA acknowledges that requiring credit score models to demonstrate use in making credit decisions may limit the number of applications submitted to the Enterprises. This concern is partially addressed by the final rule provision permitting pilot programs. The availability of pilot programs will be an essential vehicle for new credit scores to demonstrate their performance history. The provisions related to pilot programs are discussed in more detail below.

H. Options for Evaluating Accuracy Test Results

A credit score model is accurate if it produces a credit score that appropriately reflects a borrower's propensity to repay a mortgage loan in accordance with its terms, permitting a credit score user to rank order the risk that the borrower will not repay the obligation in accordance with its terms relative to other borrowers. The accuracy standard is measured by statistical testing. The final rule adopts a transitional approach to evaluating the results of the statistical testing.

Under the transitional approach, one standard for accuracy would be applied to the initial Credit Score Assessment undertaken by an Enterprise, and another standard would be applied to subsequent Credit Score Assessments in response to a future solicitation. The transitional approach will require the Enterprises to apply the same standard to all applications received in response to the initial solicitation. This transitional approach will permit an Enterprise to assess the score currently in use,

Classic FICO, pending a determination on any other applications received by the Enterprise in response to the initial Credit Score Solicitation.

1. Proposed Rule

FHFA proposed four options for evaluating credit score accuracy test results in the Credit Score Assessment: a comparison approach, a champion-challenger approach, a benchmark-based approach, and a transitional approach. The four options reflect different approaches for comparing the statistical results from the credit score models being evaluated. The comparison approach would require an Enterprise to consider the credit score accuracy results of the new model(s) but would not establish a bright-line standard. The champion-challenger approach would require that the accuracy of the new credit score exceed the accuracy of the credit score(s) that are in use by the Enterprises. The benchmark approach would require all applicants to meet or exceed a benchmark established by regulation or by FHFA notice. The transitional approach would apply one of the above approaches to the initial solicitation and apply a different approach to subsequent evaluations.

2. Comments Received

A majority of the commenters who addressed the four options in the proposed rule supported some variation of the transitional approach. The primary rationale provided by commenters to support the transitional approach was that the transitional approach would allow for the validation and approval of Classic FICO in the initial Credit Score Assessment. Some commenters recommended that the Enterprises immediately validate and approve Classic FICO, while one commenter stated that Classic FICO should be reviewed under the same process used for any other credit score model.

Some commenters noted that Classic FICO has been tested by virtue of its use across the industry and within Enterprise systems for many years. These commenters stated that the Enterprises should be able to validate and approve Classic FICO consistent with this final rule on an expedited basis. One commenter stated that “regardless of the option that is adopted in the final rule, FHFA and the Enterprises should validate and approve Classic FICO immediately rather than require the model to undergo the lengthy process envisioned in the proposed rule. Such a step would significantly reduce transition uncertainty for market participants and ensure that there are no market disruptions prior to the approval of any new models (including new models developed by FICO).”

Most of the commenters that addressed the other options in the proposed rule recommended that they be used in combination with the transitional approach. A few commenters supported a standalone champion-challenger approach, stating that it would provide a clear standard for approval. Some commenters supported the comparison approach as a means of ensuring that the credit score models currently in use could meet the standard. Several other commenters opposed the comparison approach, stating that it would provide too much discretion and therefore would lack transparency. Similarly, most of the commenters that addressed the benchmark approach opposed it due to uncertainty about how the benchmark would be set.

3. Rationale for Final Rule

FHFA agrees that there are benefits to the industry to validate and approve the score currently in use, Classic FICO, while also applying a fair and rigorous validation and approval process for all credit score model applications. The final rule provides that

all credit score models must meet the same criteria for validation and approval.

However, FHFA recognizes that the long use and widespread industry acceptance of Classic FICO may allow an Enterprise to accelerate the validation and approval process for this model.

The final rule adopts the transitional approach because it offers the smoothest transition from the current use of Classic FICO to any new credit score model. Section 310 permits an Enterprise to continue to use the current credit score model until November 20, 2020. The transitional approach will abate the risk of the Enterprises failing to validate and approve a credit score model under the final rule before this date.

Under the transitional approach, the standard for accuracy in the initial Credit Score Assessment will be different from the standard for accuracy in subsequent Credit Score Assessments. For the initial Credit Score Assessment, a champion-challenger approach would be problematic due to the lack of a validated and approved credit score to serve as the champion. Multiple commenters suggested instead setting a benchmark threshold based on the performance of Classic FICO for the initial Credit Score Assessment.

The final rule requires the Enterprises to establish a credit score accuracy benchmark for the initial Credit Score Assessment. FHFA expects that the accuracy benchmark for the initial Credit Score Assessment will be informed by the accuracy of the credit score model currently used by the Enterprises, Classic FICO. Establishing a benchmark informed by Classic FICO is appropriate because the model has been used by the Enterprises and the mortgage finance industry for more than 12 years. In addition, FHFA has found the Classic FICO score to be a reasonable measure of default risk for the

Enterprises' internal purposes. The Enterprises will publish the accuracy benchmark for the initial Credit Score Assessment in the initial Credit Score Solicitation.

This approach to setting an accuracy benchmark for the initial Credit Score Assessment will permit an Enterprise to validate and approve Classic FICO while continuing to evaluate other credit score models for which it receives applications in response to the initial Credit Score Solicitation. If an Enterprise validates and approves Classic FICO and then validates and approves another credit score model, the Enterprise may replace Classic FICO with the newly validated and approved credit score model.

The final rule adopts a credit score accuracy standard for Credit Score Assessments in response to future solicitations that will be based on the validated and approved credit score model(s) in use at that time. This is equivalent to the champion-challenger approach where the applicant's "challenger" credit score model must be more accurate than the "champion" credit score model that is in use. One commenter suggested adding an accuracy improvement margin such that the applicant's credit score would have to be more accurate than the existing credit score by a threshold.

Considering the implementation costs associated with introducing a new credit score into the mortgage marketplace, requiring an improvement in accuracy is reasonable. However, establishing such a threshold in the final rule could provide less flexibility to the Enterprises. An Enterprise may consider the relative accuracy of different credit score models as part of the Enterprise Business Assessment, including whether any improvement is sufficient to justify the costs and benefits associated with adoption of a new credit score requirement.

Several commenters mentioned the known testing bias where new credit scores will seem more accurate than legacy credit scores, when in fact they are not more accurate. In the absence of a simple solution to abate the statistical bias, some commenters recommended requiring new credit score models exceed the accuracy of the existing credit score model. An alternative viewpoint expressed by two commenters was that requiring an applicant's credit score to be equally as accurate as the current credit score model in use would enable more credit score models to pass the Credit Score Assessment and be evaluated in the Enterprise Business Assessment phase.

One commenter stated that credit score models that pass the Credit Score Assessment may have greater credibility in the market. However, it is important to note that the Credit Score Assessment is only one step of the overall validation and approval process. When an application passes the Credit Score Assessment, an Enterprise has determined that a credit score meets the minimum testing criteria for the limited purpose of the Credit Score Assessment. The statistical results of the Credit Score Assessment should not be extrapolated beyond these minimum testing criteria. The Credit Score Assessment does not evaluate the appropriateness of a credit score model for any other purposes, and an Enterprise determination as part of the Credit Score Assessment should not be viewed as an endorsement of the credit score model.

I. Assessment of Impact on Enterprise Operations and Risk Management, and Impact on Industry

The proposed rule would have required that the Enterprise Business Assessment include a cost-benefit analysis of the potential operational impact on industry and borrowers of using a particular credit score model. FHFA received a number of

comments raising concerns with the potential cost and time required for an extensive cost-benefit analysis, with some commenters concerned that the cost of this analysis would be shifted to applicants through excessive upfront or assessed fees. The final rule does not make any change to the proposed provisions on application fees or cost-benefit analysis. Under the final rule, the Enterprise is responsible for conducting the Enterprise Business Assessment, which includes a cost-benefit analysis. The final rule does not permit an Enterprise to assess an applicant for the costs of this analysis beyond the upfront application fee and any assessment for third-party data acquisition costs. The final rule also provides that the cost-benefit analysis must be completed within the 240 days allotted for completing the Enterprise Business Assessment.

1. Proposed Rule

Under the proposed rule, the Enterprise Business Assessment included an evaluation of the impact that using the applicant's credit score model would have on Enterprise operations (including any impact on purchase eligibility criteria and loan pricing) and risk management (including counterparty risk management), in accordance with standards and requirements related to prudential management and operations and governance set forth in other FHFA regulations.⁴

The Enterprise Business Assessment would evaluate the impact of using the applicant's credit score model on mortgage industry operations and mortgage market liquidity, including costs associated with implementation of a newly approved credit score model. This evaluation also would consider whether the benefits of using credit scores produced by that model can reasonably be expected to exceed the costs.

⁴ See 12 CFR part 1236 and 1239.

Consideration of the costs and benefits would include implementation and ongoing costs, projected benefits and costs to the Enterprises and borrowers, as well as potential impacts on market liquidity and the cost and availability of credit.

