NATIONAL ASSOCIATION OF REALTORS®

REALTOR®

The Voice For Real Estate®

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REGULATORY & INDUSTRY
RELATIONS DEPARTMENT

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

RE: FACT Act Scores Study, Matter No. P044804

Ladies and Gentlemen:

On behalf of the more than 1 million members of the NATIONAL ASSOCIATION OF REALTORS® (NAR), the Institute for Real Estate Management (IREM), and the Certified Commercial Investment Member (CCIM) Institute, I am pleased to offer comments to the Commission on the FACT Act Scores Study. The NATIONAL ASSOCIATION OF REALTORS®, "The Voice for Real Estate," is America's largest trade association, representing more than 1 million members, including NAR's five commercial real estate institutes, its societies, and its councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries. NAR members belong to one or more of some 1,700 local associations or boards and 54 state and territory associations of REALTORS®.

IREM, an NAR affiliate, is an association of professional property and asset managers who meet strict criteria in the areas of education, experience, and ethics. The 16,000 IREM members manage all types of investment real estate. The Institute educates real estate managers, certifies the competence and professionalism of individuals and organizations engaged in real estate management, advocates on issues affecting the real estate management industry, and enhances its members' professional competence to better meet the needs of their clients.

The CCIM Institute is also an NAR affiliate. The CCIM Institute confers the CCIM designation. The Institute stresses education, networking, and ethical practice. Over 7,500 commercial real estate professionals currently hold the CCIM designation and work in 1,000 markets.

FTC Study

The Fair and Accurate Credit Transactions Act of 2003 (FACT Act) requires the Federal Trade Commission (FTC), in consultation with HUD's Office of Fair Housing and Equality Opportunity, to study:

- The effects of using credit scores and credit-based insurance scores on the availability and affordability of financial products and services.
- The statistical relationship between credit scores and credit-based insurance scores and the quantifiable risks and actual losses experienced by providers of financial products and services.
- The extent to which the use of credit scoring models, credit scores, and credit-based insurance scores affect the availability and affordability of credit and insurance, and the extent to which the use of underwriting systems relying on these models could achieve comparable results through the use of factors with less negative impact.
- The extent to which credit scoring systems are used by businesses, the factors considered by the systems, and the effects of variables not taken into account.

As the FACT Act requires, the FTC has invited public comment on the methodology and research design for the study.

REALTOR® Concerns

REALTORS® support ongoing efforts to improve the credit score and insurance-based credit score systems. It is especially important to make the systems more transparent so consumers can identify and correct errors that harm their scores and obtain information about the scores and their effect on the availability and affordability of mortgages and property insurance. These changes would help consumers shop more effectively for the best deals.

The availability of mortgage credit and property and liability insurance at a fair and reasonable cost is central to the home purchase transaction that, in turn, is central to the businesses of REALTORS®. REALTORS® are also affected when they rely on credit scores in connection with managing, selling, buying, and leasing residential rental property and other commercial property, act as mortgage brokers, or are affiliated with a mortgage lender or insurance broker. When a consumer seeking to become a homeowner enters a home purchase contract but has problems obtaining a mortgage or the necessary insurance on the property, the REALTOR® is often called upon to help resolve the problems. REALTORS® see first hand the negative impacts on consumers when flawed credit scores or insurance scores make it hard or impossible for their clients to purchase homes.

Both credit scoring and credit-based insurance scoring models are built on the credit history patterns of groups of individuals using consumer reporting agency (credit bureau) records. These comparative patterns translate into statistics used as the basis for estimating how a majority of individuals with common characteristics will perform in the future. There are three important distinctions between the two systems:

- Credit scores predict the likelihood of default on a loan. Insurance scores are designed to predict the likelihood that a policyholder or applicant will submit a claim.
- Consumer reports and credit scores are often made available to the loan officer as part of the prospective borrower's file. Consumer reports and insurance scores are almost never made available to the insurance agent out of concern for possible violation of the Fair Credit Reporting Act.
- The most important distinction between the two systems is the statistical relationship. Research and experience have substantiated the relationship between credit characteristics and loan default ratios, but not the relationship between credit characteristics and claims ratios.

