Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FEDERAL HOUSING FINANCE AGENCY

12 CFR Part 1254

RIN 2590–AA98

Validation and Approval of Credit Score Models

AGENCY: Federal Housing Finance Agency.

ACTION: Proposed rule.

SUMMARY: The Federal Housing Finance Agency (FHFA) is proposing a 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. FHFA requests public comment on all aspects of this proposed rule.

DATES: FHFA will accept written comments on the proposed rule on or before March 21, 2019.

ADDRESSES: You may submit your comments on the proposed rule, identified by regulatory information number (RIN) 2590–AA98, by any one of the following methods:

- *Agency website: www.fhfa.gov/open-for-comment-or-input.*
- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments. If you submit your comment to the Federal eRulemaking Portal, please also send it by email to FHFA at *RegComments@fhfa.gov* to ensure timely receipt by FHFA. Include the following information in the subject line of your submission: Comments/RIN 2590–AA98.
- *Hand Delivered/Courier:* The hand delivery address is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590–AA98, Federal Housing Finance Agency, Eighth Floor, 400 Seventh Street SW, Washington, DC 20219. Deliver the package at the Seventh Street entrance Guard Desk, First Floor, on business days between 9 a.m. and 5 p.m.
- *U.S. Mail, United Parcel Service, Federal Express, or Other Mail Service:* The mailing address for comments is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590–AA98, Federal Housing Finance Agency, Eighth Floor, 400 Seventh Street SW, Washington, DC 20219. Please note that all mail sent to FHFA via U.S. Mail is routed through a national irradiation facility, a process that may delay delivery by approximately two weeks.

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 mailing address is: Federal Housing Finance Agency, 400 Seventh Street SW, Washington, DC 20219. The telephone number for the Telecommunications Device for the Deaf is (800) 877–8339.

SUPPLEMENTARY INFORMATION:

I. Comments

FHFA invites comments on all aspects of the proposed rule and will take all comments into consideration before issuing a final rule. Copies of all comments will be posted without change, and will include any personal information you provide such as your name, address, email address, and telephone number, on the FHFA website at *http://www.fhfa.gov.* In addition, copies of all comments received will be available for examination by the public through the electronic rulemaking docket for this proposed rule also located on the FHFA website.

Commenters are encouraged to review and comment on all aspects of the proposed rule, including the definition of a complete application, the timelines for submitting applications, and the standards and criteria for validation and approval of credit score models.

II. Background

A. Statutory Requirement for Validation and Approval of Credit Score Models

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.[1] Section 310 does not require an Enterprise to use third party credit scores as part of its business operations or purchase decisions. Instead, it provides that if an Enterprise elects to condition the purchase of a mortgage loan on the provision of a borrower's credit score, that credit score must be produced by a model that has been validated and approved.[2]

Section 310 imposes separate requirements on FHFA and the Enterprises. FHFA must first issue regulations establishing standards and criteria for the validation and approval of credit score models by the Enterprises. Each Enterprise must then publish a description of a validation and approval process that it will use to evaluate applications from credit score model developers, consistent with the standards and criteria established by FHFA 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 predicting borrower credit behaviors (such as default), and consistency of any model with Enterprise safety and soundness. This proposed rule establishes criteria for the validation and approval process consistent with section 310.

B. Current Enterprise Use of Credit Scores

The Enterprises currently use credit scores in four primary ways. First, some Enterprise loan purchase programs require a minimum credit score as part of determining eligibility. Second, the Enterprises use credit scores within their automated underwriting systems (AUS).[3] Freddie Mac uses credit scores

[1] Section 310 defines ''credit score'' as, in relevant part, ''a numerical value or a categorization created by a third party derived from a statistical tool or modeling system.'' *See* 12 U.S.C. 1454(d)(1) and 1717(b)(7)(A)(i). The proposed rule would define this to mean that the statistical tool or modeling system was created by the third party.

[2] The Enterprises use credit scores derived from credit score models. However, the validation and approval process would apply to the credit score model rather than the credit scores derived from the model.

[3] An Enterprise automated underwriting system (AUS) is a proprietary system made available to

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as part of the risk assessment within its AUS, while Fannie Mae uses credit scores as a minimum threshold in its AUS. Third, the Enterprises publish grids that disclose price adjustments known as Loan Level Price Adjustments (LLPAs) for Fannie Mae, and Post-Settlement Delivery Fees (Delivery Fees) for Freddie Mac. LLPAs and Delivery Fees are based on a combination of the borrower's representative credit score (currently Classic FICO) and the original loan-to-value (LTV) ratio.[4] Finally, the Enterprises disclose credit scores to investors of Enterprise securities, to Credit Risk Transfer (CRT) investors, and in Securities and Exchange Commission (SEC) corporate filings.

Where appropriate, the proposed rule would require an Enterprise to consider how credit scores are used in its systems as part of its evaluation of credit score models (*e.g.,* consideration of LLPAs and Delivery Fees and potential impact on eligibility). However, the proposed rule would not require an Enterprise to use a credit score in any particular system, nor would it require an Enterprise to use a credit score in a particular way. While the Enterprises currently use credit scores in four primary ways, the Enterprises may change how they use credit scores in the future.

For example, Freddie Mac currently uses a third party credit score (if available) combined with borrower attributes and credit attributes supplied by the nationwide consumer reporting agencies (CRAs) within its AUS. Fannie Mae uses borrower attributes and credit attributes from the nationwide CRAs. Fannie Mae also uses a third party credit score as an eligibility threshold for its AUS (currently, Classic FICO 620 if available). The proposed rule would not require an Enterprise to use a credit score in a particular way in its AUS, or in any other system that uses a credit score. In addition, if an Enterprise does not currently use a third party credit score in a particular purchase system, the proposed rule would not require an Enterprise to incorporate a third party credit score into that system.

Credit scores are only one factor considered by the Enterprises in determining whether to purchase a loan. Because an Enterprise AUS can consider borrower-related data independent of the consumer credit data from the consumer reporting agencies (*e.g.,* income and assets) as well as additional information about the loan and property (*e.g.,* LTV ratio), an Enterprise AUS will always be more accurate than any third party credit score model, used alone, at rank ordering loans by likelihood of borrower default.

C. Conservatorship Scorecard Project To Assess Updating Enterprise Credit Score Requirements

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.[5] One element of that strategic goal has been the consideration of possible changes to the credit score model required by the Enterprises.[6] Although Classic FICO remains adequate for Enterprise purposes, FHFA has acknowledged potential benefits of the Enterprises using more recently developed credit score models. From 2015 to 2018, FHFA has engaged with the Enterprises, market participants and other interested parties on possible changes to the Enterprise credit score requirements, including understanding the operational challenges and hurdles of various updated credit score proposals.

In response to FHFA's *2015 Conservatorship Scorecard,* the Enterprises began assessing the feasibility of updating their credit score requirements, including the potential impact of a change on Enterprise operations and systems, and whether updating the requirements would generate additional access to mortgage credit for creditworthy borrowers while maintaining consistency with Enterprise credit requirements and risk-management practices.

The 2015 assessment began by defining the scope of potential credit score models to review. FHFA and the Enterprises conducted an in-depth review of three models: Classic FICO, FICO 9, and VantageScore 3.0. While there were other credit score models available at that time, FHFA and the Enterprises limited the evaluation to credit score models that had nationwide coverage and that could produce credit scores based on data from all three nationwide CRAs.[7] FHFA and the Enterprises determined it would not be practical to build and estimate Enterprise internal models for every credit score model available.

In 2016, FHFA and the Enterprises met with lenders, consumer groups, investors, trade associations, and other market participants to discuss the possible impacts of changing the Enterprises' credit score model requirements. FHFA was focused on better understanding how the industry uses credit scores and possible impacts to industry if the Enterprises were to make a change to their credit score model requirements. In addition, FHFA was focused on how long it might take the mortgage finance industry to adopt such a change. The independent outreach FHFA conducted in 2016 informed the four proposals in the 2017 Credit Score Request for Input (RFI).

As part of the industry feedback, most market participants stated that they would need a significant period of time, approximately 18–24 months, to implement a credit score change after an announcement from the Enterprises.

D. Credit Score Request for Input

In 2017, FHFA determined that it would be useful to solicit input publicly. In December of 2017, FHFA issued an RFI on possible updates to the Enterprise credit score model requirements. The RFI was based on FHFA's review of the operational impact of any credit score change and growing concerns about how competition should factor into the decision to update the credit score model. FHFA publicly communicated its intent to make a decision about the Enterprise credit score model requirements in 2018, upon finishing review of responses to the RFI.

The RFI was focused on four proposals: (1) Maintain a single credit score; (2) adopt an optional waterfall of credit scores; (3) require multiple credit scores; or (4) let the lender choose the credit score. The RFI sought public input on the concerns market participants had expressed to FHFA, including concerns about the potential costs and benefits of updating the Enterprise credit score requirements.

other parties (*e.g.,* lenders and loan originators) to help them assess whether a loan is eligible for purchase by an Enterprise.

[4] The Enterprises have required the use of FICO 5 from Equifax, FICO 4 from TransUnion, and FICO Score from Experian, which are collectively referred to as ''Classic FICO,'' since 2004.

[5] *https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2014StrategicPlan05132014Final.pdf.* This goal aligns with the purposes stated in the Safety and Soundness Act and the Enterprises' charter acts.

[6] Since 2013, FHFA has issued an annual Conservatorship Scorecard that sets forth expectations for activities to be undertaken by the Enterprises to further FHFA's strategic goals as conservator. Beginning in 2015, each Conservatorship Scorecard has called for the Enterprises to increase access to mortgage credit for creditworthy borrowers. This includes assessing the feasibility of updating the credit score requirements consistent with the Enterprises' risk-management practices.

