Statement for the record
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For the

House Financial Services Subcommittee on Financial Institutions and Consumer Credit
Hearing Entitled: "An Overview of the Credit Reporting System"
September 10, 2014

Chairwoman Capito, Ranking Member Meeks, and Members of the Subcommittee on Financial Institutions and Consumer Credit:

Thank you for the opportunity to submit written testimony with regard to the September 10, 2014 hearing entitled "An Overview of the Credit Reporting System." The National Consumer Reporting Association (NCRA) has considerable expertise and interest in the issues before the Subcommittee and in how our nation's credit reporting system serves both consumers and financial institutions alike.

About the National Consumer Reporting Association

Founded in 1992, the National Consumer Reporting Association (NCRA) is a national trade organization of consumer reporting agencies and associated professionals that provide products and services to hundreds of thousands of mortgage lenders and property managers who use consumer reports for housing decisions.

Headquartered in suburban Chicago, NCRA's membership includes 70% of the mortgage credit reporting agencies in the United States that produce a credit report that meets the requirements of Fannie Mae, Freddie Mac, and HUD for mortgage lending.

NCRA's fastest growing membership category is tenant screening firms due to NCRA's focus on housing issues and the educational programs designed for multifamily housing needs. All NCRA members can obtain FCRA certification programs for both employees and their clients, the end-user of the consumer credit information. NCRA's end-user programs are specifically focused on supporting the needs of mortgage lenders and the multifamily housing industry. NCRA's Education and Compliance committee supports continuing education through NCRA's Annual Conference and regular webinars covering ever-changing industry dynamics. Additionally, NCRA offers educational materials in its weekly newsletter covering both mortgage and multifamily issues, along with a complete economic recap and forecast for the week ahead.

Credit Reports Used for America's Housing Market are Unique

At the outset, it is important to note that credit reports used for housing purposes differ from other types of credit reports. Data from one or more (Federal requirements mandate the use of all three national credit repositories' data in mortgage reports[1]) of the national credit repositories is included in a housing credit report; however, this is only part of the report.

Mortgage reports require the merging of data from all three repositories into one report as a minimum standard, and resident screening reports typically include other data sources not found in the national credit repositories. Property managers often require public record sources for evictions and criminal histories under HUD guidelines for housing assistance and in addition to local regulations for the promotion of safe rental housing. Credit reports for housing purposes also require a much higher level of customer service. Anxious renters or buyers, invested property managers or real estate agents, and the mortgage lender funding the transaction all demand higher levels of customer service than the benchmarks set by the Fair Credit Reporting Act (FCRA).

These differences may seem minor but actually are so significant that only one of the three national credit repositories offers mortgage credit reports on a retail level to the mortgage industry[2]. While all three national repositories have divisions that offer resident screening reports to the multifamily housing industry, there are about 300 other consumer reporting agencies that specialize in resident

[1] Fannie Mae's Single Family Selling Guide 9/24/2013 https://www.fanniemae.com/content/guide/sel092413.pdf
Freddie Mac's Single-Family Seller/Servicer Guide, Vol. 1; Chapter 37, 9/24/2013 http://www.freddiemac.com/sell/guide/
HUD 4155.1, Mortgage Credit Analysis for Mortgage Insurance, Section 4155.1 1.C.2b
http://www.hud.gov/offices/adm/hudclips/handbooks/hsgh/4155.1/41551HSGH.pdf

[2] Equifax via Equifax http://www.equifax.com/business/mortgage Trans Union and Experian have both been in the retail mortgage credit reporting industry previously, however neither are currently in the industry and have been out of the market for more than six years.

screening reports for the multifamily rental housing industry. NCRA has provided much more detailed information about these differences in the forward of the Suffolk University Law Review's special edition for the June, 2012 Credit Reporting and Score Symposium held in partnership with the National Consumer Law Center[3].

NCRA Supports H.R. 1767, The Medical Debt Responsibility Act

An issue debated in this Congress, as well as in both the 110th and 111th Congresses is the impact of paid medical collection accounts on a consumer's ability to obtain credit. Medical collection accounts can lower a consumer's credit score in most credit scoring models for up to seven years, even after the debt has been paid. This adverse impact hinders the consumer's ability to obtain reasonable interest rates, insurance rates, and other financial services. H.R.1767, The Medical Debt Responsibility Act, addresses this issue with a simple fix that requires the removal of medical debts from a consumer's credit history within 45 days of payment.