2. Comments Received

Many commenters addressed the cost-benefit analysis in the Enterprise Business Assessment. Commenters generally were in favor of the proposed cost-benefit analysis in the Enterprise Business Assessment. Several commenters cited the importance of this provision as part of prudent decision-making practices. Other commenters supported the provision but suggested changes, stating that the provision was too vague and should explicitly require engagement with industry stakeholders to seek input on industry costs.

Some commenters were concerned that the Enterprises would have an unlimited amount of time to conduct the cost-benefit analysis and that the costs of such an analysis would be borne by the applicant. One commenter suggested that the cost-benefit analysis should be made public, either through making the raw data from the Enterprises' analysis available or in the form of an Enterprise white paper.

Several commenters, including associations representing smaller lenders, expressed concern that replacement of a credit score model, or the use of multiple credit score models at the same time, would present significant lender implementation costs which might especially impact smaller lenders. The commenters noted that those costs may not be worth the benefits of a new credit score model, especially given the higher expected costs associated with the use of multiple credit score models.

3. Rationale for Final Rule

The proposed rule included the requirement for a cost-benefit analysis in the Enterprise Business Assessment, which was limited in time and scope. The final rule adopts the cost-benefit analysis provision as proposed. The final rule requires the cost-benefit analysis to evaluate the impact of using the credit score model on industry operations and mortgage market liquidity, including costs associated with implementation of a newly approved credit score. Because the cost-benefit analysis is one element of the overall Enterprise Business Assessment, the cost-benefit analysis must be conducted within the 240-day timeframe for completing the Enterprise Business Assessment.

The final rule provides that each applicant must pay an up-front application fee established by the Enterprise. This application fee is intended to cover the direct costs to the Enterprise of conducting the Credit Score Assessment. An Enterprise also may assess an applicant for the cost of obtaining third-party data and credit scores necessary for testing purposes. The Enterprises are responsible for any costs associated with the Enterprise Business Assessment.

Finally, the final rule does not make changes in response to comments recommending that the rule be more explicit about engaging with industry stakeholders. FHFA expects that the Enterprises will engage with industry stakeholders if necessary to complete the cost-benefit analysis. For example, an Enterprise may consider the need for mortgage insurers to update and submit their premium rate sheets to state insurance regulators for approval, as well as the need for MBS and CRT investors to re-estimate mortgage performance and valuation models.

J. Competitive Effects

As discussed above, the final rule does not include the proposed conflicts-of-interest certification, which would have required independence of a credit score model developer from any data provider. However, the final rule still includes an evaluation of competitive effects as one component of the Enterprise Business Assessment. This will allow an Enterprise to consider whether using a particular model would promote or discourage competition in the industry.

1. Proposed Rule

The proposed rule would have required the Enterprise Business Assessment to include an evaluation of whether using the applicant's credit score model could have an impact on competition in the industry. This evaluation would consider whether use of a particular credit score model could have an impact on competition due to any ownership or other business relationship between the credit score model developer and any other institution.

2. Comments Received

FHFA received numerous comments on the proposed competition provisions. As previously discussed, many commenters opposed the conflicts-of-interest certification requirement in the application, and FHFA is eliminating the requirement for an applicant to certify its independence as a component of the application. However, many commenters also suggested that it is appropriate for an Enterprise to consider whether using a particular credit score model may have competitive effects on the industry – positive or negative – during an Enterprise Business Assessment.

These commenters supported addressing competition as part of the rulemaking and the Enterprise evaluations, with some commenters believing that “that increased

market competition in the credit-score industry could be beneficial to both consumers and lenders because it can improve efficiency, decrease pricing, and potentially expand the market of consumers for mortgage products.” Other commenters expressed concerns about vertical integration and about the lack of other participants in the credit score market.

3. Rationale for Final Rule

The final rule adopts the provision requiring the Enterprise Business Assessment to include consideration of the potential impact selection of a credit score could have on competition. An Enterprise may consider whether using a particular credit score model would contribute to consolidation or vertical integration. This type of evaluation is not unusual for the Enterprises. In the normal course of business, an Enterprise may consider the potential impact on consolidation as part of its review of third-party providers. For example, the Enterprises consider consolidation risk when doing business with servicers, sub-servicers, counterparties, vendors, and third-party providers. A similar evaluation is appropriate for the review of competitive effects in the market for credit score model developers.

An assessment of competitive effects is just one component of the broader Enterprise Business Assessment. Overall, the Enterprise Business Assessment requires the Enterprises to consider multiple factors including, but not limited to, review of fair lending impacts, impact on risk management, and assessment of the credit score model developer as a third-party provider. FHFA expects that an Enterprise’s review of competitive effects will be considered in conjunction with all other criteria established for the Enterprise Business Assessment.

K. Pilot Programs

Section 310 requires that a credit score model have a historical record of measuring and predicting default rates and other credit behaviors. This could pose a challenge for newer credit scores. The proposed rule would have allowed for the Enterprises to use pilot programs for credit scores as a way for the Enterprises to evaluate and track performance of potential new credit scores with minimal disruption.

Comments were supportive of the proposed provision on pilot programs, which the final rule adopts, with some clarifications.

1. Proposed Rule

The proposed rule would have permitted the Enterprises to engage in pilot programs to learn about credit score models. Such pilot programs would balance the section 310 requirement that a credit score model have “a historical record of measuring and predicting default rates and other credit behaviors” with desirable innovation in credit score models. A pilot program could assist an Enterprise in determining the appropriate standards and criteria for a Credit Score Solicitation, including requirements for applications from credit score model developers.

The proposed rule would have required FHFA to review and approve any credit score pilot of an Enterprise, and the proposed rule would have permitted FHFA to impose terms, conditions, and limitations as it deemed appropriate. Pilot programs generally would be of limited duration and scope. This would reinforce the “test and learn” nature of a pilot program and would ensure consistency with section 310’s requirement that any score used by an Enterprise be validated and approved.

2. Comments Received

All of the commenters that addressed pilot programs supported allowing the Enterprises to engage in pilot programs and other testing initiatives. One commenter stated that “[t]his is perhaps the most important provision in the proposed rule. And it will be the provision with the most long-lasting impact in terms of encouraging innovation and progress,” if new scoring models are able to help “thin” or “no-file” consumers and expand access to mortgage credit without increasing risk. Another commenter stated that “[t]he pilot program process that [FHFA proposed] for new scoring models in the rule is exactly the right approach to encourage and promote innovation, competition and the use of true alternative data and alternative methods,” and that pilots should be encouraged rather than just permitted. Other commenters agreed that pilots would be consistent with the intent of section 310, which they described as encouraging competition among and innovation by credit score model developers. Several commenters noted that pilots could be helpful in advancing the use of alternative data such as rental, utility, and telecommunications data, as well as consumer-permissioned data such as depository data.

Several commenters suggested types of pilots that might be beneficial. One commenter suggested that the Enterprises could conduct a pilot on “a subset of borrowers that did not have a credit score and were manually underwritten by the Enterprises to assess how well a new credit score predicts the propensity of these borrower to repay their mortgages.” Another commenter suggested pilot programs “for new models that go beyond conventional minimum scoring criteria” to score consumers new to credit (those whose credit files show no accounts that have been opened for six or more months), consumers who may be “involuntarily inactive” and have derogatory information such as

a past delinquency on file, and consumers who are voluntarily inactive. Pilot programs for credit score models that use alternative data could demonstrate whether future models using such data would be able to accurately and inclusively score a larger portion of the population.

Several commenters suggested that the final rule provide for transparency and public awareness of pilot programs. One commenter suggested FHFA publicly report on new pilots and the results of pilots while another suggested FHFA “maximize” transparency by regularly informing the public of approved pilots, publicly sharing the results from pilots, and providing the public information about Enterprise and FHFA actions that follow pilots. Similarly, another commenter suggested that the terms of pilots should be transparent, limitations on duration and scope should be made publicly available, and that the public should be provided information on the types of institutions participating in the pilot and the qualitative and quantitative metrics for evaluating pilots.

One commenter suggested that requirements for implementing a pilot be less restrictive and time intensive than the proposed credit score model validation and approval process. Another commenter suggested that all pilot program applicants be assessed and compared against each other, considering that there would be no incumbent or benchmark credit score model to use for comparison. That commenter also noted that pilots should include model testing across the populations and market conditions they are intended to address.

Some commenters also addressed transitioning from a pilot program to wider use of a validated and approved credit score, with one commenter suggesting that a model that successfully completes a pilot program then be eligible to undergo a Credit Score

Assessment and another suggesting that FHFA provide clear guidance about how a credit score model would transition from a pilot program to the full validation and approval process to full implementation by the Enterprises.