[7] Currently, there are three nationwide CRAs—Equifax, Experian, and TransUnion. These companies gather, store, and sell consumer credit data, including credit scores that are produced by algorithms developed by other companies (*e.g.,* FICO or VantageScore LLC) supplied with consumer credit data from a CRA.

FHFA encouraged all parties to provide as much information and insight as possible in response to the RFI.

FHFA received over 100 responses to the RFI.[8] The responses came from all parts of the mortgage finance industry including consumers, mortgage lenders, mortgage insurers, and non-profit housing agencies. A central theme from RFI respondents was that the operational challenges of implementing a multi-credit score approach would outweigh any benefits. As one RFI respondent noted, ''changes to Enterprise credit score requirements could have widely-felt implications for borrower access to credit, origination costs in the primary mortgage market, the ability to fully analyze and properly price mortgage credit risk, and liquidity in the secondary mortgage market.''

E. Effect of the Act on the Conservatorship Scorecard Project

FHFA was in the process of making a determination on updating the Enterprise credit score requirements when the Economic Growth, Regulatory Relief, and Consumer Protection Act was enacted on May 24, 2018. Although FHFA had announced its intent to make a decision about the Enterprise credit score model requirements in 2018, FHFA announced in July 2018 that it was shifting its focus to development of notice and comment rulemaking to implement the credit score requirements consistent with section 310. FHFA stated that it would not make a decision on updating the credit score required by the Enterprises until after the credit score model validation and approval process required by section 310 has been established.

F. Assessment of Borrowers Without Credit Scores

Each Enterprise has updated its respective AUS in recent years to process loans for borrowers who lack a credit score. In September 2016, Fannie Mae upgraded Desktop Underwriter (DU) with the capability to underwrite loan applications where both the borrower and co-borrower lack a credit score.[9] In June 2017, Freddie Mac updated Loan Product Advisor (LPA) with the same capability to underwrite both borrower and co-borrowers who lack a credit score.[10] Development of the ''no score AUS'' reduces the significance of third party credit scores within each Enterprise's AUS. The Enterprises' guidance to lenders related to borrowers who lack a credit score now provides that if a borrower has other housing-related tradelines (such as demonstrated rental payments or utility payments), those borrowers can be evaluated through the AUS. The ability of an Enterprise AUS to assess borrowers who lack a credit score is an additional consideration in assessing the impact of the use of any credit score model on access to credit.

G. Development of Proposed Rule Reflects Public Input Received

In developing the proposed rule, FHFA has given careful consideration to all aspects of the 2015, 2016, and 2017 Scorecard projects and related work. The proposed rule also has been informed by responses to the RFI. For example, FHFA considered feedback received from the industry related to some of the operational and implementation concerns in determining how often it would be feasible for the Enterprises to update their credit score requirements.

Based on research and analysis conducted for the past three years, a primary consideration in FHFA's analysis has been weighing the costs of adopting a newer credit score model against the potential benefits. The significant costs and complexity for the Enterprises and industry in making a change to the required credit score were weighed against potential improvements in accuracy and borrower access to credit. More recently developed credit score models capture post-crisis borrower behavior, which more accurately reflects today's borrowers than older models, and also include rental payment data, when available. While a newer credit score model would likely be more accurate than an existing credit score model, a borrower's credit score is not the only factor used by an Enterprise AUS to make a purchase decision, reducing the significance of any improvement in accuracy.

The proposed rule reflects FHFA's balancing of these costs and benefits and is based on both the requirements of section 310 and multiple years of public outreach and empirical research by FHFA and the Enterprises.

III. Features of the Proposed Rule

A. Enterprise Validation and Approval Process

The proposed rule would establish a four-phase validation and approval process: (1) Solicitation of applications from credit score model developers, (2) an initial review of submitted applications, (3) Credit Score Assessment, and (4) Enterprise Business Assessment. In addition, the proposed rule would set the minimum standards and criteria for each step in the process.

As part of the solicitation phase of the process, each Enterprise would publish a Credit Score Solicitation that would include the opening and closing dates of the solicitation time period during which the Enterprise would accept applications from credit score model developers. It would 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 and criteria for conducting a Credit Score Assessment and an Enterprise Business Assessment; and other content as determined by an Enterprise.

As part of the application review phase of the process, an Enterprise would determine whether each application submitted by a credit score model developer is complete. An Enterprise could request additional information if necessary. An application would be complete only after the Enterprise has received all required fees and information, including any necessary data from a third party. An Enterprise would not be obligated to conduct an assessment of a credit score model if an Enterprise is not in receipt of a complete application within the timeframes in this proposed rule.

During the Credit Score Assessment phase of the process, each credit score model would be assessed 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. A credit score model must pass the Credit Score Assessment to be reviewed by an Enterprise during the Business Assessment phase.

During an Enterprise Business Assessment phase, which is the fourth and final phase of the process, an Enterprise would assess the credit score model in conjunction with the Enterprise's business systems. The Enterprise must assess the accuracy and reliability of credit scores where used within the Enterprise's systems,

[8] RFI responses are available online on FHFA's website at *https://www.fhfa.gov/AboutUs/Contact/Pages/input-submissions.aspx* (select ''Credit Score'' in the menu).

[9] Desktop Originator/Desktop Underwriter Release Notes, DU Version 10.0, Fannie Mae (Last Updated June 20, 2016) *https://www.fanniemae.com/content/release_notes/du-do-release-notes-06252016.pdf.*

[10] *http://freddiemac.mwnewsroom.com/press-releases/freddie-mac-loan-advisor-suite-sm-to-cut-mortgage-otcqb-fmcc-1282556.*

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. A credit score model may be approved by an Enterprise during the Business Assessment phase, and only then would the credit score model be considered validated and approved for purposes of section 310.

The Credit Score Assessment and Enterprise Business Assessment steps may not necessarily happen sequentially. However, 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. The proposed rule would require that an Enterprise update its credit score requirements to reflect the outcome of the validation and approval process. However, the proposed rule does not address *how* an Enterprise's credit score requirements would be updated should a new credit score model be approved. How approved credit score model(s) are implemented, including the timeframe for the Enterprises to transition from one credit score to another score or scores, would be best addressed through direction that will be provided by FHFA outside of the final rule but consistent with FHFA statutory obligations.

FHFA requests comment on any operational impacts or considerations that should be addressed in implementing any newly approved credit score models, including timing between approval of any new credit score model and required delivery of the new score(s) to an Enterprise or whether there are issues related to implementation that are not covered by the proposed rule.

B. Timeframes for Enterprise Application Determinations

A key consideration in structuring the process in four phases is to address the statutory requirements of section 310, which references solicitation, application, validation, and approval. Section 310 also requires the Enterprises to make ''a determination with respect to any application submitted'' and provide notice of that determination no later than 180 days after the date on which an application is submitted, subject to two 30-day extensions.

The proposed rule would require each Enterprise to complete the Credit Score Assessment in no more than 180 days, with the possibility of no more than two 30-day extensions. The proposed rule would establish a separate 240-day maximum time period for the Enterprises to conduct the Enterprise Business Assessment. As discussed above, the Credit Score Assessment and Enterprise Business Assessment could overlap. However, the maximum, combined time for these two parts of the process could be as much as approximately 16 months depending on whether FHFA granted any extensions for the Credit Score Assessment. This proposal aligns with FHFA's knowledge of the time needed to conduct testing similar to the testing proposed for the Credit Score Assessments. Based on FHFA and Enterprise experience assessing credit score models and the process outlined in this proposed rule, FHFA determined 180 days, or even 240 days, would not give an Enterprise sufficient time to conduct both the Credit Score Assessment and the Enterprise Business Assessment for all possible applications submitted during the solicitation period.

By taking this approach, the proposed rule would establish reasonable and realistic deadlines for each phase of the process—solicitation period, application review, Credit Score Assessment, and Enterprise Business Assessment. The proposed rule would establish a time period for application submission that includes a review for completeness and notification to an applicant to address deficiencies, before the solicitation period ends and the Credit Score Assessment begins. An Enterprise would be required to notify an applicant of its determination under the Credit Score Assessment within 180 days from the start of the Credit Score Assessment, with up to two extensions of 30 days each, consistent with section 310. These timeframes may be adjusted based on future public notice and comment as FHFA and the Enterprises gain experience with the validation and approval process.

Under the proposed rule, the determination that a credit score model passes the Credit Score Assessment would be separate from the determination that a credit score model meets the criteria of an Enterprise Business Assessment resulting in Enterprise approval. A credit score model would only be approved if an Enterprise determines that it meets the criteria under both the Credit Score Assessment and an Enterprise Business Assessment. The Enterprise Business Assessment would allow an Enterprise to complete a comprehensive assessment of the impact of a new credit score when used in an Enterprise's proprietary systems, fair lending impact, impact on Enterprise operations, Enterprise risk management and impact to industry, as well as any other criteria evaluated by an Enterprise. The proposed rule would provide an Enterprise 240 days to complete the Enterprise Business Assessment. This would be in addition to the maximum 240 days (including extensions) to complete the Credit Score Assessment phase.