In May, 2014, the Consumer Financial Protection Bureau (CFPB) released a report that found consumers' credit scores may be overly penalized for medical debt that goes into collections and shows up on their credit report. According to the CFPB's study, credit scoring models may underestimate the creditworthiness of consumers who owe medical debt in collections. Many credit scoring models also may not be crediting consumers who repay medical debt that has gone to collections.[4]

NCRA members routinely witness the inflated negative impact of medical collections in America's credit reporting system and in the process of correcting consumer disputes on inaccurate medical collections for both mortgage loans and resident screening reports. We have supported legislation to resolve this issue in all three Congresses as we believe that medical debts are distinct from all other debts and therefore, should be treated differently for credit reporting purposes. Medical debt is not applied for like other traditional credit accounts as it stems from services required to support life, with the most extreme debts often incurred during extreme medical situations. We agree with CFPB Director Richard Cordray, who during the press conference announcing the CFPB study said, "Getting sick or injured can put all sorts of burdens on a family, including unexpected medical costs. Those costs should not be compounded by overly penalizing a consumer's credit score".[5]

[3] Suffolk University Law Review, Volume XLVI 2013 Number 3, Symposium – Credit Reporting and Credit Scoring, http://suffolklawreview.org/wp-content/uploads/2014/01/Clemans_Lead.pdf

[4] Consumer Financial Protection Bureau, CFPB Study Finds Medical Debt Overly Penalizes Consumer Credit Scores, May 20, 2014 http://www.consumerfinance.gov/newsroom/cfpb-study-finds-medical-debt-overly-penalizes-consumer-credit-scores/

[5] Ibid

Another problem related to medical debt is the complex and often dysfunctional billing process for medical services that frequently pins consumers between medical providers, medical billing companies, insurance companies, and collection agencies. NCRA members have heard from many consumers who had their credit reports harmed by medical collection accounts that had not been previously billed to the consumer. Other consumers have had medical collection accounts harm their credit reports that were ultimately paid by insurance companies, but not until after the collection was placed on their report. Due to all of these factors, we support the proposal that medical collection accounts be recognized for this difference and treated differently than all other collection accounts in the FCRA.

A solution to this problem would be to pass H.R.1767, which requires medical collections to be removed from a consumer's credit history within 45 days after being satisfied so the collection can no longer be a part of their credit profile and impact credit scores. It is a simple, reasonable bill that costs the Federal government nothing and is supported by many major industry groups and leading consumer advocacy groups[6].

Also relevant to the issue of medical debt, in August 2014, credit score giant FICO® released its latest credit score model, 9.0[7]. One of the most positive features of this new score is FICO®'s change with regard to calculation of medical collections, greatly reducing the potential negative impact on consumers. While the media noted all of the improvements associated with the expected changes this new credit score model will bring to consumers with respect to medical collection accounts, it is important to note that it will be some time before consumers experience its beneficial impact. As noted in numerous articles, it takes time for lenders to incorporate new score models into their underwriting, if they choose to make the change to the new score model at all.

With respect to the mortgage market, positive impacts of FICO® 9.0 likely will take even longer to implement. The mortgage lending market changes only as quickly as Fannie Mae/Freddie Mac and HUD allow underwriting changes, and these entities historically has been very slow to act. Since these agencies dictate which credit score models are accepted, it realistically could be years before they are implemented.[8]

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[6] Coalition letter to Senator Tim Johnson and Michael Crapo regarding S. 160, May 13, 2013, https://www.sendspace.com/pro/dl/hz2d9n

[7] FICO Press Release, FICO Score 9 Introduces Refined Analysis of Medical Collections August 7, 2014 http://www.fico.com/en/about-us/newsroom/news-releases/fico-score-9-introduces-refined-analysis-medical-collections/

[8] Washington Post, August 22, 2014 New FICO model could raise scores, but it may not help homebuyers anytime soon, Ken Harney http://www.washingtonpost.com/realestate/new-fico-model-could-raise-scores-but-it-may-not-help- home-buyers-anytime-soon/2014/08/20/1828cf60-2705-11e4-958c-268a320a60ce_story.html

The current score models required by Fannie/Freddie/HUD are: Equifax Beacon® 5.0; Experian®/Fair Isaac Risk Model V2SM; and TransUnion FICO® Risk Score, Classic 04[9]. Each of these score models have been replaced by two to three generations of credit scores by both FICO and the credit score model owned by the three national credit bureaus, VantageScore. The current models required for mortgage lending are based on consumer spending habits from the 2004 – 2005 pre-financial crisis era, which have very distinct differences from the post-financial crisis consumer spending patterns of today.

With regard to the multifamily rental housing market, even greater numbers of Americans are negatively impacted by medical debt issues than in the mortgage marketplace. In 2009, about 35% of the US population lived in rental housing vs. owned homes[10]. Since renters are five times more likely to move than are homeowners,[11] each year millions more American families are hindered in their attempts to obtain fairly priced rental housing due to the widespread use of older credit scoring models in the multifamily industry.

