Comment #: 79

WELLS FARGO

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Federal Trade Commission
Office of the Secretary
Washington, D.C. 20580
VIA E-MAIL

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Subject: FACT Act Scores Study;
Matter No. P044804

Ladies and Gentlemen:

Wells Fargo & Company ("Well Fargo") appreciates the opportunity to comment on certain aspects of the study mandated by the FACT Act on the effects of credit scoring and credit-based insurance scores on the availability and affordability of financial products. Wells Fargo is one of the country's leading integrated financial services organizations (the "Study"). Wells Fargo includes a national bank with branches in 23 states, a consumer finance company, insurance agencies and brokerages, and securities broker-dealers and investment advisors.

Credit scoring has been in use in the financial services industry for at least 45 years. However, most consumers were probably unaware of scoring until the mid-90's when, for the first time, it became widely used in mortgage lending. At about the same time, scoring systems designed to predict insurance risk were developed using traditional credit bureau data ("credit-based insurance scores"). In this letter "credit scoring" or "credit scores" refer to the statistical models developed to predict some form of credit risk. "Insurance scoring" or "insurance s cores" refer to similar statistical models developed to predict insurance risk. And "scoring" or "scores" refer to such statistical models generically.

Probably the most important aspect of the Study will be how "negative or differential treatment is defined. Because basic economic factors such as income, net worth, employment and education are not equally distributed in American society by race/color/national origin it should come as no surprise that credit risk is also not equally distributed. The function of a credit scoring system is to accurately predict credit risk regardless or race/color/national origin [or any other prohibited factor, except for age which may be used in credit scoring systems subject to certain constraints, 12 CFR §202.6(b)(2)]. Credit scoring is not intended, and should not be expected, to compensate for past discrimination. Thus the key question to be answered by the Study must be, "Does scoring predict risk equally regardless of whether the subject is a member of a protected class?" rather than, "Are the score distributions the same for members of all protected classes as they are for white males?"

During the 1990's Fair, Isaac and Company, Inc. ("Fair Isaac") conducted a number of studies on how low-income and minority credit applicants faced under both custom and credit bureau-based credit scoring systems. (Because race/ethnicity data were not directly available, Fair, Isaac used zip codes with high minority concentrations as a surrogate for race/ethnicity. See "The Effectiveness of Scoring on Low-to-Moderate-Income and High-Minority Area Populations" by Martell et al., 1997. Predictably, the score distributions for the low-income and minority populations were lower than those for the population as a whole. However, the score-to-risk relationships were almost identical, and, to the extent there wee any differences in those relationships, those differences consistently favored the low-income and minority applicants. Other organizations (e.g., the national consumer reporting agencies and government sponsored enterprises such as Fannie Mae and Freddie Mac) conducted similar studies and obtained similar results.

We believe that any attempt to analyze the impact of specific factors in scoring systems, or the impact of factors not currently used in scoring systems, must be approached with great caution. In developing a scoring system there are usually dozens - sometimes more than a hundred - of factors that would have some predictive value on a stand-alone basis. However, once ten to twelve of the most predictive factors are incorporated into the scoring system, additional factors seldom have any significant marginal value. and, in most cases, there is a certain level of fungibility among various types of factors.

For example, "stability characteristics" - time at address, time on job, age, time in credit bureau file, etc. - which are each predictive on a stand-alone basis. Nevertheless it would be unusual to use all of them in any given scoring system, and it is usually possible to substitute one for another. someone unfamiliar with the development of scoring systems might conclude that predictive information had been omitted when, in fact, it would not have added any incremental predictive value. However, while not affecting the overall effectiveness of the scoring system, the substitution of one factor for another may have different impacts on different parts of the applicant population. Thus any consideration of individual factors must carefully control for impacts of adding, subtracting or substituting any particular factor on <u>all</u> parts of the applicant population.

From the questions asked, it is evident that the Commission is well aware that data on certain characteristics of credit and insurance applicants will not be available in all instances (e.g., data on ethnicity, race, color and national origin may be available for loans covered by HMDA but not other types of credit), and data on some characteristics (e.g., religion or creed) may not be available at all. While location of the applicant's residence may be a reasonable surrogate for other factors which have a direct bearing on the risk a scoring system is intended to predict (e.g., income with respect to credit risk or crime rate with respect to insurance risk).

Finally, we urge the Commission to bear in mind that scoring systems attempt to predict the <u>risk</u> of future events. By definition, risk can only be measured at an aggregate level. Being subject to that limitation does not mean that scoring systems are flawed. In evaluating the effectiveness and fairness of scoring, the Commission should not compare scoring to some non-existent standard of perfection, but rather should measure it against other available methods of making similar decisions.

Wells Fargo appreciates the opportunity to comment on the Study. If you have any questions regarding these comments, please contact the undersigned at (415) 396-0940 or mccorkpl@wellsfargo.com.

Respectfully yours,