C. Alignment of Enterprises

FHFA may direct the Enterprises to align their assessment processes or the decisions on approved credit score model(s) under FHFA's authority as regulator or conservator of the Enterprises. For example, FHFA may determine as regulator that it is necessary to align the Enterprises on approved credit score model(s) to help maintain efficiency and liquidity in the secondary mortgage market, a core purpose of the Safety and Soundness Act and the charter acts. Or FHFA may determine that alignment is necessary to facilitate the Enterprise credit risk transfer (CRT) programs or the development and implementation of the Uniform Mortgage-Backed Security (UMBS).[11]

While the Enterprises remain in conservatorship, on the same basis FHFA could use its authority as conservator of the Enterprises to direct the Enterprises to adopt aligned validation and approval processes or outcomes. FHFA may also use its existing authority as regulator or conservator to establish other credit score requirements for the Enterprises. For example, FHFA may require the Enterprises to continue to require lenders to deliver loans with a single credit score, or FHFA may require the Enterprises to allow use of more than one credit score for delivery of loans.

The proposed rule would require the Enterprises to provide FHFA with prior notice of a determination to approve an application. Such prior notice would provide FHFA with an opportunity, if appropriate, to require the Enterprises to adopt aligned determinations on some or all applications. However, the 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

[11] *See, e.g.,* Uniform Mortgage-Backed Security proposed rule, 83 FR 46889 (Sept. 17, 2018).

which credit score models are validated and approved for use.

FHFA expects that the Enterprises will regularly consult with FHFA, in the Agency's role as regulator or as conservator. FHFA would retain its ability, in its role as regulator or conservator, to provide the Enterprises with guidance on alignment and the use of one credit score model or multiple credit score models at any point in the Enterprises' solicitation and review process. However, the proposed rule would not address how multiple credit score models, if approved, would be implemented and/or required by an Enterprise. These decisions could be handled through FHFA's authority as regulator or as conservator.

FHFA requests comments on the approaches described above. In addition, FHFA requests comments on whether the Agency should consider alternatives to these approaches.

D. Credit Score Model Developer Independence

The proposed rule would prohibit an Enterprise from approving any credit score model developed by a company that is related to a consumer data provider through any common ownership or control, of any type or amount. The proposed rule would also require the Enterprises to consider competitive impacts more generally in assessing applications from credit score model developers. In developing this approach, FHFA has considered and worked to balance a number of policy concerns, including potential conflicts of interest, potential competitive effects (positive and negative), and burdens on prospective applicants and the Enterprises.

The Credit Score RFI, as discussed earlier, sought input on credit score competition and consolidation in the credit score marketplace. Feedback indicated concerns with the competitive position of VantageScore, LLC when compared to other credit score model developers, by virtue of its joint ownership by three nationwide consumer reporting agencies (CRAs). The CRAs own the data that both VantageScore, LLC and its competitors use to build their credit score models. They also set the prices for the different credit scores, subject to any license fees charged by the credit score model developer. Each CRA has the ability to set the prices for its own use, or an affiliated company's use, of the consumer credit data that is reported to that CRA. Vertical integration with a credit score model developer could, in theory or practice, permit the CRA to sell credit scores constructed from data (including the scoring algorithm) that the CRA owns more cheaply.

Given these considerations, FHFA believes it is appropriate to propose prohibiting common ownership or control of the credit score model developer and the owner of consumer credit data. To implement this prohibition, the proposed rule would require each application to include a certification that no owner of consumer data necessary to construct the credit score model is related to the credit score model developer through common ownership or control. Establishing a clear threshold requirement in the application process will put an applicant on notice that, unless it can make that certification, its application will not be approved. This approach is intended to avoid a party with a prohibited relationship expending time and money to complete and submit an application with associated fees that an Enterprise ultimately would not validate and approve.

The proposed rule seeks to avoid a possible negative impact on competition among credit score models, for example if pricing of credit scores and consumer credit reports were used to reduce competition and, thereafter, to increase prices. Although the proposed prohibition could limit the number of possible credit score model developers that would be able to submit an application, it would ensure that any approved credit score model would not unfairly benefit the institution that developed the credit score model. To date, FHFA has not identified a degree of common ownership or control that would clearly avoid its concerns. Therefore, even a minority ownership interest would be subject to the prohibition. FHFA requests comment on whether there are examples of common ownership or control by type or amount that would not reasonably give rise to anti-competitive concerns or if there are other safeguards that could address or avoid such concerns.

FHFA also believes changing or using a new credit score model could have other competitive effects, or give rise to other conflicts of interest, that should be considered by an Enterprise in determining whether to approve a model. While feedback on the Credit Score RFI focused on competition concerns related to the joint-ownership structure of VantageScore, LLC, the proposed rule would require the Enterprises to consider competition concerns more broadly. FHFA has previously stated that its ''objective is not to help any particular company sell more credit scores, but to determine how to appropriately balance the safety and soundness of the Enterprises while maintaining liquidity in the housing finance market,'' and this remains the case.[12]

The proposed rule would require an Enterprise to consider potential conflicts of interest and competitive effects in assessing the costs and benefits of approving any credit score model in the Enterprise Business Assessment. An applicant would be required to provide information on any business relationship with any other party that may give rise to a conflict of interest beyond the upfront application certification of whether it is related to a data provider (including information about the credit score model developer's corporate and governance structure, and any ownership, control, or relationship to any other institution). An Enterprise also would be required to consider other potential effects on competition, including positive effects.

FHFA requests comment on the proposed approach of requiring an upfront certification in addition to an assessment of competitive effects in the Enterprise Business Assessment. FHFA also requests comment on any alternative approaches for assessing and evaluating conflicts of interest and other competitive effects.

IV. Summary of the Proposed Rule

A. No Required Use of Credit Scores; No Expectation of Continued Use

The proposed rule would set forth requirements and limitations on how the Enterprises validate and approve credit score models. Section 310 does not require the Enterprises to use a credit score for any purpose. It does require, however, that if an Enterprise elects to condition its purchase of mortgages on provision of a credit score, that score must be derived from a model that has been validated and approved in accordance with statutory and regulatory requirements. Likewise, if an Enterprise elects to condition its purchase of mortgages on provision of a credit score, it also must use the validated and approved credit score in all of its purchase-related systems and procedures that currently use a credit score. The proposed rule would incorporate these statutory provisions and would address several related situations.

First, the proposed rule would expressly state that an Enterprise is not required to use a third party credit score. For example, if an Enterprise in the future no longer uses a third party

[12] *https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/CreditScore_RFI-2017.pdf,* pg. 19.

credit score in any purchase-related systems or procedures, the Enterprise would not be subject to the requirements of this proposed rule. However, if an Enterprise continues to price loans based on credit score and LTV ratios (LLPAs and Delivery fees), the Enterprise would still be subject to the requirements of this proposed rule, even if the Enterprise no longer used credit scores in any other manner.

Second, the proposed rule would expressly state that an Enterprise is permitted either to replace an existing credit score model with a newly approved credit score model or to continue to use the existing credit score model along with the newly approved credit score model. For example, if an Enterprise is using a validated and approved score, and in response to a new solicitation validates and approves a new credit score, an Enterprise could ''retire'' the existing validated and approved credit score. This would be considered replacement of an existing model. Alternatively, an Enterprise would have the option to use both the existing validated and approved credit score model and the new validated and approved credit score model. Section 310 expressly permits replacement of one validated and approved credit score model with another validated and approved model, and it does not establish any standard for replacement, other than that the models must be validated and approved.

Finally, the proposed rule would expressly state that the use of a credit score by an Enterprise does not create any right or expectation to continued use of that credit score. Section 310 does not require an Enterprise to continue to use previously validated and approved credit score models. Section 310 does not create, and FHFA does not recognize, any right or expectation of a party with an interest in a credit score model used by an Enterprise to its continued or continuing use. Under the statute and under the proposed rule, an Enterprise would have the option to stop using a previously approved credit score model, with no obligation or liability of any kind.

B. Enterprise Solicitation of Applications From Credit Score Model Developers

1. Overview

The proposed rule would permit FHFA periodically to require the Enterprises to solicit applications from credit score model developers. The proposed rule addresses the solicitation process, the required content of an Enterprise solicitation, and the review of Enterprise proposed solicitations by FHFA prior to Enterprise publication.

FHFA would establish the need for an Enterprise solicitation by notice to the Enterprises. Because assessing a credit score model is time-consuming and requires the acquisition of significant amounts of consumer credit data, and because of the potentially significant implementation costs to industry, it would not be efficient or cost effective (for an Enterprise, an applicant, or other market participants) to require that an Enterprise consider applications for validation and approval submitted at *any* time. Instead, the proposed rule would allow FHFA to establish a periodic solicitation process.

Under the proposed rule, an Enterprise would *not* be required to consider any application that is *not* received in response to a particular solicitation. An Enterprise could review and conduct preliminary empirical analysis on any application received outside of a particular solicitation. However, an Enterprise would not be permitted to approve any application not submitted in response to a solicitation. Outside of the periodic solicitations required by FHFA, there would be periods of time during which an Enterprise would not be expected or required to solicit applications and during which any credit score it is then using would not be subject to change. The proposed rule addresses timing requirements for the first solicitation for applications, while also creating a framework for setting similar deadlines for future solicitations.

The proposed rule would require FHFA to review and approve each Credit Score Solicitation from an Enterprise. The proposed rule would require that, after an Enterprise receives notification from FHFA, the Enterprise publish the description of its validation and approval process prior to, and in conjunction with, soliciting applications. This approach would ensure that potential applicants and the public are provided with information about regulatory and Enterprise requirements and considerations. Thus, the Enterprise description, which the proposed rule refers to as a ''Credit Score Solicitation,'' would cover the Enterprise's validation and approval process as well as requirements that an application, and the applicant, must meet in order for a credit score model to be considered by an Enterprise. The publication of the Enterprise Credit Score Solicitation would satisfy section 310's requirement that an Enterprise ''make publicly available'' a description of its validation and approval process.