NCRA believes that the changes in FICO® 9.0 represent significant improvements and recommends their immediate implementation. At the same time, NCRA understands that without regulation or legislation some lenders may never adopt the new model and some consumers will never realize the benefits of these important changes.

Another longtime NCRA issue addressed in FICO 9.0 is that of allowing rental payments to be factored into credit decisions. Rarely are the rental payments included in the credit history of consumers, and until FICO® 9.0, if the information was presented there was no methodology in the main FICO® credit scoring models for it to be calculated.

Having included these major changes in FICO® 9.0 the FICO® score will move closer in calculation to the VantageScore treatment of collections and rental payments. Because many lenders have moved to the VantageScore for credit card and other non-mortgage credit decisions,

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[9] Fannie Mae's Single Family Selling Guide September 24, 2013
https://www.fanniemae.com/content/guide/sel092413.pdf
Freddie Mac's Single-Family Seller/Servicer Guide, Vol. 1; Chapter 37, September 24, 2013
http://www.freddiemac.com/sell/guide/
HUD 4155.1, Mortgage Credit Analysis for Mortgage Insurance,
http://www.hud.gov/offices/adm/hudclips/handbooks/hsgh/4155.1/41551HSGH.pdf

[10] National Multifamily Housing Council, Quick Facts: Resident Demographics, NMHC tabulations of 2013 Current Population Survey, Annual Social and Economic Supplement, U.S. Census Bureau (http://www.census.gov/cps). Updated October 2013 http://www.nmhc.org/Content.aspx?id=4708

[11] U.S. Census Bureau Reports, May 10, 2010 Residents Move at Higher Rate in 2009 After Record Low in 2008
http://www.census.gov/newsroom/releases/archives/mobility_of_the_population/cb10-67.html

these are not radical changes and need to be embraced as soon as possible by all sectors of the lending community.

The Credit Report Post Financial Crisis

One of the results of the 2008 financial crisis is that mortgage lending standards are now very tight, allowing only those borrowers with the very good credit access to the mortgage loans.[12]
With the QM and QRM regulations in effect, the tight credit market is not likely to improve soon as many lenders are reluctant to lend outside of the "Qualified" standards due to the additional risk. Claims of redlining, and concerns about fair access to mortgage loans are increasing.[13] Concerns about the accuracy of the data in the credit reporting system has been studied with troubling findings by the Federal Trade Commission (FTC), which reported that 20% of consumer credit reports contain errors[14]. This has the most severe impact on consumers on the border of credit worthiness, where concerns of Disparate Impact bring added problems to the recovery of the housing market.

There needs to be improvements in the system that provides consumers an opportunity to have their true credit risks analyzed. The system currently being used to underwrite mortgage loans remains unchanged (with the exception of higher credit score requirements) from that which allowed for all of the loans that failed leading up to the 2008 mortgage crisis. A solution is needed to evaluate consumers on the fringe of the QM and QRM approval before they are sent into the much higher cost Non-QM and QRM loans. Such a solution would provide a mechanism for documenting a consumer's full credit accounts history and for verifying questionable data that is now being used regardless of warning signs of potential errors and omissions on the reports.

The current automated underwriting systems in place encourage lenders to ignore the warning signs, and can punish those who seek corrections via added costs and risk overlays. Loans needing to include non-traditional credit accounts[15] or numerous corrections to serious credit reporting

[12] USA Today Money, September 14, 2011, Tight standards make mortgage tough to get, Julie Schmit, http://usatoday30.usatoday.com/money/economy/housing/story/2011-09-15/mortgages-tough-to-get/50405698/1
[13] National Mortgage News, September 8, 2014 Here Come the Redlining Investigations, Ari Karen, http://www.nationalmortgagenews.com/blogs/hearing/here-come-redlining-investigations-1042565-1.html?utm_medium=email&ET=nationalmortgage%3Ae4000903%3Aa%3A&utm_campaign=-sep%208%202014&utm_source=newsletter&st=email
[14] Federal Trade Commission, December 2012, Report to Congress Under Section 319 of the Fair and Accurate Credit Transactions Act of 2003, http://www.ftc.gov/sites/default/files/documents/reports/section-319-fair-and-accurate-credit-transactions-act-2003-fifth-interim-federal-trade-commission/130211factareport.pdf
[15] Fannie Mae Selling Guide, August 26, 2014 B3-5.4-01 Non-traditional credit reports https://www.fanniemae.com/content/guide/selling/b3/5.4/01.html

issues often get "referred" by the automated underwriting systems requiring a "manual underwrite" to override the automated decision. This means higher costs and tougher underwriting guidelines and many lenders refuse to fund loans under these conditions[16]. While discussing these topics it is imperative to understand that this must be done with lending safety in mind, avoiding a repeat of the pre-crisis lending practices, some of which are already resurfacing[17].