3. Rationale for Final Rule

To promote public awareness and transparency, FHFA intends to apply as much of the credit score validation and approval process established by this final rule as is appropriate, considering the nature of any pilot programs that may be considered by an Enterprise. For example, FHFA anticipates that the Enterprises may solicit applications for pilot programs. A solicitation for pilot programs would include much of the same information as a Credit Score Solicitation. Because of the potentially wide variation among pilot programs, the final rule does not restrict the ability of FHFA or the Enterprises to vary the requirements for a pilot program solicitation based on the specific pilot program in question.

The final rule requires that an Enterprise must submit any pilot program to FHFA for review and approval. An Enterprise may submit a proposed pilot program at any time, regardless of whether FHFA has initiated a solicitation period for all applicants. FHFA may impose terms, conditions, or limitations on the pilot program to ensure that it clearly addresses any regulatory requirements that a pilot applicant is required to meet and any other Enterprise standards and criteria.

To address concerns that pilots might be perceived as “exceptions” to the full regulatory validation and approval process, the final rule provides that each pilot program will be subject to limits on the duration and scope of the pilot. The final rule allows FHFA to extend the duration of a pilot for good cause shown.

FHFA acknowledges the interest commenters expressed in making information about pilots publicly available. FHFA expects to assess publication of information about pilot programs in the context of the review and approval process for pilots.

IV. Other Comments Received

This section addresses comments on other significant topics, including themes outside the scope of this rulemaking.

A. Lender Choice

Some commenters suggested that the final rule permit lenders to select the credit score used to underwrite a mortgage for delivery to an Enterprise. While the concept of lender choice was one of four approaches on which FHFA requested input from the public in the 2017 Credit Score RFI, this issue is outside the scope of this rulemaking. As stated previously, the final rule does not address how multiple approved credit score models would be implemented.

B. Tri-Merged Credit Report

The Enterprises have long required a tri-merged credit report, pursuant to which lenders are required to purchase credit scores and credit reports from all three CRAs. Several commenters noted that competition could be encouraged among the CRAs if the Enterprise requirement for a tri-merged report was eliminated. While FHFA stated in the 2017 Credit Score RFI that changes to the tri-merged report are under consideration, the tri-merged report requirement is outside the scope of this rulemaking.

While FHFA may at some point review and evaluate changing the requirement of lenders to purchase credit reports and scores from all three CRAs, FHFA and the Enterprises would need to fully understand the costs and benefits before making any

change to the tri-merge requirement. FHFA aims to simplify and reduce costs associated with mortgage origination and the acquisition process, while ensuring the Enterprises manage their credit risk exposure appropriately.

C. Encourage New Credit Data Repositories

One commenter stated that FHFA should encourage the creation of additional credit data repositories. The commenter suggested that one mechanism for encouraging such new entrants would be to require the Enterprises to sell mortgage payment data to any new credit data repositories. While FHFA supports competition in the credit data and credit score industry generally, the specific steps recommended by the commenter are outside the scope of this rulemaking.

D. Use of Nontraditional Consumer Credit Data

Several commenters supported the use of consumer credit data that is not traditionally found in the CRAs. FHFA agrees with commenters on the potential benefits of using nontraditional data, such as data on payment of rent, utility data, or telecommunications data. The Enterprises currently consider alternative housing-related data such as rental payments or utility payments where available. However, the use of nontraditional consumer credit data is outside the scope of this rulemaking.

E. Transparency/Release of Information

Several commenters suggested that FHFA or the Enterprises make additional disclosures of information if and when a new credit score model is to be implemented. These commenters requested that FHFA or the Enterprises disclose the criteria for, and the results of, any cost-benefit analysis of a new credit score model, and also that comprehensive data be disclosed so the market can understand the impact of a new credit

score model. The commenters stated that this type of transparency will increase confidence in the new credit score model.

Although a discussion of implementation is outside the scope of this rulemaking, FHFA acknowledges the importance of public understanding of the impact of, and confidence in, any new credit score model. FHFA and the Enterprises will consider how to facilitate public understanding of any new credit score model, including the potential sharing of non-proprietary information, at the time a new credit score model is approved.

F. Request for Enterprises to Provide Raw Credit Score Data

Some commenters requested that the Enterprises provide access to the historical loan-level data and credit scores used for the empirical testing of credit scores conducted by FHFA and the Enterprises from 2015 to 2018 pursuant to FHFA's Conservatorship Scorecards. FHFA received similar requests in response to the 2017 Credit Score RFI. While the data used for that empirical testing has not been made public, Enterprises make available to the public several other loan-level data sets that include credit scores.

The final rule does not require the Enterprises to make data available to industry or the public for parallel testing. The data used for empirical testing of credit scores is generally proprietary data that may be costly to obtain and may be subject to restrictions on further sharing. Industry participants are encouraged to work with the credit score model developers and CRAs to acquire any data needed to update their internal models or to conduct parallel testing of credit score models.

G. Consider Enterprise Mission

While several commenters noted the Enterprises' public mission, one commenter requested that FHFA revise its proposal on the Enterprise Business Assessment to require

consideration of the positive effect a model could have on expanding the universe of creditworthy borrowers and potential homebuyers, as an offsetting factor to the cost of adopting and implementing that model. FHFA believes this sentiment is already reflected in the final rule, which requires the Enterprises to consider potential benefits to borrowers, including benefits related to cost and availability of credit. FHFA also interprets its regulations, and expects the Enterprise to implement them, with full awareness of other statutory duties that may be implicated, including duties related to Enterprise safety and soundness, acting consistently with the public interest, support of mortgages for low- and moderate-income families, and compliance with fair lending laws. Consequently, FHFA does not believe the requested change is necessary.

H. Consider Eliminating LLPAs and Delivery Fees

Some commenters noted that consumers with lower credit scores are more likely to be subject to higher LLPAs and Delivery Fees and thus may pay more for credit. One commenter noted that consumers with lower credit scores are disproportionately likely to have low or moderate incomes or to be minorities. The commenter stated that LLPAs and Delivery Fees could reduce access to credit for such consumers and suggested eliminating LLPAs and Delivery Fees on that basis.

LLPAs and Delivery Fees are used by the Enterprises to compensate for the credit risk of a mortgage loan. To the extent that credit scores are used in setting the LLPAs and Delivery Fees, the final rule requires that the credit scores be produced from validated and approved models. As other commenters have expressed, innovation in credit score models could result in improved understanding of borrower creditworthiness that may result in reduced cost of credit for some borrowers. However, the question of

establishing specific requirements for Enterprise loan pricing (including LLPAs and Delivery Fees) is outside the scope of this rulemaking.

I. Discontinue the Rulemaking

One commenter stated that the proposed rule is a waste of taxpayer dollars. The commenter urged FHFA to discontinue the rulemaking process and to go back to Congress to gain additional guidance. However, section 310 requires FHFA to establish standards and criteria for the validation and approval of credit score models. This final rule meets that statutory obligation.

V. Section-by-Section Analysis of Final Rule

A. Purpose and Scope, Definitions, and Computation of Time — §§ 1254.1, 1254.2 and 1254.3

Section 1254.1 of the final rule sets out the purpose of the final rule, to establish the standards and criteria that an Enterprise must satisfy in creating a process for the validation and approval of credit score models. Section 1254.1 of the final rule also describes the four major components of the validation and approval process.

Section 1254.2 of the final rule defines key terms used in the regulation. The definitions distinguish between a “credit score” and a “credit score model.” As defined in the final rule, a “credit score” is a numerical value that is derived from a statistical tool or model, while a “credit score model” is the statistical tool or model itself. Consistent with section 310, the definition of “credit score model” is limited to models created by third parties. In other words, “credit score model” does not include any statistical tool or model created by an Enterprise, such as an AUS. The final rule defines a “credit score

model developer” as any person with ownership rights in the intellectual property of a credit score model.

The proposed rule would have defined “nationwide consumer reporting agency” consistent with the definition in the Fair Credit Reporting Act (15 U.S.C. 1681a). The final rule omits this definition because the term is not used in the regulation.

Section 1254.3 of the final rule clarifies how time periods will be measured for the various requirements and deadlines set forth in the final rule.

B. Enterprise Use of Credit Scores — § 1254.4

Section 1254.4 of the final rule provides that an Enterprise is not required to use a credit score for any business purpose. However, if an Enterprise requires a credit score as a condition of purchasing a mortgage, the credit score must be produced by a credit score model that has been validated and approved in accordance with the final rule. As discussed in more detail above, the final rule permits an Enterprise to use credit scores that are subject to a limited pilot program being conducted by the Enterprise in accordance with the final rule.

Section 1254.4 of the final rule also provides that an Enterprise may replace any validated and approved credit score with any other validated and approved credit score. The proposed rule would have provided that such replacement was at the discretion of the Enterprise. However, as discussed in more detail above, the final rule provides that an Enterprise must submit any proposed determination to FHFA for review and approval. This prior approval requirement applies to any proposed determination to replace one credit score model with another, and so the final rule omits the phrase indicating that replacement is at an Enterprise’s discretion. However, the final rule still provides that

use of a credit score model by an Enterprise does not create any expectation of or right to continued use of that credit score model.