Under the proposed rule, the solicitation process would involve: (1) A notice from FHFA to the Enterprises informing the Enterprises that FHFA has determined that a review of new credit score models is timely; (2) development of a Credit Score Solicitation by each Enterprise; (3) review of each Solicitation by FHFA; (4) publication of the Solicitation by each Enterprise; and (5) a time period, determined by FHFA and communicated through the Enterprises to the public, during which the Enterprises will accept applications for validation and approval of credit score models. These steps are addressed below.

2. FHFA Notice to the Enterprises To Solicit Applications

The proposed rule states FHFA's authority to determine when an Enterprise is required to solicit applications from credit score model developers. An Enterprise would not be permitted to solicit applications except in response to a notice from FHFA. In general, FHFA would provide notice to an Enterprise establishing when the Enterprise must begin soliciting applications, the length of time the solicitation period is open and applications will be accepted, and the deadline for an Enterprise to submit its proposed Credit Score Solicitation to FHFA for review.

To establish a reasonable expectation of when an Enterprise would be required to initiate a validation and approval process, the proposed rule would provide that FHFA require a solicitation every seven years, determined from the date of the preceding solicitation, except as otherwise determined by FHFA. Requiring a solicitation any more frequently would lessen the likelihood that the benefits of transitioning to a new score would outweigh its costs, including costs to applicants and the Enterprises to assess a proposed new model. In proposing seven years, FHFA has attempted to balance those concerns and establish a realistic timeframe not only for the Enterprises but for the rest of the mortgage finance industry. FHFA is seeking comment on whether the proposed seven year solicitation of applications from credit score model developers is too frequent or not frequent enough.

The proposed rule also would permit FHFA to require the Enterprises to solicit applications either sooner or later than seven years, in appropriate circumstances. For example, FHFA may determine not to initiate a solicitation within seven years, and thus that a credit score in use in the future should

continue to be used, because the cost to industry of changing from one score to another could be avoided and any intended benefit of a new score could be achieved by an enhancement to an Enterprise AUS instead. In proposing a very flexible approach to determining the time between Enterprise solicitations, FHFA is seeking to balance the value of a reasonable public expectation that the Enterprises will periodically review updated credit scores, with the ability to act when circumstances indicate that the regulatory time period is either too long or too short.

The proposed rule would require that the process for the initial solicitation begin within 60 days of the effective date of the final rule. The initial solicitation time period would begin on a date determined by FHFA and would extend for 120 days.

3. Enterprise Development of a Credit Score Solicitation and Content

For solicitations after the initial solicitation, each Enterprise must develop a Credit Score Solicitation after receiving a notice from FHFA. The Credit Score Solicitation would describe the Enterprise validation and approval process, which must be in accordance with the minimum standards and criteria of the regulation.

The Credit Score Solicitation also would address the Enterprise process for assessing credit score models, as well as 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, consistent with section 310. The proposed rule would establish 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 proposed rule both permit additional standards to be imposed by an Enterprise and such additional standards, criteria, or requirements would be addressed in the Credit Score Solicitation.

4. FHFA Review of Enterprise Solicitation

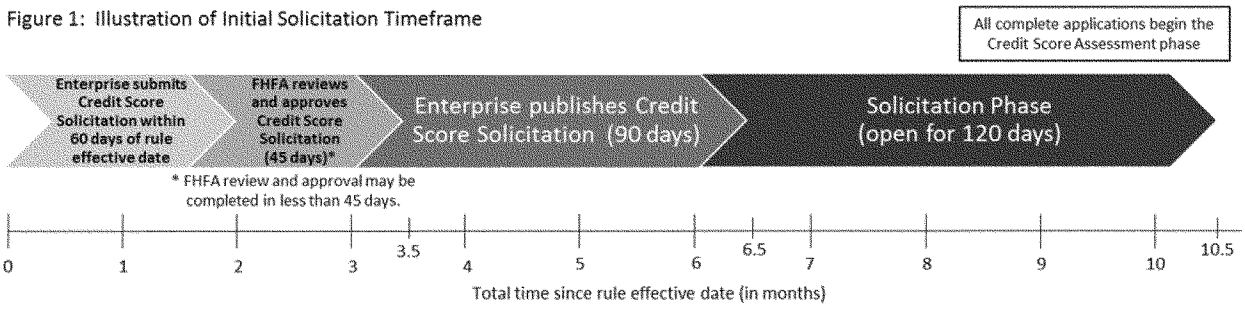
The proposed rule would require an Enterprise to submit a Credit Score Solicitation to FHFA for review prior to the start of any solicitation period. FHFA review will allow the Agency to object to any additional Enterprise standards, criteria or requirements or to impose any terms, conditions or limitations that FHFA determines appropriate. The proposed rule would establish a 45-day period for FHFA review, which may be extended by FHFA if necessary.

Because a notice from FHFA requiring a new solicitation would require each Enterprise to submit a current Credit Score Solicitation to FHFA for review, the review also would meet the statutory requirement that FHFA ''periodically'' review the Enterprise's validation and approval process to ensure the process remains appropriate, adequate, and in compliance with applicable FHFA regulations and requirements.[13] This does not mean, however, that FHFA could not review the Enterprise's approval and validation process as part of its usual supervisory processes, including examinations. Further, FHFA review and approval of an Enterprise Credit Score Solicitation would not prevent FHFA from taking any subsequent appropriate supervisory action.

5. Timeframes for Solicitation

The proposed rule would provide that each Enterprise make publicly available its Credit Score Solicitation for at least 90 days prior to the start of the solicitation period. In order to ensure that the Enterprises are accepting applications during the same time period, FHFA expects to require each Enterprise to publish its Credit Score Solicitation on the same date. Once the initial solicitation period begins, it would extend for 120 days. For subsequent solicitations, FHFA would determine both the frequency of the solicitations and the length of a particular solicitation period. FHFA recognizes that for subsequent solicitation periods, 120 days may not be suitable and therefore builds into the regulation the flexibility to allow for a longer or shorter timeframe that would better serve applicants and the housing industry. The timeframes for the initial solicitation are illustrated in Figure 1.

Figure 1: Illustration of Initial Solicitation Timeframe



These timeframes ensure that the Credit Score Solicitation is handled in an expeditious manner while providing applicants sufficient time to review the fees and the information required for a complete application prior to expending resources to submit an application. The proposed timeframes are consistent with timeframes in practice between FHFA and the Enterprises for reviewing and responding to proposals.

C. Enterprise Initial Review of Submitted Applications

1. Overview

The proposed rule would establish the criteria an application must meet to be considered complete. Each applicant would be required to submit: (1) An application fee; (2) a fair lending certification; (3) information to demonstrate use of the model by industry; (4) a conflicts-of-interest certification and other information on credit score model developer qualifications; and (5) any other information required by an Enterprise in the Credit Score Solicitation. An application would not be considered complete until an Enterprise has obtained any data necessary for testing. An application would be complete when an Enterprise determines that the

[13] 12 U.S.C. 1454(d)(8) and 1717(b)(7)(H).

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).

Under the proposed rule, an Enterprise would have no obligation to assess any incomplete application. As required by section 310, each applicant would 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, or has questions about information provided, the applicant would have the opportunity to respond within the 120-day solicitation period. FHFA recognizes that information required from a third party, such as consumer credit data, may be beyond the control of the applicant. The proposed rule would allow third parties to deliver information to an Enterprise within a reasonable time period that may extend beyond the 120-day solicitation period.

2. Application Fees and Assessment for Costs

The proposed rule would require each applicant to be responsible for the costs associated with validating and approving its credit score model. It is typical for the Enterprises to assess a fee for reviewing and approving counterparties and/or vendors seeking a business relationship with them. Therefore, the proposed rule would permit an Enterprise to require each applicant to pay an application fee established by the Enterprise to cover reasonable costs, including expenses incurred as part of the application review process. The proposed rule also would permit 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 Compliance and Certification

The proposed rule would require each applicant to provide a certification that addresses compliance with federal fair lending requirements. The certification would address protected classifications under the Equal Credit Opportunity Act (ECOA), the Fair Housing Act, and the Safety and Soundness Act.[14] Because an Enterprise would not necessarily have access to the factors used in the development of the credit score model or used by the credit score model to produce credit scores, the fair lending certification would provide assurances that the credit score model is not based on any protected classifications. The certification would be required to state that no characteristic that is based directly on or is highly correlated with such a protected classification was used in the development of the credit score model or is used by the credit score model to produce credit scores.

The proposed rule also would require each applicant to 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. Statements about compliance with consumer regulatory standards that do not relate to the model's compliance with federal fair lending requirements related to protected classifications would be insufficient to satisfy this requirement. For example, statements about the ability to satisfy standards relating to generating reasons for adverse action or satisfying the standard for an empirically derived, demonstrably and statistically sound credit scoring system would not be sufficient.[15]

4. Demonstrated Use

In addition to the fair lending certification, the proposed rule would require the application to demonstrate use of the credit score by creditors to make credit decisions. This requirement would ensure that the credit score model is employed by creditors. To demonstrate use, the application could include testimonials by non-mortgage and/or mortgage lenders or bank validation reports that show the applicant's credit scores were used in underwriting credit.

While FHFA generally believes that the Enterprises should not validate and approve credit scores that have not been used by a creditor in some capacity, FHFA recognizes that limiting applications to those credit score models that have been used to make credit decisions may impede innovation and potential market acceptance of new credit score models. In other words, it may be difficult for credit score model developers to demonstrate the viability of their credit scores to creditors without entities like the Enterprises engaging them in ''test and learn'' pilots. The provisions related to pilot programs are discussed in more detail below.