Credit Scores

When credit scores were introduced by the Fair Isaac Corporation more than 40 years ago, there had been no test of causation, and some consumers were denied access to homeownership based on inquiries for credit while shopping—one of the very behaviors that an open market should encourage. Eventually, enough experience accumulated, and consumers succeeded in forcing rating companies to acknowledge their models were wrong. Credit score companies adopted policies that recognize consumer patterns for shopping for the best deal and otherwise improved their formulas. But the formulas themselves remain secret, and questions remain about how well credit scores predict the risk of loan default.

In 2000, after immense pressure from consumer advocates and the real estate industry, Fair Isaac started to release details about its model. A FICO score is comprised of the following factors:

- The borrower's debt payment history—35 percent.
- How much the borrower owes on how many accounts—30 percent.
- Length of borrower's credit history—15 percent.
- How many new accounts the borrower has opened and how many recent request for credit the borrower has made—10 percent.
- The types of accounts the borrower has and how many of each—10 percent.

In addition, the FACT Act requires consumer reporting agencies to disclose credit scores and related explanatory information. Many mortgage lenders must make comparable disclosures about the credit scores they obtain from a consumer reporting agency or that they develop and use themselves. The FACT Act also improved the tools consumers have to correct errors in their credit reports that will help improve the accuracy of credit scores.

While these are significant improvements, concerns remain. Because each consumer reporting agency has its own credit scoring model, maintains its own consumer files, and manages its own information provider relationships, there is concern about the effect of inconsistent and inaccurate information on a consumer's credit score. The resulting higher monthly payments can place unfair burdens on the budgets of consumers, make default more likely, and even prevent consumers from becoming homeowners. In addition, many lenders have their own credit scoring models, and while the FACT Act requires them to disclose the score and the key factors going into the model, the disclosures may occur late in the process so consumers have difficulty shopping for the best rates and other features of a mortgage loan. Even with the FACT Act disclosures, consumers remain in the dark about the details of how a score is actually computed. In many cases, consumers do not understand how crucial the score is for determining the cost of the loan and even whether the consumer qualifies for a loan at all—which can be particularly confusing when lenders advertise rates that are available only to those with the best credit. And it is still not easy for consumers to correct errors in their credit histories. Some lenders rely on credit scores almost exclusively, which makes these problems even more of a concern.

All of these problems put clients of REALTORS® at a disadvantage when shopping for a loan. Accordingly, NAR would support well-considered proposals to improve the transparency of the credit scoring system.

Credit-Based Insurance Scores

Even after qualifying for a mortgage using credit scores and other underwriting criteria, buyers must still qualify for insurance. There is a significant risk that some consumers are paying too much for property or liability insurance or inappropriately being denied insurance altogether—either initially or at renewal. It is important for the FTC study to point the way towards the elimination of artificial barriers to homeownership presented by untested models and inaccurate data limiting the availability of property and liability insurance. While the insurers argue that they have empirical evidence validating the use of insurance scores, NAR believes that the evidence they rely on is actuarial data that support only a correlation analysis, and that there does not exist a rigorously developed, statistically sound insurance scoring model that should be relied upon to assess insurance risk. The FTC study should determine whether credit-based insurance scores accurately predict insurance risk, which will provide the basis for necessary improvements in the insurance score system and reassure consumers that the system is reasonable and fair.

The public policy debate on insurance scoring is fueled in part by the absence of specific and objective information that substantiates that there is a relationship between credit histories and insurance claims or how insurance premiums are priced for various insurance score ranges. Adding to the distrust of insurance scoring is the absence of public information about the insurance scoring models, the unwillingness of the insurance companies to disclose scores, and the lack of information about the key factors affecting how much to charge policyholders. This is in sharp contrast to credit scores where a consumer can go to www.myfico.com and see an example of how different FICO scores may affect the annual percentage rate and monthly payment on a sample 30-year fixed rate mortgage. Further, the factors that are the basis for computing credit scores are public information. Finally, consumers are frustrated by the lack of consumer protections available to applicants for insurance who are turned down and policyholders whose policies are not renewed because of negative credit information.