C. Enterprise Solicitation of Applications from Credit Score Model Developers — § 1254.5

The final rule addresses the solicitation process, the minimum required contents of an Enterprise solicitation, and details and timing of the review of Enterprise proposed solicitations by FHFA prior to Enterprise publication. The final rule establishes that the solicitation process involves: (1) a notice from FHFA to the Enterprises that FHFA has determined that the Enterprises must undertake a solicitation; (2) development of a Credit Score Solicitation by each Enterprise; (3) review and approval of the Credit Score Solicitation by FHFA; (4) publication of the Credit Score Solicitation by the Enterprise; and (5) the time period during which the Enterprises will accept applications for validation and approval of credit score models. Each step is addressed below.

1. Solicitation Process Initiated by FHFA

Section 1254.5(a) of the final rule permits FHFA to require the Enterprises to solicit applications from credit score model developers for the review and approval of the credit score model by an Enterprise. FHFA will determine in its discretion whether to open a solicitation for credit score model developers to apply for consideration.

FHFA may open a solicitation at its own initiative or based on a request from an Enterprise or any other party. Such requests may be based on a reasonable belief on the part of an Enterprise or interested party that a new score has the potential to be materially beneficial to the mortgage market and merits earlier consideration. In determining the need for future solicitations, FHFA will consider potential benefits of updating the credit score model requirements and the costs to industry of changing from one credit score

model to another, and whether an update to the credit score model could be achieved by an enhancement to an Enterprise AUS. For example, FHFA may determine there is no need to open a solicitation in the future because an Enterprise no longer conditions mortgage purchases on the provision of a credit score.

Section 1254.5(a) of the final rule also provides that FHFA will notify an Enterprise of the requirement to solicit applications. The notice will state when the Enterprise must begin soliciting applications, the deadline for an Enterprise to submit its proposed Credit Score Solicitation to FHFA, and the length of time the solicitation period is open. Each Enterprise is required to submit a “Credit Score Solicitation” to FHFA for review and approval in response to an FHFA initiated solicitation.

The final rule does not require an Enterprise to consider any application that is received outside of a solicitation established by FHFA. An Enterprise could review and conduct preliminary empirical analysis if an application is received outside of a particular solicitation, and this analysis could prompt an Enterprise to request that FHFA open a solicitation. However, an Enterprise would not be permitted to approve an application that was not submitted in response to a solicitation.

2. Required Content of a Credit Score Solicitation

Section 1254.5(b) of the final rule requires that a “Credit Score Solicitation” must cover the Enterprise’s validation and approval process, including the requirements that an application must meet in order for a credit score model to be considered by an Enterprise. The final rule permits the Enterprises to establish requirements in addition to those set forth in the rule.

Specifically, the final rule requires each Credit Score Solicitation to provide the opening and closing dates of the period during which applications will be accepted, describe information that must be included in each application, and describe the process by which the Enterprise will obtain data for assessing applicants' credit score models. The Credit Score Solicitation must describe the Enterprise validation and approval process, including the processes for the Credit Score Assessment and the Enterprise Business Assessment. The process must be in accordance with the minimum standards and criteria of section 310 and the final rule. For example, the Credit Score Solicitation must address the standards or criteria for accuracy, reliability, and integrity, and any method of demonstrating that the credit score has a historical record of measuring and predicting credit behaviors, including default rates, as required by section 310.

The final rule establishes minimum standards and criteria for validation and approval of credit score models. An Enterprise may have valid business reasons for imposing additional standards and criteria. Section 310 and the final rule both permit additional standards and criteria to be imposed by an Enterprise. Any additional standards, criteria, or requirements must be included in the Credit Score Solicitation, and are subject to FHFA review and approval.

3. FHFA Review of Enterprise Solicitation

Section 1254.5(c) of the final rule requires FHFA to review and approve or disapprove each Credit Score Solicitation submitted by an Enterprise, including any Credit Score Solicitations submitted jointly by the Enterprises. The final rule requires an Enterprise to submit a Credit Score Solicitation for FHFA review prior to the start of the solicitation period. FHFA may object to any additional Enterprise standards, criteria, or

requirements, or impose any terms, conditions, or limitations that FHFA determines appropriate. The final rule establishes a 45-day period for FHFA to complete its review, which may be extended by FHFA if necessary.

Because the Credit Score Solicitation must describe the Enterprise validation and approval process, FHFA's review of each Credit Score Solicitation meets the statutory requirement that FHFA "periodically" review the Enterprise validation and approval process.⁵ This review does not prevent FHFA from reviewing an Enterprise's validation and approval process as part of its usual supervisory processes, including examinations.

4. Publication of Credit Score Solicitation

Section 1254.5(d) of the final rule provides that after receiving approval of the Credit Score Solicitation from FHFA, the Enterprise must make publicly available the Credit Score Solicitation for at least 90 days prior to the start of the solicitation time period. This will provide prospective applicants time to consider whether to submit an application for review. In particular, the 90-day publication period will provide applicants a reasonable period to review the fees and the information required to complete an application prior to expending resources to submit an application. The publication of the Enterprise Credit Score Solicitation satisfies section 310's requirement that an Enterprise "make publicly available" a description of its validation and approval process.

5. Timeframes for Solicitation

Section 1254.5(a) provides that the solicitation period will be determined by FHFA. Based on comments received, FHFA wants to ensure that the Enterprises are

⁵ 12 U.S.C. 1454(d)(8) and 1717(b)(7)(H).

accepting applications concurrently. Therefore, FHFA expects to require each Enterprise to publish its Credit Score Solicitation on the same date. Section 1254.5(e) of the final rule requires that each Enterprise submit its Credit Score Solicitation for the initial solicitation within 60 days of the effective date of the final rule. The initial solicitation time period will begin on a date determined by FHFA and will extend for 120 days. For future solicitation time periods, FHFA will review the Credit Score Solicitations submitted by the Enterprises and consider the appropriate length of time the solicitation window should be open.

D. Submission and Initial Review of Applications — § 1254.6

1. Overview

Section 1254.6 of the final rule establishes the minimum criteria an application must meet to be considered complete, including: (1) an application fee; (2) a fair lending certification; (3) information to demonstrate use of the credit score model by the lending industry; (4) information on the qualifications of the credit score model developer; and (5) any other information required by an Enterprise in the Credit Score Solicitation. The final rule also addresses submission of applications, Enterprise determination of each application's completeness, notice to applicants of the status of the application as complete, and acquisition of historical consumer credit data by an Enterprise. Finally, the final rule establishes that an Enterprise is not required to evaluate any application that is not complete.

2. Application Fees and Enterprise Assessment for Costs

Section 1254.6(a)(1) of the final rule requires each applicant to pay an application fee that is intended to cover the direct cost to the Enterprise of the Credit Score

Assessment. The final rule also permits an Enterprise to address conditions under which it would refund a portion of the application fee. Section 1254.6(b) of the final rule also permits an Enterprise to assess applicants for the costs associated with acquiring third-party data and credit scores, either in addition to or instead of an up-front application fee.

3. Fair Lending Certification and Compliance

Section 1254.6(a)(2) of the final rule requires each applicant to address compliance of the credit score model and the credit scores it produces with federal fair lending requirements, and to certify that no characteristic used in the development of the credit score model or as a factor in the credit score model to produce credit scores is based directly on or is highly correlated solely with prohibited classifications, as defined by the Equal Credit Opportunity Act (15 U.S.C. 1691(a)(1)), the Fair Housing Act (42 U.S.C. 3605(a)), and the Safety and Soundness Act (12 U.S.C. 4545(1)).

4. Demonstrated Use

Section 1254.6(a)(3) of the final rule requires an applicant to demonstrate use of the credit score by creditors to make lending decisions. The final rule does not establish a standard for meeting the demonstrated use component, but permits an Enterprise to address criteria for demonstrating use in its Credit Score Solicitation. Enterprise criteria may include, for example, submissions of testimonials by lenders who use the applicant's credit score for underwriting credit.

5. Qualifications of Credit Score Model Developer

Section 1254.6(a)(4) of the final rule requires each applicant to provide information on the qualifications of the credit score model developer, including a description of the developer's relevant experience, financial capacity, corporate structure

(including relationships through common control or ownership), governance structure, and past financial performance. Each Credit Score Solicitation may also set forth other required information related to qualifications, in the Enterprise's discretion.

6. Additional Enterprise Standards and Criteria

Section 1254.6(a)(5) of the final rule permits the Enterprises to establish additional requirements for applicants. Each Enterprise must include all application requirements in its Credit Score Solicitation, including requirements established by the Enterprise in addition to those established by the final rule.