5. Conflicts of Interest Certification and Qualification of Credit Score Model Developer

The last application criterion in the proposed rule involves the credit score model developer's qualifications. To implement the conflicts of interest prohibition discussed above, FHFA is proposing to require each applicant to certify that no owner of consumer data necessary to construct or test the credit score model is related to the credit score model developer through any degree of common ownership or control. In addition, the proposed rule would require the application to demonstrate the credit score model developer's experience and financial capacity. This would include a detailed description of the developer's corporate and governance structure, including any common ownership or control with an entity that owns, prices, and provides access to consumer data. An application also would be required to provide information about the past financial performance of the credit score model developer, including audited financial statements for the preceding three years. This information provided by the applicant would allow an Enterprise to evaluate the experience and financial capacity of the credit score model developer as well as the basis for the conflicts of interest certification.

As a general prudential standard, each Enterprise is required to manage its counterparty and vendor risk.[16] In this context, if an Enterprise chooses to require provision of a borrower's credit score as a condition of purchasing a mortgage, the Enterprise must be reasonably assured that the type of credit score it specifies will be available within the market, and thus that the credit score model developer is, and will remain, financially viable. To understand the credit score model developer as a potential counterparty, the proposed rule would require each application to address the applicant-developer's corporate structure, governance structure, and financial performance, including audited financial statements for the three full years preceding the year of application. An Enterprise may require an applicant to certify that there has been no material change to information submitted on the developer's qualifications prior to approving a credit score model.

6. Additional Enterprise Standards and Criteria

The proposed rule would permit the Enterprises to establish additional

[14] 15 U.S.C. 1691(a) (ECOA); 42 U.S.C. 3605(a) (Fair Housing Act); 12 U.S.C. 4545(1) (Safety and Soundness Act).

[15] 12 CFR 1002.2(p), 1002.9(b)(2).

[16] *See generally,* 12 U.S.C. 4513b; see also 12 CFR parts 1236 and 1239.

requirements for the application. 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. Data Acquisition

The proposed rule would permit an Enterprise to acquire any data that it may require to conduct the Credit Score Assessment. Such data would typically include historical credit scores on a test set of existing Enterprise loans at origination. For example, in the 2015 assessment conducted by FHFA and the Enterprises, the Enterprises each purchased Classic FICO, VantageScore 3.0, and FICO 9 scores from one of the nationwide CRAs. Each application must include a reasonable process for the Enterprise to acquire the applicant credit score and data on existing loans and future loans. Applicants whose credit scores incorporate multiple sources of consumer credit information (*e.g.,* credit scores based on information from the nationwide CRAs yet augmented with data outside of the three nationwide CRAs) will need to work with the Enterprises on a process to acquire the applicant's credit scores on existing Enterprise loans.

8. Timing and Notices

The proposed rule would require an Enterprise to provide certain notices to an applicant, including an application status notice and a notice of whether an applicant's application is complete. The notices are intended to keep the applicant informed about the status of its application and provide an opportunity to identify and address questions or deficiencies. Section 310 requires that an Enterprise provide an applicant with a status notice no later than 60 days from the date the application is submitted to an Enterprise. The proposed rule would require an Enterprise to include any information about the application, specifically if there is any missing or additional required information. The Credit Score Assessment and the Business Assessment of the validation and approval process also require notifications to the applicant. FHFA is seeking comment on the number of notifications, and whether the proposed notifications are the appropriate notifications for the applicant to be kept abreast of its application throughout the validation and approval process.

Once an Enterprise makes a determination of completeness of an application, the proposed rule would require an Enterprise to notify the applicant that its application is complete. As noted earlier, applications would be considered complete once an Enterprise has all the information needed to begin the Credit Score Assessment, including any information from the applicant as well as any data that may be obtained from a third party.

D. Credit Score Assessment

1. Overview

The proposed rule would require Fannie Mae and Freddie Mac to undertake a Credit Score Assessment of each credit score model for which it has received a complete application. The Credit Score Assessment would include an evaluation of the accuracy and reliability of credit scores on a stand-alone basis (outside of an Enterprise's internal systems and procedures), along with an assessment of the integrity of the scores produced by the model. The tests for accuracy and reliability of credit scores within an Enterprise's internal systems and procedures would be considered after the Credit Score Assessment phase, as part of an Enterprise Business Assessment.

The proposed rule would permit 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. Because the Credit Score Assessment considers accuracy and reliability of the credit score outside of the Enterprise systems, FHFA requests comment on whether the Credit Score Assessment could be conducted jointly by the Enterprises for each application. If so, an applicant could submit an application to each Enterprise, but the Enterprises would work together to conduct a single Credit Score Assessment for each application.

The proposed rule would establish standards for accuracy, reliability and integrity and would require that an application pass the Credit Score Assessment in order to be considered in the next phase of the process (Enterprise Business Assessment).[17] A credit score model that does not pass the Credit Score Assessment would not be eligible to be approved by an Enterprise under the Enterprise Business Assessment.

2. Standards or Criteria for Accuracy

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. This 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. FHFA has considered several options for assessing the accuracy test results. Under each of the options being considered by FHFA, which are discussed further below, the Enterprises would conduct substantially the same statistical tests for credit score accuracy yet the outcome of the accuracy testing would be determined by the assessment option. This section first describes the statistical tests that would be conducted and then describes each of the four options under consideration.

a. Testing for Accuracy

Conceptually, statistical tests of credit score accuracy measure the separation between the credit score distribution of the defaulted loans with the credit score distribution of the non-defaulted loans. The Kolmogorov-Smirnov statistic (K–S), divergence, and Gini coefficient are common statistical measures used to measure the ability of a credit score model to separate defaulted borrowers from non-defaulted borrowers. Beyond the common set of tests, the Enterprises are encouraged to explore additional score performance measures and statistical tests.

The proposed rule would not define specific parameters for the testing that would be conducted by an Enterprise. The proposed rule would require that testing utilize one or more industry standard statistical tests for demonstrating divergence among borrowers' propensity to repay, applied to mortgages purchased by an Enterprise. Although the proposed rule allows flexibility for the Enterprises to define the specific parameters of testing, FHFA expects that the Enterprise testing requirements would include a definition of default.

Critical to accuracy testing of a credit score is the definition of default, which 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 and FHFA is seeking comment, with supporting information, on any additional default definitions.

The proposed rule would include a requirement that the Enterprise test accuracy on subgroups of loans. The loan sets obtained for testing would

[17] Section 310 requires an Enterprise to establish a process pursuant to which an Enterprise will not validate and approve a credit score model that does not ''satisf[y] minimum requirements of integrity, reliability, and accuracy.'' 12 U.S.C. 1454(d)(3)(A) and 1717(b)(7)(C)(i). Elsewhere, section 310 states that the credit score model must ''compl[y] with any standards and criteria established by'' FHFA. *Id.,* 1454(d)(3)(D) and 1717(b)(7)(C)(iv).

have to contain sufficient observations to perform the accuracy 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, thin credit file loans at origination, 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 credit score models' accuracy is critically important to borrowers and investors in these challenging cases because the credit scores will be in close proximity to critical thresholds.

b. Options for Evaluating Test Results

FHFA has considered four options for evaluating test results: A comparison-based approach, a champion-challenger approach, a benchmark-based approach, and a transitional approach. The proposed rule language is based on the comparison-based approach, but FHFA may adopt any of the four approaches in the final rule or consider other options suggested in the comments. Each of the four approaches is discussed in more detail below.

Each of the four options under consideration would include a minimum standard that a credit score model must meet, in that ''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 standard is measured by statistical testing. However, the four options reflect different approaches for comparing the statistical results from the credit score models being evaluated to each other.

FHFA is considering four options for evaluating test results in part to address potential concerns about the continued use of Classic FICO. Section 310 requires an Enterprise to use a validated and approved score at a defined point in the future. One way to ensure that a validated and approved score is available before that defined point would be to approve Classic FICO. This would not require any additional time to implement because Classic FICO is already in use. Continuing to use Classic FICO could be beneficial to the Enterprises and other market participants in smoothing the transition away from using a credit score from a model that has not been validated and approved to an environment in which an Enterprise must only use credit scores from models that have been validated and approved.

i. Comparison-Based Approach

The first option under consideration is a comparison-based approach. This is the option reflected in the proposed rule text. Under this approach, an Enterprise would test the credit scores under consideration for accuracy and would be required to evaluate whether the new model produced credit scores that are more accurate than any credit score the Enterprise is then using. While an Enterprise would be required to assess accuracy on a comparative basis, the proposed rule would not establish a bright-line test for minimum accuracy that a credit score model would have to meet to pass the Credit Score Assessment.

The comparison-based approach would allow flexibility for an Enterprise to make any determination based on the results of the comparison. For example, an Enterprise could determine that a particular credit score model did not meet the Credit Score Assessment based on the comparison if the credit score model performed substantially worse than other credit score models in measuring accuracy. An Enterprise would be permitted to determine that a credit score model met the accuracy standard if it performed substantially as well as other credit score models being tested. Because the comparison-based approach would not include a bright-line test for minimum accuracy, an Enterprise would be permitted to make a determination on this aspect of the Credit Score Assessment even if there were no relevant comparison available for the credit score model being tested. In that case, the accuracy standard would be successful rank-ordering of borrowers, as stated in proposed § 1254.7(b)(1).