NAR Recommendations—Credit Scores

While the FACT Act makes significant improvements in the credit scoring system, NAR believes there is a need for a full FTC study to assess the extent to which, if any, the current credit score system makes it impossible or more costly for consumers who are good credit risks to become homeowners. NAR also supports efforts to make the system more transparent. One way to do this would be to require all credit reporting agencies, not just national agencies, to provide one free credit report and credit score annually, upon request.

NAR Recommendations—Insurance Based Credit Scores

Test the Causation. The insurance companies and providers of credit-based insurance scores are in the best position to provide information to the FTC about the insurance scoring system. We are not aware they have offered any proof of a causal relationship that insurers contend shows that an individual with a low score due to a worse credit history will file more insurance claims than an individual with better credit, all other things being equal. The study should assess this premise.

Using this insurance company and score provider information, and information derived or developed from other sources, the FTC should design a study that tests whether it is appropriate to use credit-based insurance scores to assess risk and set premium rates. Rather than taking a trial and error approach to the development of insurance scores—to the detriment of consumers—the FTC should work with the insurance industry to develop a longitudinal study of underwriting criteria, insurance scores, and losses to track variables used in underwriting against losses due to claims unrelated to risk, such as fraudulent behavior, to validate the models and data. In particular, the FTC should develop a thorough understanding of the importance of each variable and its potential to represent consumer characteristics that are not relevant to insurance underwriting. In sharp contrast to mortgage underwriting, for example, where the lender must consider the ability of the borrower to repay the loan and the value of the collateral, the insurer's need to consider whether the consumer can afford to pay the premium is relatively unimportant. If the policy holder fails to pay the premium, the insurance company can cancel the policy. The study should assess the extent, if any, it is appropriate to consider a consumer's credit history in connection with underwriting the risk of loss.

Give State Insurance Regulators Access to Underwriting Criteria. While insurers have opposed disclosure of underwriting criteria, state insurance regulators should have access to insurance company underwriting criteria and risk methodologies so consumers may be assured that insurance company practices are reasonable and not discriminatory. This will help give consumers, lenders, and other interested parties confidence in the system. You may wish to recommend requiring that state insurance commissioners hire consumer ombudsmen to complement this effort.

Urge Congressional Action; Retain State Authority. Assuming the results of the FTC study validate the concerns of REALTORS®, NAR urges FTC to recommend to Congress that it enact reforms to improve the current system, such as those we support. The NATIONAL ASSOCIATION OF REALTORS® advocates the disclosure of insurance scores, the key factors that go into computation of an insurance score, the date of the score, and a sufficient explanation to facilitate understanding what impact the insurance score may have on the insurance underwriting decision.

The FACT Act gives consumers the right to one free copy of their credit report and credit score each year. While we understand that the FACT Act requires national credit reporting agencies that compile and maintain consumer files related to insurance claims to make one free copy of the claim file available annually, upon request, it is not clear that they must also provide a free copy of the insurance score. Consistent with our recommendation for credit scores, NAR also recommends that the free disclosure requirement be extended to all consumer reporting agencies, not just those that operate on a nationwide basis. Finally, insurance companies should be required to disclose insurance scores to the same extent as mortgage lenders are required to disclose credit scores. We suggest that you recommend these reforms to Congress as a way to promote transparency in the system and because insurance scores are becoming just as important as credit scores to consumers seeking to purchase a home and should be just as readily available.

States have been active in this area and many have enacted legislation to address insurances scoring, ranging from clarifying use, to requiring disclosure, and even to prohibiting the use of credit-based insurance scores. NAR would not support efforts to preempt these state laws, except to the extent they would be in direct conflict with any statutory federal standards.

Thank you for the opportunity to comment on the important issues raised by the credit score and credit-based insurance score study.

Sincerely,

Joseph M. Ventrone
Managing Director, Regulatory and Industry Relations Department