7. Data Acquisition

Section 1254.6(b) of the final rule permits an Enterprise to acquire any historical consumer credit data necessary to test the credit score model's record of measuring default rates and other credit behaviors. Such data typically include historical credit scores on a test set of existing Enterprise loans at origination. Applicants whose credit scores incorporate multiple sources of consumer credit information (*e.g.*, credit scores based on information from the nationwide CRAs augmented with data outside of the three nationwide CRAs) will be required to work with the Enterprises on a process to obtain the applicant's credit scores on existing Enterprise loans. FHFA recognizes that information required from a third party, such as consumer credit data, may be beyond the control of the applicant. The final rule permits third parties to deliver information to an Enterprise within a reasonable time period that may extend beyond the 120-day solicitation period. However, an application is not complete unless and until an Enterprise has received all the necessary data needed to undertake a Credit Score Assessment.

As stated above, the final rule also permits an Enterprise to assess applicants for reasonable costs associated with the acquisition of third-party data and credit scores.

8. Completeness of Applications

Section 1254.6(c) of the final rule requires the Enterprises to review each application that is submitted within the solicitation period. Within 60 days after the date of submission, the Enterprise must provide the applicant a status notice of the application. Each applicant will be responsible for submitting the documentation required within the timeframe imposed by the final rule. If the applicant needs to provide additional information in order for the application to be complete, the deadline for submitting that information is the close of the solicitation period. Required information from a third party, such as consumer credit data, may be submitted to an Enterprise after the close of the solicitation period.

The final rule provides that an application is complete when an Enterprise determines that the required information has been received from the applicant and any third-party (*i.e.*, any data requested from a third-party on behalf of the applicant for use by the Enterprise).

The final rule establishes that an Enterprise has no obligation to assess any incomplete application. As required by section 310, each applicant will receive an application status notice informing the applicant of any additional information needed in conjunction with an application. If an Enterprise determines that an application is incomplete, the applicant would have the opportunity to respond within the designated 120-day solicitation period.

The final rule does not require an Enterprise to consider any application that is received outside of a solicitation established by FHFA. An Enterprise could review and conduct preliminary empirical analysis if an application is received outside of a particular solicitation, and this analysis could prompt an Enterprise to request that FHFA open a solicitation. However, an Enterprise would not be permitted to approve an application that was not submitted in response to a solicitation.

E. Credit Score Assessment — § 1254.7

1. Overview

Section 1254.7 of the final rule requires each Enterprise to undertake a Credit Score Assessment of each credit score model for which it has received a complete application. The Credit Score Assessment includes an evaluation of the accuracy, reliability, and integrity of credit scores on a stand-alone basis (outside of an Enterprise's internal systems and procedures). The final rule addresses the standards or criteria for accuracy, reliability, and integrity for this purpose, and sets forth an accuracy standard for the initial Credit Score Solicitation to facilitate the transition to validated and approved credit score models. The final rule also addresses who may conduct such evaluations, and the timeframe in which the Credit Score Assessment must be completed.

2. Testing for Accuracy and Reliability

Section 1254.7(b) of the final rule requires that the Enterprises conduct statistical testing that uses one or more industry standard statistical tests for demonstrating divergence among borrowers' propensity to repay, applied to mortgages purchased by an Enterprise. The final rule does not define specific parameters for the testing that would be conducted by an Enterprise for accuracy testing. Although the final rule allows

flexibility for the Enterprises to define the specific parameters of testing, FHFA requires that the Enterprise testing requirements include a common definition of default.

The definition of default is critical to accuracy and reliability testing of a credit score. A definition of default includes two parts, the occurrence of an event (*e.g.*, delinquency) and a time horizon (*e.g.*, 24 months since origination). Currently, the generally accepted definition of default is a 90-day delinquency during a two year period. FHFA expects that the Enterprises will use the generally-accepted definition of default during the Credit Score Assessment. However, FHFA encourages the Enterprises to consider testing using other definitions in addition to the testing using the generally-accepted definition.

FHFA requested comment on any additional default definitions. Commenters generally supported the proposed language and mentioned the benefits of the Enterprises using an aligned definition of default. One commenter indicated that the definition of default should be longer given that mortgages have long maturities. The predictive power of credit scores at origination declines as the mortgage ages beyond two years, while other factors like payment history and home equity (or LTV) increase in predictive power. While the aligned definition of default is reasonable, consistent with industry standard and consistent with how the Enterprises use credit scores, the Enterprises are encouraged to test longer performance windows.

The final rule includes a requirement that the Enterprise test accuracy and reliability on subgroups of loans. The loan sets obtained for testing would have to contain sufficient observations to perform the tests on subgroups. It is unlikely that the accuracy of a credit score is constant across the entire credit score distribution. Subgroup

testing could be applied to loan-to-value groups, credit score groups, and thin credit file loans at origination, as well as new credit files and files with a past delinquency. It is expected that credit score accuracy will decline when applied to thin, stale, and new credit files, yet the accuracy of credit score models is critically important to borrowers and investors for thin files because such credit scores will likely be close to current underwriting thresholds.

3. Accuracy Standard

Section 1254.7(c)(1) of the final rule provides that a credit score model is accurate if it produces credit scores that appropriately reflect a borrower's propensity to repay a mortgage loan in accordance with its terms. An accurate credit score permits a credit score user to correctly rank order the risk that the borrower will not repay the obligation in accordance with its terms relative to other borrowers.

The final rule requires an Enterprise to establish a credit score accuracy cutoff as a benchmark for the initial Credit Score Assessment. Applicants' credit scores must be as accurate as the benchmark in order to pass the Credit Score Assessment. FHFA expects that the benchmark for the initial Credit Score Assessment will be informed by the accuracy of the credit score in use today, Classic FICO.

The final rule establishes that future Credit Score Assessments must use the validated and approved credit score models in use at the time the testing is conducted as the accuracy standard. Basing the benchmark on the most accurate validated and approved score in use at that time is equivalent to the champion-challenger approach where the applicant's credit score model (the "challenger") must be more accurate than the existing credit score model in use (the "champion").

4. Reliability Standard

Section 1254.7(c)(2) of the final rule establishes the reliability standard that must be met as part of the Credit Score Assessment. Under the reliability standard, a credit score model is reliable if it produces credit scores that maintain accuracy through the economic cycle. The final rule requires that an Enterprise evaluate whether a new credit score model produces credit scores that are at least as reliable as the credit scores produced by a credit score model that the Enterprise is then using, as demonstrated by appropriate testing.

The final rule requires an Enterprise to test at least two sets of Enterprise loans to evaluate credit score reliability. The first group of loans would represent recently underwritten loans with sufficient performance history consistent with the definition of default. The second set of loans would be selected from a period earlier than the estimation data used to develop the new credit scores and at a point in the economic cycle different from the first loan group. The Enterprises would define the loan sets conditional on origination period (or acquisition period) and include all single-family loans within the specified periods.

5. Integrity Standard

Section 1254.7(c)(3) of the final rule establishes a standard for integrity that must be met as part of the Credit Score Assessment. Under the integrity standard, a credit score model has integrity if, when producing a credit score, it uses relevant data that reasonably encompasses the borrower's credit history and financial performance. To be validated, a credit score model applicant would be required to demonstrate to the Enterprise that the model has integrity, based on appropriate evaluations or requirements

identified by the Enterprise (which may address, for example, the level of aggregation of data or observable data that may not be omitted or discounted when constructing a credit score).

One commenter recommended that the integrity standard in proposed § 1254.7(b)(3) also provide that “No credit score model may be eliminated from consideration based solely on the test for integrity, unless it clearly fails to meet the criteria set out by the Enterprise, but performance on this test may be considered as one factor in the overall Credit Score Assessment.” FHFA recognizes that the integrity standard in the final rule is more subjective than the accuracy and reliability standards, which are based on statistical testing. However, determining whether particular data elements are relevant to the borrower’s credit history and financial performance is necessarily a subjective determination. The additional language recommended by this commenter would not change the subjective nature of the determination and therefore the final rule does not include the suggested language. FHFA expects the Enterprises to apply the integrity standard based on their reasonable judgment of which data elements are necessary for a credit score model to consider.

The integrity standard should be evaluated subjectively but consistently in the Credit Score Assessment. The goal of the standard is to ensure that the credit score model developer utilized available data elements that are relevant and legally permissible. Improvements in the range of consumer information available to credit score model developers may improve credit score accuracy. The integrity standard is designed to permit credit score model developers to innovate.

6. Additional Enterprise Standards and Criteria

Section 1254.7(c)(4) of the final rule permits an Enterprise to establish additional requirements for the Credit Score Assessment. The Enterprise would be required to include any additional requirements in its Credit Score Solicitation, and those requirements would be subject to FHFA review and approval as discussed above.

7. Required Testing

Section 1254.7(c) of the final rule permits an Enterprise to conduct its own testing for the Credit Score Assessment or to contract with a third party to test each credit score model. In addition, the Enterprises are permitted to jointly conduct the Credit Score Assessment for all complete applications received in response to a solicitation.