The flexibility of a comparison-based approach without a bright-line test could raise certain challenges. Among these are concerns that the accuracy standard itself would not inform the public and applicants as to how an Enterprise would make its determination of accuracy. These transparency concerns would be mitigated by the proposed requirement that an Enterprise provide an explanation of the reasons for disapproval of an application to the applicant. Even so, a requirement that an Enterprise explain after making its decision how it considered and applied the accuracy standard would not inform the public or prospective applicants about how the Enterprise would consider and apply criteria in future decisions.

ii. Champion-Challenger Approach

As another possible standard, the second option under consideration is a champion-challenger approach that would require that the applicant's credit score(s) be more accurate than the existing credit score in use at the Enterprises, as demonstrated by appropriate testing. Score accuracy directly benefits borrowers and investors since an Enterprise relies on credit risk measures generated from its AUS. Accepting a less accurate credit score model would negatively impact borrowers and investors.

Newer credit score models should statistically outperform legacy credit score models for several reasons. First, newer credit score models incorporate borrower information that was not available when the legacy credit score models were designed and estimated. Second, newer credit score models are estimated (or ''trained'') on more recent borrower credit histories. More recent historical borrower behaviors better represent current borrower behaviors than older credit histories. In addition, overlap between the estimation (or ''training'') data and the accuracy testing data should benefit the credit score model with the greatest time period overlap. Lastly, when comparing accuracy tests on old and new credit scores with loans that were originated with the old credit score, studies, such as Hand and Adams (2014), show that a component of the newer credit score's improved accuracy is an artifact of the biased testing sample.[18] Although the amount of bias may be small, the bias makes the new credit score appear more accurate than the old credit score. Therefore a new score is not as accurate as the old score if the new score tests only as accurate as the old score. With expectations that the accuracy results for newer credit score models prove stronger than those for the older credit score model, the standard that a new credit score be more accurate than the existing credit score could be a reasonable minimum standard.

One drawback to requiring as the standard for accuracy that the new score perform *better than* the old score is that it does not provide a standard for assessing the accuracy of the old score. Thus, this standard could effectively prevent an Enterprise from continuing to use an ''old'' score. For example, adoption and application of a ''must perform better than'' comparative standard could result in the Enterprises

[18] The Hand and Adam (2014) study is a simplified study in contrast to the complicated underwriting and purchase process at the Enterprises.

not validating and approving Classic FICO. This could have negative consequences. For example, an Enterprise may determine Classic FICO to be sufficient to meet the business needs of the Enterprise, such that costs and disruptions of changing to a new score are not justified. The champion-challenger approach could prevent the Enterprise from continuing to use Classic FICO in that situation.

To address concerns of a ''more accurate than'' comparative standard, FHFA has considered establishing a standard that any new score must perform ''as well as'' the old score to pass the Credit Score Assessment. Based on the bias described above, however, FHFA has concerns that such a standard may not be appropriate.

iii. Benchmark-Based Approach

To avoid the concerns of either the comparison-based approach or the champion-challenger approach, FHFA is also considering a third option, which would establish an absolute statistical standard and would require all scores to meet a benchmark. FHFA could either adopt the benchmark level as part of this rulemaking or FHFA could determine the benchmark level and publish it through an order issued in conjunction with any notice to an Enterprise at the time of opening a solicitation period. Based on credit score model testing undertaken for the Conservatorship Scorecard project, FHFA believes an appropriate statistical standard would be to define a test statistic (K–S, Gini, or equivalent) as the threshold. All complete applications would be tested for accuracy and the results compared to the threshold test statistic. FHFA also recognizes that other statistical measures could be supported, and for that reason considered whether a K–S range would be another option for measuring accuracy. In this case, however, establishing a range would present the same issues as selecting a single threshold because the lowest end of the range would operate as the binding accuracy measure.

This approach would permit all scores under consideration, and any score then in use, to be measured against the same benchmark. Both a score then in use and any new score being considered could pass or fail the benchmark. Defining a specific regulatory benchmark could present other issues, however. For example, if a specific benchmark is known in advance, applicants or testers could engineer scores or testing methods to meet it. In addition, requiring that a score meet a regulatory benchmark may excessively value that consideration (*i.e.,* accuracy) among other considerations for which there are not regulatory benchmarks.

iv. Transitional Approach

FHFA is also considering a transitional approach, whereby one standard for accuracy would be applied for purposes of the first Credit Score Assessment undertaken by an Enterprise, and another standard applied for subsequent Assessments in response to a future solicitation. This approach would apply the same standard to all applications received in response to the initial solicitation in addition to the existing credit score model currently in use. This could permit an Enterprise to validate and approve Classic FICO pending a determination on any other applications received by the Enterprise. This may be necessary to meet statutory timeframes for an Enterprise to be using a validated and approved credit score model.

Under this approach, FHFA would permit an Enterprise to validate and approve the score currently in use while continuing to consider whether to validate and approve other scores for which it received applications in response to the same Credit Score Solicitation. If, shortly after validating and approving the score currently in use, an Enterprise validated and approved another score, section 310 would permit the Enterprise to replace the first validated and approved score with any other validated and approved score.

If a transitional approach is adopted, FHFA is considering a method for determining accuracy for the initial Credit Score Assessment that could be applied to all ''new'' credit scores and the credit score currently in use (Classic FICO). Because of issues that arise with a champion-challenger approach as applied to a score currently in use, FHFA anticipates that the transitional approach would entail either a benchmark-based approach (meaning, selection of a statistical benchmark that all scores, including the ''old'' score, must meet in order to pass the Credit Score Assessment) or a comparison-based approach. Further, if a transitional approach were adopted, FHFA would establish a standard for determining accuracy for subsequent Credit Score Solicitations in the same rulemaking. That standard could be any that is discussed above (*i.e.,* a comparison-based approach, champion-challenger approach, or a benchmark-based approach) or could be a different approach, taking into consideration comments received.

v. Request for Comment on Specific Options

As discussed above, FHFA sees value in and has concerns with each approach described. FHFA may adopt any of these options in the final rule or may revise any of the options after considering public comments.

If FHFA adopts a comparison-based approach, the final rule would include a requirement that an Enterprise evaluate accuracy based on a comparison of each credit score model to any other credit score model under consideration, including the model that produces the score currently in use by an Enterprise. This approach for assessing the accuracy of a new score is reflected in the proposed rule text set forth below. The comparison-based approach would not include a bright-line test regarding the outcome of the comparison.

If FHFA adopts a champion-challenger approach, the final rule would include a relative measure under which each model under consideration would be compared to the others, and would include a bright-line test regarding the outcome of the comparison.

If FHFA adopts a benchmark-based approach, the final rule would include a bright-line test that a credit score model, or the credit scores produced from it, must meet in order to pass the Credit Score Assessment. The final rule could either include an absolute statistical cutoff to which each model's accuracy test would be compared, or provide that the specific statistical cutoff would be established by FHFA order.

If FHFA adopts a transitional approach, the final rule would include one measure that a credit score model, or the credit scores produced from it, must meet in order to pass the initial Credit Score Assessment, and a different measure that must be met by later applicants in response to subsequent Credit Score Solicitations.

FHFA welcomes comment on all approaches and all standards described above, and in particular on whether there is a basis on which one should be preferred to others or another.

3. Reliability Standard

The proposed rule would establish a 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 proposed rule would require 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. Delinquency rates increase and decrease over the economic cycle; however, the rank ordering ability of the credit score should remain over the cycle.

The proposed rule would require that the Enterprises 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.

The proposed rule would ensure that new credit score models are not ''over-fitted'' to recent loan quality and borrower credit behavior. ''Over-fitting'' is a characterization of a model where the model predicts exceptionally well on the two years of credit records used to estimate the model, yet predicts poorly outside of those two years. Testing credit score accuracy at a minimum of two points in the economic cycle should also ensure the credit score models retain the ability to rank order credit risk over the economic cycle.

4. Integrity Standard

The proposed rule would establish 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 observed by the developer 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).

The proposed integrity standard would 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. Today, the most common credit score models are developed on consumer credit files owned by the nationwide CRAs. In the future, credit score model developers may use consumer credit information outside of the CRAs or the CRAs may expand the breadth of consumer credit information collected. Improvements in the range of consumer information available to credit score model developers may improve credit score accuracy. The proposed integrity standard is designed to encourage credit score model developers to innovate.

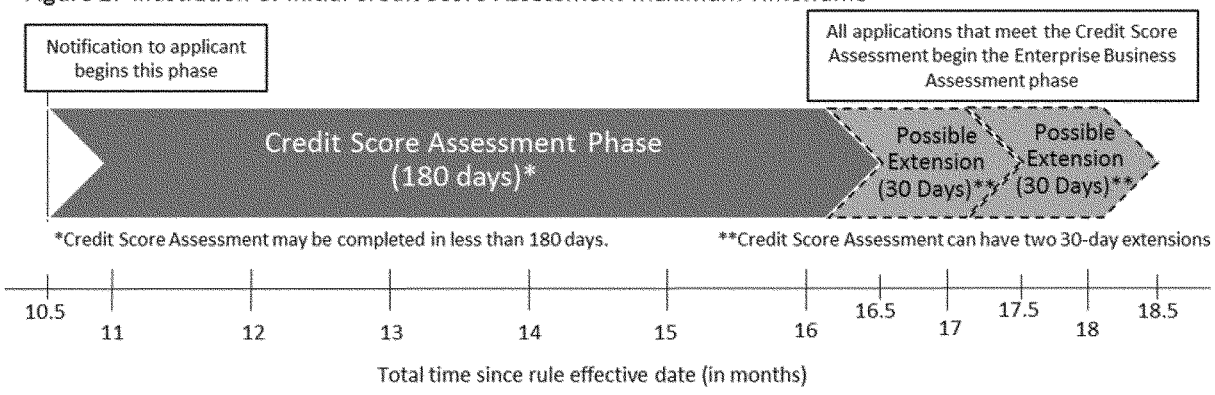
5. Additional Enterprise Standards and Criteria

The proposed rule would permit the Enterprises 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.

