Comment #: 98

National Association of Mortgage Brokers

August 16, 2004

Office of the Secretary
Federal Trade Commission
600 Pennsylvania Avenue, NW
Room H-159 (Annex N)
Washington, DC 20580

Re: FACT Act Scores Study, Matter No. P044804

Dear Sir or Madam:

The National Association of Mortgage Brokers (NAMB) appreciates the opportunity to comment on the study the Federal Trade Commission is about to undertake on the effects of credit scores on the availability and affordability of mortgages. Before providing the FTC with our suggestions, we describe the role played by mortgage brokers in the home loan finance process.

Mortgage Brokerage Industry

Mortgage brokers act as intermediaries between consumers and lenders when the borrower finances the purchase a home or refinances an existing mortgage. A typical broker maintains business relationships with various lenders to provide consumers with numerous financing options. These partnerships allow the 44,000 mortgage broker companies employing over 360,000 employees in the United States to offer consumers the most competitive mortgage products available. Mortgage brokers originate two out of every three residential loans in any given year by advising homebuyers throughout the home financing process and delivering cost effective mortgages to consumers. As the single largest group of loan originators, mortgage brokers undoubtedly have played a significant role in increasing the rate of homeownership in the United States to an all-time high of 69.2 percent.

NAMB is the only national trade association exclusively devoted to representing the mortgage broker industry. As the voice for mortgage brokers, NAMB speaks on behalf of more than 24,000 members in all 50 states and the District of Columbia. NAMB offers educational courses and certification programs to mortgage professionals to enhance and maintain their professional expertise. By adhering to a strict code of ethics and best lending practices, NAMB members guide consumers through the mortgage loan origination process. NAMB's government affairs representation ensures the voice of the mortgage broker industry is heard on Capitol Hill.

Prescribed Methodology and Research Design of the Study

Sec. 215 of the FACT Act requires the FTC and the Federal Reserve Board, in consultation with the Office of Fair Housing and Equal Opportunity of HUD, to conduct a study on the effects of credit scores and credit-based insurance scores on the availability and affordability of financial products. Our comments below address the questions related to this study asked by the FTC in the Federal Register.

1. How should the effects of credit scores and credit based insurance scores on the price and availability of mortgages, auto loans, credit cards, other credit products, and property and casualty insurance be studied? What is a reasonable methodology for measuring the price and availability of mortgages, auto loans, credit cards, other credit products, and property and casualty insurance, and the impact of credit scores and credit based insurance scores on those prices and availability?

NAMB can speak only on the effects of credit scoring on price and availability of mortgages. We believe that the largest impact to the mortgage industry as far as price and availability of new innovative loan products has come through the use of credit scores and automated underwriting. In developing a study to judge the effects of credit scoring on the availability of mortgages and their pricing, one would have to structure the study to consider the availability of mortgages and their pricing prior to the national use of credit scores in underwriting and pricing in 1995. Since the largest impact has been the development of the 97 to 107 percent loan to value (LTV) products, it should be fairly easy to compare the qualifying requirements and maximum loan to value requirements for the loan products available in 1993 through 1995 to the product qualifying requirements and maximum LTVs available today. Due to the use of automated underwriting, more consumers are being approved for home loans today than ever before. Without credit scoring to assist in predicting the risk of repayment of debt by consumers, automated underwriting would not exist. The primary barriers to homeownership have lessened over the years, as the secondary mortgage market has become more comfortable with using credit scores to assess repayment risks.

The capability to better predict risk of repayment of debt has allowed new loan products to emerge requiring no down payment and significantly larger percentages of the borrowers income to be used in qualifying for the new loan. This has lowered the cash requirement and income barriers for many borrowers in ECOA protected classes. Therefore, the only counterfactual to use to determine the effects of credit scores on the price and availability would be to set up a study using the pre-1995 qualifying criteria without the use of the credit scores. The next step would consist of identifying the loan products available at that time, their maximum LTVs and the limitations placed on these products versus the loan products available today with their maximum LTVs and their limitations. The question would then become whether more consumers are approved for mortgages today than were approved for home loans in the past.

2. An effect can often only be measured relative to a counterfactual (that is, relative to some hypothetical alternative situation). To determine the effects of credit scores on the

price and availability of credit products, what is a reasonable counterfactual to the current use of credit scores? To determine the effects of credit-based insurance scores on the price and availability of property and casualty insurance, what is a reasonable counterfactual to the current use of credit-based insurance scores?

Please see our response to question number 1.

3. Paragraph (a)(2) of Section 215 requires a study of "the statistical relationship, utilizing a multivariate analysis that controls for prohibited factors under the (ECOA) and other known risk factors, between credit scores and credit-based insurance scores and the quantifiable risks and actual losses experienced by businesses." (The ECOA "prohibited factors" are race, color, religion, national origin, sex or marital status, and age.) What is an appropriate multivariate technique for studying this relationship? What data would be required to undertake such an analysis? What data are available to undertake such an analysis?