8. Timing and Notices

Section 1254.7(d) of the final rule requires an Enterprise to provide a notice to each applicant that has submitted a complete application when an Enterprise will begin the Credit Score Assessment. The final rule provides that the Credit Score Assessment will begin no earlier than the close of the solicitation period unless FHFA determines that the assessment should begin on an earlier date. For example, FHFA may permit an Enterprise to begin a Credit Score Assessment prior to the close of the solicitation period if an Enterprise has concluded the application is complete, and the Enterprise has all the necessary data to begin a Credit Score Assessment.

The final rule requires an Enterprise to complete the Credit Score Assessment period within 180 days. The final rule permits FHFA to authorize not more than two extensions of the Credit Score Assessment period that shall not exceed 30 days each, upon a written request and showing of good cause by an Enterprise.

Section 1254.7(d) of the final rule also requires that an Enterprise notify an applicant if the application has passed the Credit Score Assessment. The final rule requires that this notification be provided no later than 30 days after the Enterprise has determined that the application has passed the Credit Score Assessment. If an application does not pass the Credit Score Assessment, the Enterprise would submit a proposed determination to FHFA as described in section 1254.9.

F. Enterprise Business Assessment — § 1254.8

1. Overview

Section 1254.8 of the final rule requires Fannie Mae and Freddie Mac to independently undertake an Enterprise Business Assessment for each credit score model that the Enterprise determines has passed the Credit Score Assessment. The Enterprise Business Assessment must include: (1) an assessment of the accuracy and reliability of credit scores within the Enterprise underwriting and other systems; (2) an assessment of possible fair lending impacts of using the credit score within the Enterprise systems and processes that use credit scores; (3) an assessment of potential impacts on Enterprise operations and risk management, and impact on industry; (4) an assessment of possible competitive effects from using a particular credit score model; (5) an assessment of the credit score model provider as a potential third-party provider; and (6) any other Enterprise standards and criteria. Because the Enterprises operate different systems, different business models, and different credit tolerances, the Enterprise Business Assessment requires each Enterprise to assess credit scores based on its specific business needs.

2. Accuracy and Reliability of Credit Scores within Enterprise Systems

Section 1254.8(b)(1) of the final rule requires an Enterprise to evaluate the accuracy and reliability of the credit score model when used within the Enterprise systems and processes. This evaluation must consider whether the credit score produced by an applicant's model is more accurate than, and at least as reliable as, the credit score that is then in use by the Enterprise. The Enterprise Business Assessment does not require an Enterprise to consider a credit score model's integrity, because the integrity of a credit score model would be established in the Credit Score Assessment phase and would not change when used in an Enterprise system or process.

3. Fair Lending Assessment

Section 1254.8(b)(2) of the final rule requires an Enterprise to evaluate the fair lending risk and fair lending impact of using the applicant's credit score model, in accordance with standards and requirements of federal fair lending laws. The fair lending assessment must also consider any impact on access to credit related to use of that credit score model.

4. Assessment of Impact on Enterprise Operations and Risk Management, and Impact on Industry

Section 1254.8(b)(3) of the final rule requires an Enterprise to consider operational impacts to the Enterprises of using the credit score produced by the applicant's credit score model, such as implementation timing and potential impacts on Enterprise risk management. That evaluation must consider whether the benefits of using the applicant's credit score can reasonably be expected to exceed the adoption and ongoing costs of using that credit score, considering costs and benefits to the Enterprises. The Enterprise also must consider potential costs and benefits across the entire mortgage

industry — origination, servicing, and securitization — of adopting a newly validated and approved credit score model. The final rule also requires an Enterprise to consider potential impacts on mortgage eligibility criteria and Enterprise pricing for loan purchases as part of any assessment.

5. Competitive Effects

Section 1254.8(b)(4) of the final rule requires an Enterprise to evaluate whether using the applicant's credit score model could have an impact on competition in the credit reporting and credit scoring industry. This evaluation must consider whether use of a particular credit score model could have an impact on competition due to any ownership or other business relationship between the credit score model developer and any other institution.

6. Third-Party Provider Review

Section 1254.8(b)(5) of the final rule requires an Enterprise to conduct a comprehensive third-party provider review for all applicants, consistent with the Enterprise's standards for approval of third-party providers. This review should address any financial, governance, operational, compliance, legal, and reputational risks associated with the third party.

7. Enterprise Standards and Criteria

Section 1254.8(b)(6) of the final rule permits an Enterprise to establish additional requirements for the Enterprise Business Assessment. An Enterprise is required to include any additional requirements in its Credit Score Solicitation, and those requirements are subject to FHFA review and approval as previously discussed.

8. Timing

Section 1254.8(c) of the final rule requires that an Enterprise complete its Enterprise Business Assessment within 240 days.

9. FHFA Evaluation

Section 1254.8(d) of the final rule provides that FHFA will conduct an independent analysis of the potential impacts of any change to an Enterprise's credit score model. This analysis will be conducted at the same time as the Enterprise Business Assessment. The analysis will provide a mechanism for FHFA to make determinations in its capacity as safety and soundness regulator of the Enterprises with respect to the Enterprise use of credit scores. Under the final rule, the FHFA evaluation could result in a requirement that an Enterprise conduct additional analysis or reporting related to credit scores. The FHFA evaluation would also permit FHFA to determine whether the Enterprises will continue to use a single credit score or will permit the use of multiple credit scores, or to require other changes. Such determination by FHFA may impact an Enterprise Business Assessment.

G. Determinations on Applications — § 1254.9

Section 1254.9(a) of the final rule requires an Enterprise to submit to FHFA a proposed determination of approval or disapproval for each application. The final rule requires an Enterprise to submit to FHFA a proposed determination of approval if an application passes both the Credit Score Assessment and the Enterprise Business Assessment. The final rule requires an Enterprise to submit to FHFA a proposed determination of disapproval of an application if the Enterprise finds at any point in the validation and approval process that the application should be disapproved. The final rule permits an Enterprise to propose disapproval of an application based on any of the

criteria identified in the Credit Score Solicitation, including any of the application requirements or any of the criteria under the Credit Score Assessment or the Enterprise Business Assessment.

FHFA will make its decision on approval or disapproval after considering the Enterprise proposal and any other information that FHFA determines appropriate. The final rule provides a 45-day review period, which FHFA may extend as needed. FHFA's review and approval of a proposed Enterprise determination must be completed before the Enterprise notifies that applicant. The final rule clarifies that the 30-day period for any approval or disapproval notification by an Enterprise to the applicant begins when FHFA has notified the Enterprise of its decision on the proposed Enterprise determination. FHFA may impose any appropriate terms, conditions, or limitations on its approval or disapproval of the Enterprise proposed determination.

1. Approval of a Credit Score Model

Section 1254.9(b) of the final rule provides if an Enterprise approves an application for a credit score model following FHFA review of its proposed determination, the Enterprise must implement the credit score model in its mortgage purchase systems that use a credit score for mortgage purchases. If an application is approved, the Enterprise will notify the applicant and the public of the approval of such application within 30 days after FHFA completes its review.

2. Disapproval of a Credit Score Model

Section 1254.9(c) of the final rule provides that, if an application is disapproved, an Enterprise must provide an applicant with a notice of disapproval no later than 30 days

after FHFA completes its review. The Enterprise must provide a description of the reason(s) for disapproval in its notice to the applicant.

H. Withdrawal of Application — § 1254.10

Section 1254.10 of the final rule permits an applicant to withdraw its application at any time during the validation and approval process by notifying the Enterprise. This allows an applicant to terminate the evaluation process for any reason after providing notice to the Enterprise. However, because an Enterprise may have already devoted considerable resources to the evaluation of the application, the final rule does not require the Enterprise to return any application fee paid by the applicant. In appropriate circumstances, an Enterprise may determine that some portion of the application fee should be refunded to the applicant or used to offset the application fee if the applicant submits a new application. However, any decision to return a portion of an application fee or apply it toward a new application would be in the sole discretion of the Enterprise.

I. Pilot Programs — § 1254.11

Section 1254.11(a) of the final rule permits an Enterprise to conduct credit score pilot programs. A pilot program will allow an Enterprise to use a credit score model that has not been validated and approved under this rule for the limited purpose of evaluating the performance of the credit score model.

Section 1254.11(b) of the final rule requires that an Enterprise must submit any proposed pilot program to FHFA for review and approval. The Enterprise must provide a complete description of the pilot program, including the purpose, duration, and scope of the pilot program. This will allow FHFA to ensure that the pilot program addresses any requirements that FHFA determines appropriate. For example, FHFA may require that

an Enterprise publish a solicitation for applicants to participate in a pilot program, or FHFA may add other terms or limitations as appropriate.

FHFA expects regulatory notice and timing requirements to apply to pilot program applications, even though the credit score model considered for a pilot program will not be subject to the full regulatory validation and approval process. FHFA believes it would be valuable to obtain from the model developer any available information that is responsive to the regulatory requirements, such as information about the ownership structure and business qualifications of the applicant.

VI. Regulatory Determinations

A. Paperwork Reduction Act

The final rule does not contain any information collection requirement that would require the approval of the Office of Management and Budget (OMB) under the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*). Therefore, FHFA has not submitted any information to OMB for review.

B. Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) requires that a regulation that has a significant economic impact on a substantial number of small entities must include an analysis describing the regulation's impact on small entities. Such an analysis need not be undertaken if the agency has certified that the regulation will not have a significant economic impact on a substantial number of small entities. 5 U.S.C. 605(b). FHFA has considered the impact of the final rule under the Regulatory Flexibility Act. The General Counsel of FHFA certifies that this final rule will not have a significant economic impact on a substantial number of small entities because the regulation applies

only to the Enterprises, which are not small entities for purposes of the Regulatory Flexibility Act.

C. Congressional Review Act

In accordance with the Congressional Review Act (5 U.S.C. 801 *et seq.*), FHFA has determined that this final rule is a major rule and has verified this determination with the Office of Information and Regulatory Affairs of the OMB.

List of Subjects in 12 CFR Part 1254

Mortgages.

Authority and Issuance

Accordingly, for the reasons stated in the **SUPPLEMENTARY INFORMATION**, and under the authority of 12 U.S.C. 4511, 4513, 4526, and Pub. L. 115-174, section 310, 132 Stat. 1296, FHFA amends subchapter C of chapter XII of Title 12 of the Code of Federal Regulations by adding new part 1254 to read as follows:

PART 1254—VALIDATION AND APPROVAL OF CREDIT SCORE MODELS

Sec.

- 1254.1 Purpose and Scope.
- 1254.2 Definitions.
- 1254.3 Computation of time.
- 1254.4 Requirements for use of a credit score.
- 1254.5 Solicitation of applications.
- 1254.6 Submission and initial review of applications.
- 1254.7 Credit Score Assessment.
- 1254.8 Enterprise Business Assessment.
- 1254.9 Determinations on applications.
- 1254.10 Withdrawal of application.
- 1254.11 Pilot programs.

Authority: 12 U.S.C. 4511, 4513, 4526 and Sec. 310, Pub. L. 115-174, 132 Stat. 1296.

§ 1254.1 Purpose and Scope.

(a) The purpose of this part is to set forth standards and criteria for the process an Enterprise must establish to validate and approve any credit score model that produces any credit score that the Enterprise requires in its mortgage purchase procedures and systems.

(b) The validation and approval process for a credit score model includes the following phases: Solicitation of Applications, Submission of Applications and Initial Review, Credit Score Assessment, and Enterprise Business Assessment.

§ 1254.2 Definitions.

For purposes of this part, the following definitions apply. Definitions of other terms may be found in 12 CFR part 1201, General Definitions Applying to All Federal Housing Finance Agency Regulations.

Credit score means a numerical value or a categorization created by a third party derived from a statistical tool or modeling system used by a person who makes or arranges a loan to predict the likelihood of certain credit behaviors, including default.

Credit score model means a statistical tool or algorithm created by a third party used to produce a numerical value or categorization to predict the likelihood of certain credit behaviors.

Credit score model developer means any person with ownership rights in the intellectual property of a credit score model.

Days means calendar days.

Mortgage means a residential mortgage as that term is defined at 12 U.S.C. 1451(h).

Person means an individual, sole proprietor, partnership, corporation,

unincorporated association, trust, joint venture, pool, syndicate, organization, or other legal entity.

§ 1254.3 Computation of time.

For purposes of this part, each time period begins on the day after the relevant event occurs (*e.g.* the day after a submission is made) and continues through the last day of the relevant period. When the last day is a Saturday, Sunday, or federal holiday, the period runs until the end of the next business day.

§ 1254.4 Requirements for use of a credit score.

(a) *Enterprise use of a credit score.* An Enterprise is not required to use a credit score for any business purpose. However, if an Enterprise conditions its purchase of a mortgage on the provision of a credit score for the borrower:

(1) The credit score must be derived from a credit score model that has been approved by the Enterprise in accordance with this part; and

(2) The Enterprise must provide for the use of the credit score by any automated underwriting system that uses a credit score and any other procedures and systems used by the Enterprise that use a credit score for mortgage purchases.

(b) *Replacement of credit score model.* An Enterprise may replace any credit score model then in use after a new credit score model has been approved in accordance with this part.

(c) *No right to continuing use.* Enterprise use of a particular credit score model does not create any right to or expectation of continuing, future, or permanent use of that credit score model by an Enterprise.

§ 1254.5 Solicitation of applications.

(a) *Required solicitations.* FHFA periodically will require the Enterprises to solicit applications from credit score model developers. FHFA will determine whether a solicitation should be initiated. FHFA will establish the solicitation requirement by notice to the Enterprises, which will include:

- (1) The requirement to submit a Credit Score Solicitation to FHFA for review;
- (2) A deadline for submission of the Credit Score Solicitation; and
- (3) A timeframe for the solicitation period.

(b) *Credit Score Solicitation.* In connection with each required solicitation, an Enterprise must submit to FHFA a Credit Score Solicitation including:

- (1) The opening and closing dates of the solicitation time period during which the Enterprise will accept applications from credit score model developers;
- (2) A description of the information that must be submitted with an application;
- (3) A description of the process by which the Enterprise will obtain data for the assessment of the credit score model;
- (4) A description of the process for the Credit Score Assessment and the Enterprise Business Assessment; and
- (5) Any other requirements as determined by the Enterprise.

(c) *Review by FHFA.* Within 45 days of an Enterprise submission of its Credit Score Solicitation to FHFA, FHFA will either approve or disapprove the Enterprise's Credit Score Solicitation. FHFA may extend the time period for its review as needed. FHFA may impose such terms, conditions, or limitations on the approval of a Credit Score Solicitation as FHFA determines to be appropriate.

(d) *Publication.* Upon approval by FHFA, the Enterprise must publish the Credit Score Solicitation on its website for at least 90 days prior to the start of the solicitation time period.

(e) *Initial solicitation.* Each Enterprise must submit its initial Credit Score Solicitation to FHFA within 60 days of the effective date of this regulation. The initial solicitation time period will begin on a date determined by FHFA and will extend for 120 days.

§ 1254.6 Submission and initial review of applications.

(a) *Application requirements.* Each application submitted in response to a Credit Score Solicitation must meet the requirements set forth in the Credit Score Solicitation to which it responds. Each application must include the following elements, and any additional requirements that may be set forth in the Credit Score Solicitation:

(1) *Application fee.* Each application must include an application fee established by the Enterprise. An Enterprise may address conditions for refunding a portion of a fee in the Credit Score Solicitation. The application fee is intended to cover the direct costs to the Enterprise of conducting the Credit Score Assessment.

(2) *Fair lending certification and compliance.* Each application must address compliance of the credit score model and credit scores produced by it with federal fair lending requirements, including information on any fair lending testing and evaluation of the model conducted. Each application must include a certification that no characteristic that is based directly on or is highly correlated solely with a classification prohibited under the Equal Credit Opportunity Act (15 U.S.C. 1691(a)(1)), the Fair Housing Act (42 U.S.C. 3605(a)), or the Safety and Soundness Act (12 U.S.C. 4545(1)) was used in the

development of the credit score model or is used as a factor in the credit score model to produce credit scores.

(3) *Use of model by industry.* Each application must demonstrate use of the credit score by creditors to make a decision whether to extend credit to a prospective borrower. An Enterprise may address criteria for such demonstration in the Credit Score Solicitation. An Enterprise may permit such demonstration of use to include submission of testimonials by creditors (mortgage or non-mortgage) who use the applicant's credit score when making a determination to approve the extension of credit.

(4) *Qualification of credit score model developer.* Each application must include any information that an Enterprise may require to evaluate the credit score model developer (*i.e.*, relevant experience and financial capacity). Such information must include a detailed description of the credit score model developer's:

(i) Corporate structure, including any business relationship to any other person through any degree of common ownership or control;

(ii) Governance structure; and

(iii) Past financial performance.

(5) *Other requirements.* Each application must include any other information an Enterprise may require.

(b) *Historical consumer credit data.* An Enterprise may obtain any historical consumer credit data necessary for the Enterprise to test a credit score model's historical record of measuring and predicting default rates and other credit behaviors. An Enterprise may assess the applicant for any costs associated with obtaining or receiving such data unless such costs were included in the up-front application fee.

(c) *Acceptance of applications.* Each application submitted in response to a Credit Score Solicitation within the solicitation time period must be reviewed for acceptance by the Enterprise.

(1) *Notice of status.* Within 60 days of an applicant's submission, the Enterprise must provide the applicant with an Application Status Notice, which will indicate whether the application requires additional information to be provided by the applicant. An applicant may submit additional information through the end of the solicitation period.

(2) *Complete application.* Completeness of an application will be determined by the Enterprise. An application is complete when an Enterprise determines that required information has been received by the Enterprise from the applicant and from any third party. Information from a third party for a specific application may be received by the Enterprise after the solicitation period closes. The Enterprise must notify the applicant upon determining that the application is complete with a Complete Application Notice.

§ 1254.7 Credit Score Assessment.