6. Timing and Notices

The proposed rule would require an Enterprise to provide a notice to each applicant that has submitted a complete application of when an Enterprise will commence the Credit Score Assessment phase. For reasons discussed previously, an Enterprise would have the flexibility to assess applications as they are completed or to assess all applications once an Enterprise has made a determination on complete applications submitted during the solicitation period. The proposed rule would provide that the Credit Score Assessment phase could begin no earlier than the close of the solicitation time period. The proposed rule would require the Credit Score Assessment period to extend for 180 days. The proposed rule would permit the Director 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 in accordance with section 310. The timeframes for the Credit Score Assessment are illustrated in Figure 2.

Figure 2: Illustration of Initial Credit Score Assessment Maximum Timeframe



The proposed rule would require that a Credit Score Assessment determination notice be provided to the applicant indicating whether the applicant's score meets the criteria of the Credit Score Assessment no later than 270 days from the beginning of the Credit Score Assessment. The proposed rule would require that this notification be provided no later than 30 days after the Enterprise makes a determination. If an applicant does not pass the Credit Score Assessment, the notice must include a description of the reason(s) why the applicant did not pass the Credit Score Assessment.

E. Enterprise Business Assessment

1. Overview

The proposed rule would require Fannie Mae and Freddie Mac to undertake an Enterprise Business Assessment of each credit score model that the Enterprise determines has met the Credit Score Assessment. The proposed Enterprise Business Assessment would be broader than the Credit Score Assessment. The Enterprise Business Assessment would include an evaluation in at least five areas: (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; (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 vendor; and (6) any other Enterprise standards and criteria. The proposed rule would allow each Enterprise to include, subject to FHFA review and approval, any additional assessment necessary to make a business case decision. The considerations in the Enterprise Business Assessment would not be new to the Enterprises and are generally part of the current course of business for the Enterprises.

In addition to the minimum requirements of accuracy, reliability, and integrity, section 310 requires that a credit score model must be ''consistent with the safe and sound operation of the [Enterprise]'' in order for an Enterprise to validate and approve the model. Several assessment criteria relate to Enterprise safety and soundness, and the use of a credit score model in the Enterprise systems. Because the Enterprises operate different systems, different business models, and different credit tolerances, the Enterprise Business Assessment would allow each Enterprise to assess credit scores based on its specific business needs.

2. Assessment of Credit Scores With Enterprise Proprietary Systems

The proposed rule would require an Enterprise to include an assessment of the accuracy and reliability of the credit score when used within its systems that use credit scores. An Enterprise Business Assessment would not consider a credit score's integrity, because the integrity of a score would be established in the Credit Score Assessment phase and would not change by use in an Enterprise's systems.

The assessment of accuracy and reliability would include statistical testing that would be similar to the tests used in the Credit Score Assessment. However, instead of testing the performance of a credit score model independent of Enterprise systems based on its ability to rank-order applicants, an Enterprise Business Assessment would consider the performance of a credit score model when used in the Enterprise systems that use credit scores, for example as a purchase threshold or as an input to the Enterprise's underwriting systems.

3. Fair Lending Assessment

The proposed rule would require each Enterprise to evaluate the fair lending risk and the 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) as part of the Enterprise Business Assessment. The Enterprises currently conduct fair lending analyses when making credit policy changes. FHFA requests comment on whether the fair lending assessment should go beyond traditional fair lending risk and compliance testing to consider, in addition, whether the credit score model has the potential to promote access to mortgage credit for creditworthy applicants across all protected classifications. FHFA requests comment on how any such additional analysis under the Enterprise Business Assessment should be defined or conducted.

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

The proposed rule would require the Enterprise Business Assessment to consider operational impacts to the Enterprises, such as implementation timing, and potential impacts on Enterprise risk management. The Enterprise Business Assessment also would consider potential impacts across the entire mortgage industry of an updated credit score model or models.

In response to the RFI, many market participants indicated that updating to the newest version of FICO would be less operationally complex than updating systems to handle multiple models. Respondents were concerned about impacts to liquidity in the secondary markets if the Enterprises permitted lenders to submit either credit score. Maintaining a single score requirement yet updating the credit score would initiate a series of changes and adoption costs throughout the mortgage industry. Lenders would have to update loan-pricing models and any lender overlays, while mortgage insurers would have to update and submit their premium rate sheets to state insurance regulators for approval. Mortgage Backed Securities (MBS) and Credit Risk Transfer (CRT) investors would have to re-estimate mortgage performance and valuation models. In light of these responses to the RFI, the proposed rule would require an Enterprise to consider impacts of a new credit score model or models and the impacts that updating may have on the entire mortgage finance industry.

The proposed rule also would require the Enterprise Business Assessment to include consideration of potential impacts on eligibility criteria and Enterprise pricing for loan purchases as part of any assessment. The Enterprise Business Assessment also would require each Enterprise to evaluate other possible impacts of a new credit score model. For example, the Enterprises currently use credit score thresholds as eligibility criteria for certain loan purchases. Similarly, the Enterprises currently establish loan delivery fees for loans based on the original credit score and LTV ratio. Switching to a new credit score model could require an Enterprise to adjust its eligibility criteria and loan pricing such that credit risk on new business is unchanged. Changing a credit score model could require updating credit score thresholds in order to maintain Enterprise credit risk tolerances.

The proposed rule would address these business considerations in terms of the impact, benefits, and costs of adopting or changing a credit score model on market participants, market liquidity, and the cost and availability of credit. FHFA believes these are important considerations, as the cost and other impacts of changing a credit score model could be significant. Likewise, FHFA recognizes that it may be difficult to quantify the benefits to borrowers in terms of the cost and availability of credit. FHFA requests comments on these considerations, including whether there are impacts, costs, or benefits that the Enterprises should specifically consider, and whether the impacted parties or areas—market participants (including borrowers, lenders, investors, and the Enterprises), market liquidity, and

availability of credit—are appropriate or should be supplemented.

5. 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 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 Vendor Review

The proposed rule would require the Enterprise Business Assessment to include a comprehensive vendor review for all applicants. FHFA expects an Enterprise, as part of its oversight of third-party vendors, to maintain a third-party vendor risk management program that assesses and manages risks associated with third-party vendor relationships. The Enterprise Business Assessment would address any financial, operational, compliance, legal, and reputational risks associated with the third party. The third-party vendor review in an Enterprise Business Assessment would evaluate the third party under any policies, procedures, and internal standards of the Enterprise, consistent with any Advisory Bulletins in effect at the time the Enterprise submits its Credit Score Solicitation to FHFA for approval. The Enterprise must follow its policies and procedures for approval and management of vendors and other third-party service providers.[19]

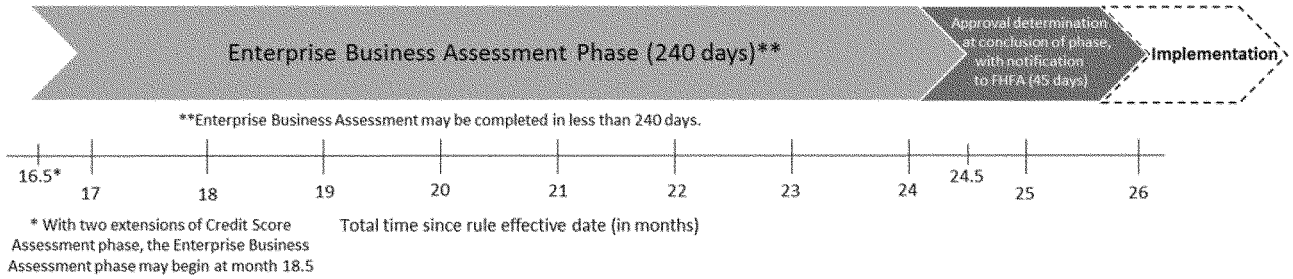
7. Enterprise Standards and Criteria

The proposed rule would permit the Enterprises to establish additional requirements for the Enterprise Business 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.

8. Timing and Notices

The proposed rule would require that an Enterprise complete the Enterprise Business Assessment within 240 days as depicted in Figure 3. Section 310 does not address a timeframe for industry adoption of a new credit score model. Based on feedback from the Credit Score RFI, which indicated that it will take the industry approximately 18–24 months to adopt a new credit score model, the proposed rule would require an Enterprise to provide notice to the industry about expected timing of changing any credit score model requirements. Whether multiple credit score models are approved for use may impact the implementation timing required by an Enterprise. The timeframes for the Enterprise Business Assessment are illustrated in Figure 3.

Figure 3: Illustration of Initial Enterprise Business Assessment Maximum Timeframe



9. Enterprise Business Assessment Approval Determination

The proposed rule would require that if an Enterprise made an approval determination at the end of the Enterprise Business Assessment, the Enterprise would have to implement each credit score model that it approves in its mortgage purchase systems that use a credit score. As discussed above, the proposed rule does not address how approved scores will be implemented (*e.g.,* waterfall approach or require all approved credit scores for every loan). FHFA expects that the Enterprise would develop a plan to update their requirements of approved score(s) in a timely manner taking into account the timeframes necessary for any system updates and industry concerns on adequate time for implementation in an orderly fashion.

