Summary of written testimony to be provided by
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Subcommittee on Financial Institutions and Consumer Credit
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On the
Mortgage Lending Reform:
A Comprehensive Review of the American Mortgage System

The Foundation of the Housing Finance Industry is Flawed

Background

The three bureau merge credit report, the standard in the housing finance industry, is one of the most common components found in the toxic loan packages. This report was created by Fannie Mae and Freddie Mac in the mid 1990's and it has a major flaw in its design. The flaw is that the credit report data, a key element in the foundation of lending decisions, is not accurate enough for this type of report for a substantial number of Americans without some added safeguards to assure accuracy.

The goal of Fannie Mae and Freddie Mac when changing to this new report type was to facilitate a totally automated mortgage lending decision, with two priorities in mind:

1. Cost Reduction – in theory the new report saves about $30 per mortgage application.
2. Speed – the credit data needed to underwrite the loan is ready in less than 10 seconds.

When the three bureau merge report became the mortgage industry standard, many other valuable elements of the credit investigation and analysis were lost, including elements that assisted in fraud prevention, consumer education, data accuracy, and quality control. These elements were no longer deemed a priority. Recent events in housing finance now show that the "cheaper and faster" methods of reviewing a mortgage applicants credit history may had a material impact on the quality of the loans granted. This is especially poignant considering that in reality millions of consumers did not realize the benefits promised by the "cheaper and faster" new report policy, finding the exact opposite to be true.

More importantly, the three bureau merge report failed in two other major areas. It assisted unscrupulous lenders to push some consumers into predatory lending programs, as well as assisting other consumers to obtain much larger loans than their true credit history would have otherwise allowed. These factors, combined with other ill fated lending practices that surfaced in the mortgage lending in recent years, combined to create the perfect storm that has contributed to the collapse of the housing finance industry that has crippled our entire economy.

Continued on reverse

The Recommended Solution

The solution to repair the foundation of the mortgage underwriting is not a complex one. We simply need to implement a mortgage credit reporting and underwriting process that blends the best of both worlds – specifically a system of reporting that allows for total automation when appropriate, but REQUIRES safeguards for the protection of both the consumer and the mortgage lender when there are signs in the consumer's credit profile that problems may exist.

The key to the solution is the REQUIREMENT for the lender to initiate an investigation and obtain a standardized explanation from the credit reporting agency who furnished the mortgage report after investigating the differences in the credit data when the credit scores vary by a significant factor. A "Mortgage Credit Reporting Agency" (or Reseller as defined in the FCRA) can investigate these discrepancies for accuracy in approximately 72 hours in most cases, allowing for a better lending decision to be made in a timely fashion when specific credit conditions warrant caution.

The first step in the solution is to access two of the three national credit repositories and average the two credit scores. When that average score is above the score level, pre-determined by the lender, at which consumers receive the best interest rate (we will use 700 as an average score for the best rate in this example), the lender proceeds with the totally automated report and lending process that is currently in place. Additionally if the average score is less than our 700 example, and the two credit scores creating the average have less than a 25 point difference between them (25 points is another example – the exact variance is yet to be determined) the lender proceeds as above only using a risk based pricing model as currently common practice in mortgage lending, or denies the loan if the risk is to great.

For all other credit situations that do not meet those criteria, those having an average score below the level of risk to the lender in which the lowest interest rate is offered, and difference in the credit scores is greater than 25 points, this is an application with questionable credit data variances that must be required to have some additional credit analysis. It is imperative for both the safety of the lending institution and the mortgage applicant that this application not be underwritten with questionable credit data.

This hybrid approach incorporates the best practices of the automated underwriting technology systems that revolutionized the mortgage process in the mid 1990's with the safeguards that protected the lending industry through previous recessions. If we don't learn from the mistakes that led to the crisis, we will surely have future problems based on more poor lending decisions.

More information about this subject will be provided for the record to the committee before the closing date for this hearing.

About NCRA

The National Credit Reporting Association, Inc. (NCRA) is a non-profit trade association founded in 1992 that represents the Consumer Reporting Industry and specifically "Mortgage Credit Reporting Agencies". NCRA represents approximately 80% of the Credit Reporting Agencies in the United States and Puerto Rico that produce specialized Mortgage Credit Reports as required by the Department of Housing and Urban Development, Fannie Mae and Freddie Mac for mortgage loan underwriting. NCRA members provide the mortgage lending community in excess of 4,000,000 mortgage credit reports per month.