(a) *Requirement for Credit Score Assessment.* An Enterprise will undertake a Credit Score Assessment of each application that the Enterprise determines to be complete. An Enterprise must determine whether an application passes the Credit Score Assessment.

(b) *Testing for Credit Score Assessment.* An Enterprise must conduct statistical tests for accuracy and reliability that use one or more industry standard statistical tests for demonstrating divergence among borrowers' propensity to repay using the industry

standard definition of default, applied to mortgages purchased by an Enterprise (including subgroups), as identified by the Enterprise.

(c) *Criteria for Credit Score Assessment.* The Credit Score Assessment is based on the following criteria:

(1) *Testing for accuracy.* A credit score model is accurate if it produces a credit score that appropriately reflects a borrower's propensity to repay a mortgage loan in accordance with its terms, permitting a credit score user to rank order the risk that the borrower will not repay the obligation in accordance with its terms relative to other borrowers.

(i) *Initial Credit Score Assessment.* For the Credit Score Assessment of applications submitted in response to the initial solicitation under § 1254.5(e), a credit score model meets the test for accuracy if it produces credit scores that meet a benchmark established by the Enterprise in the initial Credit Score Solicitation, as demonstrated by appropriate testing.

(ii) *Subsequent Credit Score Assessments.* For the Credit Score Assessment of applications submitted in response to any later solicitation under this part, a credit score model meets the test for accuracy if it produces credit scores that are more accurate than the credit scores produced by any credit score model that is required by the Enterprise at the time the test is conducted, as demonstrated by appropriate testing.

(2) *Testing for reliability.* A credit score model is reliable if it produces credit scores that maintain accuracy through the economic cycle. The Credit Score Assessment must evaluate whether a new credit score model produces credit scores that are at least as reliable as the credit scores produced by any credit score model that is required by the

Enterprise at the time the test is conducted, as demonstrated by appropriate testing. Testing for reliability must demonstrate accuracy at a minimum of two points in the economic cycle when applied to mortgages purchased by an Enterprise (including subgroups), as identified by the Enterprise.

(3) *Testing for integrity.* A credit score model has integrity if, when producing a credit score, it uses relevant data that reasonably encompasses the borrower's credit history and financial performance. The Credit Score Assessment must evaluate whether a credit score model applicant has demonstrated that the model has integrity, based on appropriate testing or requirements identified by the Enterprise (which may address, for example, the level of aggregation of data or whether observable data has been omitted or discounted when producing a credit score).

(4) *Other requirements.* An Enterprise may establish requirements for the Credit Score Assessment in addition to the criteria established by FHFA.

(c) *Third-party testing.* Testing required for the Credit Score Assessment may be conducted by:

- (1) An Enterprise; or
- (2) An independent third party selected or approved by an Enterprise.

(d) *Timing of Credit Score Assessment.* (1) An Enterprise must notify the applicant when the Enterprise begins the Credit Score Assessment. The Credit Score Assessment will begin no earlier than the close of the solicitation time period, unless FHFA has determined that an Enterprise should begin a Credit Score Assessment sooner. The Credit Score Assessment will extend for 180 days. FHFA may authorize not more

than two extensions of time for the Credit Score Assessment, which shall not exceed 30 days each, upon a written request and showing of good cause by the Enterprise.

(2) An Enterprise must provide notice to the applicant within 30 days of a determination that the application has passed the Credit Score Assessment.

§ 1254.8 Enterprise Business Assessment.

(a) *Requirement for Enterprise Business Assessment.* An Enterprise will undertake an Enterprise Business Assessment of each application that the Enterprise determines to have passed the Credit Score Assessment. An Enterprise must determine whether an application passes the Enterprise Business Assessment.

(b) *Criteria for Enterprise Business Assessment.* The Enterprise Business Assessment is based on the following criteria:

(1) *Accuracy; reliability.* The Enterprise Business Assessment must evaluate whether a new credit score model produces credit scores that are more accurate than and at least as reliable as credit scores produced by any credit score model currently in use by the Enterprise. This evaluation must consider credit scores as used by the Enterprise within its systems or processes that use a credit score for mortgage purchases.

(2) *Fair lending assessment.* The Enterprise Business Assessment must evaluate the fair lending risk and fair lending impact of the credit score model in accordance with standards and requirements related to the Equal Credit Opportunity Act (15 U.S.C. 1691(a)(1)), the Fair Housing Act (42 U.S.C. 3605(a)), and the Safety and Soundness Act (12 U.S.C. 4545(1)) (including identification of potential impact, comparison of the new credit score model with any credit score model currently in use, and consideration of potential methods of using the new credit score model). This evaluation must consider

credit scores as used by the Enterprise within its systems or processes that use a credit score for mortgage purchases. The fair lending assessment must also consider any impact on access to credit related to the use of a particular credit score model.

(3) Impact on Enterprise operations and risk management, and impact on industry. The Enterprise Business Assessment must evaluate the impact using the credit score model would have on Enterprise operations (including any impact on purchase eligibility criteria and loan pricing) and risk management (including counterparty risk management) in accordance with standards and requirements related to prudential management and operations and governance set forth at parts 1236 and 1239 of this chapter. This evaluation must consider whether the benefits of using credit scores produced by that model can reasonably be expected to exceed the adoption and ongoing costs of using such credit scores, considering projected benefits and costs to the Enterprises. The Enterprise Business Assessment must evaluate the impact of using the credit score model on industry operations and mortgage market liquidity, including costs associated with implementation of a newly approved credit score. This evaluation must consider whether the benefits of using credit scores produced by that model can reasonably be expected to exceed the adoption and ongoing costs of using such credit scores, considering projected benefits and costs to the Enterprises and borrowers, including market liquidity and cost and availability of credit.

(4) Competitive effects. The Enterprise Business Assessment must evaluate whether using the credit score model could have an impact on competition in the industry. This evaluation must consider whether use of a credit score model could have

an impact on competition due to any ownership or other business relationship between the credit score model developer and any other institution.

(5) *Third-Party Provider Review.* The Enterprise Business Assessment must evaluate the credit score model developer under the Enterprise standards for approval of third-party providers.

(6) *Other requirements.* An Enterprise may establish requirements for the Enterprise Business Assessment in addition to the criteria established by FHFA.

(c) *Timing of Enterprise Business Assessment.* The Enterprise Business Assessment must be completed within 240 days.

(d) *FHFA Evaluation.* FHFA will conduct an independent analysis of the potential impacts of any change to an Enterprise's credit score model. FHFA will initiate its analysis no later than the beginning of the Enterprise Business Assessment. Based on its analysis, FHFA may:

(1) Require an Enterprise to undertake additional analysis, monitoring, or reporting to further the purposes of this part;

(2) Require an Enterprise to permit the use of a single credit score model or multiple credit score models; or

(3) Require any other change to an Enterprise program, policy, or practice related to the Enterprise's use of credit scores.

§ 1254.9 Determinations on applications.

(a) *Enterprise determinations subject to prior review and approval by FHFA.* An Enterprise must submit to FHFA a proposed determination of approval or disapproval for each application. Within 45 days of an Enterprise submission, FHFA must approve or

disapprove the Enterprise's proposed determination. FHFA may extend the time period for its review as needed. FHFA may impose such terms, conditions, or limitations on the approval or disapproval of the Enterprise's proposed determination as FHFA determines to be appropriate.

(b) *Approval of a credit score model.* If an Enterprise approves an application for a credit score model following FHFA review of its proposed determination, the Enterprise must implement the credit score model in its mortgage purchase systems that use a credit score for mortgage purchases. The Enterprise must provide written notice to the applicant and the public within 30 days after the FHFA decision on the proposed determination.

(c) *Disapproval of a credit score model.* If an Enterprise disapproves an application for a credit score model following FHFA review of its proposed determination, the Enterprise must provide written notice to the applicant within 30 days after the FHFA decision on the proposed determination. An application may be disapproved under this section at any time during the validation and approval process based on any of the criteria identified in the Credit Score Solicitation. The notice to the applicant must provide a description of the reasons for disapproval.

§ 1254.10 Withdrawal of application.

At any time during the validation and approval process, an applicant may withdraw its application by notifying an Enterprise. The Enterprise may, in its sole discretion, determine whether to return any portion of the application fee paid by the applicant.

§ 1254.11 Pilot programs.

(a) *Pilots permitted; duration of pilots.* An Enterprise may undertake pilot programs to evaluate credit score models. If a pilot program involves a credit score model not in current use by an Enterprise, the credit score model is not required to be approved under this part.

(b) *Prior notice to FHFA.* Before commencing a pilot program, an Enterprise must submit the proposed pilot program to FHFA for review and approval. The Enterprise's submission to FHFA must include a complete and specific description of the pilot program, including its purpose, duration, and scope. FHFA may impose such terms, conditions, or limitations on the pilot program as FHFA determines to be appropriate.

/s/
Mark A. Calabria,
Director, Federal Housing Finance Agency.

Date: August 13, 2019