F. Enterprise Actions on Applications

1. Overview

The proposed rule would require an Enterprise to make a determination on each application that it determines to be complete. An Enterprise could determine that an application should be approved or disapproved. The proposed rule would permit an applicant to withdraw its application at any time during the validation and approval process.

2. Enterprise Determinations

The proposed rule would permit an Enterprise to approve an application after it completes the Enterprise Business Assessment.

The proposed rule would permit an Enterprise to disapprove an application at any point in the validation and approval process. An application could be disapproved based on any of the criteria identified in the Credit Score Solicitation, including any of the application requirements (for example, if an application did not include a required certification) or any of the criteria under the Credit Score Assessment or the Enterprise Business Assessment. If an Enterprise determines that an application should be disapproved, the proposed rule would require an Enterprise to provide the applicant with a notice of disapproval no later than 30 days after a determination is made. If an Enterprise disapproves an application, the Enterprise would be required to provide a description of the reason(s) for disapproval, as provided in section 310. If an application is approved, the Enterprise would be required to make its approval determination public.

3. FHFA Review of Enterprise Determination

The proposed rule would require an Enterprise to provide notice to FHFA

[19] *See* 12 CFR part 1236 (Prudential Management and Operations Standards); Advisory Bulletin 2018–08, ''Oversight of Third-Party Provider Relationships,'' Sept. 28, 2018.

once an Enterprise has made a decision to approve or disapprove an application at least 45 calendar days prior to notifying the applicant and/or the public. This 45-day notice would be required for any decision to approve or disapprove an application. In all cases, the proposed rule would require that FHFA be notified prior to an Enterprise notifying an applicant or the public of its decision. Prior notice to FHFA would ensure that FHFA has had an opportunity to determine how to handle future changes, updates to, or replacement of, any credit score model(s). Prior notice would permit FHFA to take any steps appropriate in FHFA's capacity as conservator or as safety and soundness regulator of the Enterprises. FHFA's review of the Enterprise determinations would be consistent with FHFA's expectations that all Enterprise initiatives be conducted in a safe and sound manner.

4. Withdrawal of Application

The proposed rule would permit an applicant to withdraw its application at any time by notifying the Enterprise. This would allow 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 proposed rule would 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.

G. Pilot Programs

1. Overview

The proposed rule would allow FHFA to approve pilot programs for the use of credit scores. Section 310 does not address pilot programs explicitly but requires that the Enterprises use a validated and approved score model in all automated underwriting systems that use a credit score and in any other mortgage purchase procedures and systems that use a credit score. It also requires that if an Enterprise conditions the purchase of mortgages on a credit score, the credit score model must be validated and approved. In addition, section 310 requires that a credit score model have a historical record of measuring and predicting default rates and other credit behaviors.

One way to gain performance history is to allow an Enterprise to collect an application from model developers and make a business assessment for the use of credit score(s) for pilot programs. If an applicant's credit score lacks usage by industry to underwrite consumer credit, it may be approved initially for a pilot program only.

The proposed rule is seeking feedback on whether an Enterprise should conduct a pilot with a new credit score model, and on how such pilots should be addressed under the regulation. For example, a pilot may be useful in augmenting the Enterprise no-score AUS. While both Enterprises have the capability to review loans that lack credit scores, the addition of a ''supplemental'' score could enhance the no-score AUS.

A pilot may also assist an Enterprise in determining the appropriate standards and criteria for the Credit Score Solicitation, including the requirements for the application. In order to test various standards and criteria for the Credit Score Solicitation, the pilot or testing initiative would itself need to be exempt from the requirements of this regulation.

Any pilot needs to be of limited duration and of limited scope. In addition, the proposed rule would require a pilot to be reviewed and approved by FHFA, which may also require changes to the program. FHFA is seeking comment on all aspects of the proposed approach on credit score pilot programs.

V. Paperwork Reduction Act

The proposed rule would 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.

VI. 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, small businesses, or small organizations must include an initial regulatory flexibility 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 proposed rule under the Regulatory Flexibility Act. The General Counsel of FHFA certifies that the proposed rule, if adopted as a final rule, will not have a significant economic impact on a substantial number of small entities because the regulation applies only to Fannie Mae and Freddie Mac, which are not small entities for purposes of the Regulatory Flexibility Act.

List of Subjects in 12 CFR Part 1254

Mortgages.

Authority and Issuance

For the reasons stated in Preamble, under the authority of 12 U.S.C. 4511, 4513, 4526 and Public Law 115–174, section 310, 132 Stat. 1296, FHFA proposes to amend subchapter C of Chapter XII of Title 12 of the Code of Federal Regulations as follows:

CHAPTER XII—FEDERAL HOUSING FINANCE AGENCY

SUBCHAPTER C—ENTERPRISES

■ 1. Add part 1254 to subchapter C to read as follows:

PART 1254—VALIDATION AND APPROVAL OF CREDIT SCORE MODELS

Sec.

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, 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).

Nationwide consumer reporting agency means a consumer reporting agency that compiles and maintains files on consumers on a nationwide basis as defined in section 603 of the Fair Credit Reporting Act (15 U.S.C. 1681a).

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, the Enterprise must:

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

(2) 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 at its discretion continue to use or 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 require solicitation to occur at least every seven (7) years, unless FHFA determines that a solicitation should occur more or less frequently. FHFA will establish the solicitation requirement by notice to the Enterprises, which will include:

(1) A 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 an 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 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 compliance and certification.* 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 nonmortgage) who use the applicant's score when making a determination to approve the extension of credit.

(4) *Conflict of interest certification and qualification of credit score model developer.* Each application must include a certification that no owner of consumer data necessary to construct the credit score model is related to the credit score model developer through any degree of common ownership or control. Each application must also 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, including audited financial statements for the preceding three years.

(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 an 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) *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. The Credit Score Assessment must evaluate whether a new credit score model produces credit scores that are more accurate than the credit scores produced by any credit score model that the Enterprise is then using, as demonstrated by appropriate testing. Testing is appropriate if it utilizes one or more industry standard statistical tests for demonstrating divergence among borrowers' propensity to repay, applied to mortgages purchased by an Enterprise (including subgroups), as identified by the Enterprise.

(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 the Enterprise is then using, as demonstrated by appropriate testing. Testing is appropriate if it utilizes one or more industry standard statistical tests for demonstrating accuracy using the industry standard definition of default, and demonstrates 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 and 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) The Enterprise must provide notice to the applicant within 30 days of the determination of whether 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.

(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 Vendor Review.* The Enterprise Business Assessment must evaluate the credit score model developer under the Enterprise standards for approval of third-party service 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) *Enterprise Business Assessment Determination.* If an Enterprise approves an application for a credit score model, the Enterprise must implement the credit score model in its mortgage purchase systems that use a credit score for mortgage purchases.

§ 1254.9 Enterprise actions on applications.

(a) *Types of actions.* An Enterprise must approve or disapprove each application.

(b) *Approval of a credit score model.* An Enterprise may approve an application upon completion of the Enterprise Business Assessment. An Enterprise must notify the applicant and the public of the approval of an application.

(c) *Disapproval of a credit score model.* An Enterprise may disapprove an application at any time during the validation and approval process based on any of the criteria identified in the Credit Score Solicitation. If an Enterprise disapproves an application at any time, the Enterprise must provide written notice to the applicant within 30 days of the disapproval determination, and the notice must provide a description of the reasons for disapproval.

(d) *Prior notice to FHFA.* An Enterprise must notify FHFA of any decision to approve or disapprove an application at least 45 days prior to an Enterprise's notification to an applicant or the public of its decision.

§ 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 Pilots.

(a) *Pilots permitted.* An Enterprise may undertake pilots or testing initiatives for a credit score model. If a pilot or testing initiative involves the use of a credit score model not in current use by the Enterprises, that credit score model is not required to be approved under this part.

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

Dated: December 12, 2018.

Melvin L. Watt,

Director, Federal Housing Finance Agency.

[FR Doc. 2018–27565 Filed 12–20–18; 8:45 am]

BILLING CODE 8070–01–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA–2018–1046; Product Identifier 2018–CE–049–AD]

RIN 2120–AA64

Airworthiness Directives; Piper Aircraft, Inc. Airplanes

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice of proposed rulemaking (NPRM).

SUMMARY: We propose to adopt a new airworthiness directive (AD) for certain Piper Aircraft, Inc. (Piper) Model PA–28–140, PA–28–150, PA–28–151, PA–28–160, PA–28–161, PA–28–180, PA–28–181, PA–28–235, PA–28R–180, PA–28R–200, PA–28R–201, PA–28R–201T, PA–28RT–201, PA–28RT–201T, PA–32–260, and PA–32–300 airplanes. This proposed AD was prompted by a report of a fatigue crack found in a visually inaccessible area of the lower main wing spar cap. This proposed AD would require calculating the factored service hours for each main wing spar to determine when an inspection is required, inspecting the lower main wing spar bolt holes for cracks, and replacing any cracked main wing spar. We are proposing this AD to address the unsafe condition on these products.

DATES: We must receive comments on this proposed AD by February 4, 2019.

ADDRESSES: You may send comments, using the procedures found in 14 CFR 11.43 and 11.45, by any of the following methods:

- *Federal eRulemaking Portal:* Go to *http://www.regulations.gov.* Follow the instructions for submitting comments.
- *Fax:* 202–493–2251.
- *Mail:* U.S. Department of Transportation, Docket Operations, M–30, West Building Ground Floor, Room W12–140, 1200 New Jersey Avenue SE, Washington, DC 20590.
- *Hand Delivery:* Deliver to Mail address above between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.

Examining the AD Docket

You may examine the AD docket on the internet at *http://*