Banking and Finance Law Daily Wrap Up, GOVERNMENT SPONSORED ENTERPRISES—FHFA floats new credit score model development, (Dec. 14, 2018)

Banking and Finance Law Daily Wrap Up

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By Jeff Williams

The Federal Housing Finance Agency has issued a proposed rulemaking that would establish standards and criteria for validating and approving third-party credit score models used by Fannie Mae and Freddie Mac. The proposed rulemaking, mandated by Section 310 of the Economic Growth, Regulatory Relief, and Consumer Protection Act, would establish a four-phase process for each of the Enterprises to validate and approve their credit score models. The regulator also announced that the agency plans to host a webinar on Jan. 9, 2019, regarding the proposed rule. Comments will be due 90 days after publication of the proposed rule in the *Federal Register*.

The four-phrase process would include: solicitation of applications from credit score model developers; review of submitted applications; credit score assessment; and Enterprise business assessment. The new rule would not require either of the Enterprises to use a third-party credit score model, nor does it require they use credit scores in any particular way, FHFA said. But, the agency said, the regulation would require that any credit score used by a mortgage purchaser to obtain a loan must be produced by a model that has been validated and approved by the Enterprise based on the requirements in the Act and FHFA regulations.

FHFA noted it had been "actively evaluating the potential impact" of a new credit score model as part of an ongoing Conservatorship Scorecard Initiative prior to EGRRCPA, but said in July it would set aside that review to focus on implementing the steps required by the Act. "One of the strategic goals established by FHFA as conservator of the Enterprises has been to maintain credit availability for new and refinanced mortgages to foster liquid, efficient, competitive, and resilient national housing finance markets," FHFA said in the proposed rulemaking. "One element of that strategic goal has been the consideration of possible changes to the credit score model required by the Enterprises. Although Classic FICO remains adequate for Enterprise purposes, FHFA has acknowledged potential benefits of the Enterprises using more recently developed credit score models."

New system. The proposed rules reflect the agency's "balancing" of the costs to the Enterprises on implementing a new system against the benefits in accuracy and borrower access to credit. As part of the solicitation phase, the proposed rules would call for each Enterprise to publish a Credit Score Solicitation that would include the opening and closing dates of the solicitation time period during which the Enterprises would accept credit score model developer applications.

During the application review process, FHFA said, the Enterprises would determine whether applications were complete, and could ask for additional information, if necessary. The Enterprises could only consider an application complete after they receive all required fees and information, the agency said.

The credit score assessment phase would require the Enterprises to evaluate each credit score model for "accuracy, reliability and integrity, independent of the use of the credit score in the Enterprise's systems, as well as any other requirements established by the Enterprise."

The fourth and final phase would require each Enterprise to assess the credit score model "in conjunction with the Enterprise's business systems," FHFA said. "The Enterprise must assess the accuracy and reliability of credit scores where used within the Enterprise's systems, possible impacts on fair lending and impact 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 vendor review, and perform any other evaluations established by the Enterprise as part of the Enterprise Business Assessment."

Timeline. The Enterprises would have 180 days to complete their Credit Score Assessment, subject to two 30-day extensions, FHFA said. A separate 240-day maximum time period would be in place for the Enterprises to conduct the Enterprise Business Assessment. While the two periods could overlap, the agency said, the two parts of the process would have to be completed within a total of 16 months.

The FHFA could require the Enterprises to align their credit score models, the agency said, but added: "[T]he proposed rule itself would not require alignment of the Enterprises. The proposed rule would allow the Enterprises to adopt independent and distinct validation and approval processes, to conduct separate evaluations of any application received and to reach different decisions about which credit score models are validated and approved for use."

FHFA also said it is appropriate to prohibit common ownership or control of the credit score model developer and the owner of consumer credit data. Each credit score model applicant would have to submit a certification that no owner of consumer data needed to construct the model is related to the credit score model developer through common ownership of control.

Companies: Fannie Mae; Freddie Mac

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