The solution to these issues is technologically feasible and not far away. It comes from the only participant in the mortgage industry best suited at documenting consumer credit data on a conflict free basis without regard to the outcome of the loan; the mortgage credit reporting agency. Their only concern is for completeness and accuracy of the report to limit the legal liability they hold to both the consumer the report is about and the lender who hired them. The solution is a new report type, the "QMCR – the Qualified Mortgage Credit Report" and a "QMCR Score." This report and score would provide a deeper review on the consumer's credit than what is currently being performed, only when a formula to detect credit concerns is triggered. The QMCR would include verifying disputed data and the inclusion of non-traditional or alternative data not currently being reported to the credit repositories. This report should be required by the Federal Housing Finance Agency and HUD to be built from the current tri-merged mortgage credit report, when the consumer's specific credit history contains the following criteria:

- A middle credit score less than the lowest allowed for the lender's best rate, and
- A greater than 25 point spread between the high and low scores.

In the current mortgage underwriting process, the middle credit score is the most important as it is used to price the loan by the lenders. If that score is more than the score level pre-determined by the lender at which consumers receive the best interest rate (we will use 720 as the score required for the best rate in this example), the lender proceeds with the current credit reporting process without change. If the middle score is less than our 720 example, and the other two credit scores not used in the pricing of the loan (the high and low of the three scores) have less than a 25 point difference between them, the lender again proceeds as before using a risk based pricing model that is currently a standard practice in mortgage lending. However, when those high and low scores have more than a 25 point spread, the lender would be ***required*** to add the QMCR to the current process.

[16] Bigger Pockets, February 24, 2014, What is a "manual underwrite" loan, http://www.biggerpockets.com/blogs/4790/blog_posts/35026-what-is-a-manual-underwrite-mortgage-loan
[17] Forbes Real Estate, March 5, 2014 Subprime Rising, Mark Greene, http://www.forbes.com/sites/markgreene/2014/03/05/subprime-rising/

This change occurs only when the consumer's specific credit situations warrant an additional credit review. The consumer's credit risk does not allow them to qualify for the lender's best interest rate for the loan, and the difference between the high and low credit scores is greater than a typical risk based pricing tier, 25 points, signaling a difference in the credit data worthy of a review for accuracy due to the added risk. After perpetration of the QMCR and the QMCR Score (about three business days) the loan could be sent back through the automated underwriting system for consideration of inclusion as a "qualified" loan for approval. It is imperative for both the safety of the lending institution and the mortgage applicant that this application is not underwritten with questionable credit data, potential missing accounts that could skew debt to income rations.

Many features of the QMCR would be similar to the time tested and proven RMCR requirements that are still claimed to produce the best quality credit reports[18], but require manual underwriting by the GSEs. The new QMCR and related score would allow for automated underwriting and include a summary of the derogatory data on the consumer report for an added value of both accuracy and financial literacy. The summary would also include a statement about the disclosure of all creditors, even those not being reported to the national credit repositories and the legal responsibility and benefit of reporting them to the mortgage consumer reporting agency. Features like this would provide added anti-fraud benefits allowing both lenders and the mortgage insurers to issue safer loans.

The QMCR and QMCR Score is a hybrid approach that incorporates the evaluation of more than 40 years of mortgage credit reporting processes to include 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 for decades.

America is now six years past the housing crisis, and the nation's housing market is still struggling to recover. It clearly is time to improve the process that provides one of the most critical documents in mortgage lending decisions. This hearing today is a positive step in that direction, but Congress and all the stakeholders must be willing to engage more fully in these issues to ensure that we do not continue to repeat the same mistakes that led to the economic crisis and housing market collapse.

Conclusion

[18] Corelogic, (the largest non-national credit repository consumer reporting agency) as well as many other consumer reporting agencies make claims similar to this one…"The Residential Mortgage Credit Report (RMCR) from CoreLogic Credco is our most comprehensive and complete mortgage credit report. Meeting or exceeding Fannie Mae, Freddie Mac, HUD and industry standards, it's the ideal mortgage credit report for complex credit histories that require verification of four or more items." http://www.corelogic.com/products/residential-mortgage-credit-report-rmcr.aspx

NCRA thanks the Subcommittee for its interest in the nation's credit reporting system. We also appreciate the opportunity to weigh in on important credit reporting issues, including the treatment of medical debt in consumer credit reports and scores, the importance of timely enactment of improvements to major credit scoring systems like FICO 9.0®, and finally the Qualified Mortgage Credit Report and Score, a solution to provide greater transparency in mortgage lending to both consumers and lenders. NCRA welcomes any questions or additional interest in the proposals detailed above. For such a discussion, please contact NCRA's Executive Director, Terry Clemans, at tclemans@ncrainc.org or via phone at 603-539-1525.