Researchers may want to develop this part of the study by comparing historical data from several areas. Researchers may also want to look at actual losses in loans with high LTVs prior to the use of credit scoring in 1995 with the losses on loans with high LTVs made with the use of credit scores as a qualifying factor on loans made after 2001. First-time homebuyers typically use loans with high LTVs. The HMDA data should be available for these time periods to use as a control factor when analyzing the data.

4. What is an appropriate methodology to determine whether the use of credit scores or credit based insurance scores results in "negative or differential treatment" of ECOA-protected classes?

Analyzing the HMDA information regarding the treatment of ECOA protected classes in underwriting loans prior to 1995 as it compares to the HMDA information regarding those same ECOA protected classes in underwriting after 2001 should give you that information. According to NAMB's contact with Fair Isaac, the developer of credit scores, we have be advised that race, color, religion, national origin, sex or marital status, and age are not factors that the credit score model considers when assessing risk. The credit score system is looking at how consumers repay their debts, how self disciplined they are in utilizing their credit, how long their credit has been established, what type of credit they use predominately and if they are shopping for more credit -- particularly if the consumers already are highly leveraged on their existing credit. The credit scoring system analyzes these variables in the same manner regardless of whether someone is a member of an ECOA protected class.

A past area of concern has been how credit scores treated the type of credit being used. In 1995, finance company accounts were treated significantly less favorable than bank issued credit.

NAMB felt that in neighborhoods comprised of large percentages of minority or ethnic populations the presence of mostly finance company accounts with the credit files of these individuals had more to do with consumer comfort than their ability to secure good credit. The small neighborhood finance company was less intimidating than the big bank downtown. Today, however, we find that trend has changed the scoring systems since most consumers have finance company entries in their credit files. Most consumers have secured financing from a finance company for a "90- 180 day same as cash" transaction at an electronic store or furniture store. Fair Isaac should be able to provide the study with a comparison of their statistics for this variable from 1995 and for today's utilization as to the weight this factor hold in the calculation of scores. The national credit reporting agencies should be able to provide statistics about the percentage of national credit files that included a finance company entry in 1995 versus today.

5. What is an appropriate methodology to determine whether the use of specific factors in credit scores or credit based insurance scores results in "negative or differential "treatment" of ECOA protected classes?

Through the use of HMDA data, a comparison could be established to determine the reason an ECOA protected class consumer was declined for a specific loan. Was it due to the credit score alone and if so was there a specific variable (indicated reason code) that was pervasive?

6. What is an appropriate methodology to determine whether there are factors that are not considered by credit scores or credit based insurance scores that result in "negative or differential treatment" of ECOA protected classes?

An analysis based on HMDA declined loan information should provide a look at the "other non-credit score" factors considered when qualifying a consumer for a loan approval to use in determining if any specific factor resulted in negative or deferential treatment of ECOA protected classes.

7. In order to address paragraphs (a)(2) and (a)(3) of Section 215, data are needed on the geography, income, ethnicity, race, color, religion, national origin, age, sex, marital status, or creed of borrowers, potential borrowers, insurance customers, or potential insurance customers. Are these data available, and if so, where?

The HMDA data will provide this information.

8. If the data discussed in question 7 are not available, what proxies are available for the geography, income, ethnicity, race, color, religion, national origin, age, sex, marital status, or creed of borrowers, potential borrowers, insurance customers, or potential insurance customers?

Census data will provide this information, but this type of testing may not provide many benefits since it tends to be very generalized in nature. Mortgage loans are done one at a time and are very specific.

9. If there are proxies for the geography, income, ethnicity, race, color, religion, national origin, age, sex, marital status, or creed of borrowers, potential borrowers, insurance customers, or potential insurance customers, what type of analysis would allow inferences to be drawn using the proxies instead of actual data on individual characteristics? What limitations are there to the inferences that can be drawn using proxies in place of data on individual characteristics?

Uncertain.

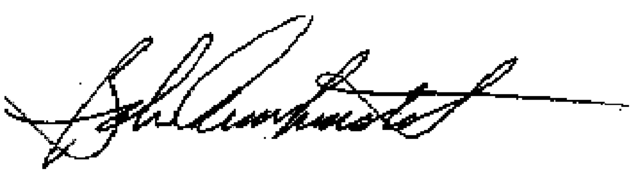
10. One potential proxy for individual characteristics may be Census data about the location where a borrower or insurance customer resides. What type of analysis would allow inferences to be drawn using data about the characteristics of the location where a borrower or insurance customer resides instead of data on individual characteristics? What limitations are there to the inferences that can be drawn using data about the characteristics of the location where a borrower or insurance customer resides in place of data on individual characteristics?

Uncertain.

Conclusion

NAMB commends the FTC for undertaking this study. Please let us know if you have questions concerning our comment letter.

Sincerely,



Bob Armbruster
President