March 24, 2005

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

RE: FACT Act Scores Study

Dear Sir or Madam,

I am writing in response to your solicitation for comments on the use and impact of credit scores. Although my comments are written as a private citizen, my professional experience includes over 20 years in various positions in the financial services and mortgage banking industry with over 14 years dedicated to regulatory compliance and risk management. Over the course of my career, I have witnessed an evolutionary transformation in the credit industry largely influenced by the advent of credit scores and the credit reporting industry as a whole, in both the origination and servicing sectors. The result of these changes has been both positive and negative.

Use of Credit Scores in Automated Underwriting. In the consumer and residential mortgage industry, automated underwriting is becoming the norm and is gaining momentum in the commercial market as well. Scoring models are built into automated decision *engines* for borrower qualification, product-fit, and pricing. Conversely, traditional manual underwriting is becoming a thing of the past and is quickly being replaced by these *decision-engines* in even the smallest of institutions to meet the competitive demand for instant response and loan production volume. Although automated underwriting using predictive scoring models has greatly increased efficiency and profitability, there remains a question as to whether any of the savings has been passed on to the consumer.

Impact in Sub Prime Mortgage Market. *Low-doc* and *no-doc* loan programs in the sub-prime residential mortgage market are widespread. Meaning, borrower's are instantly qualified and priced into the appropriate product based on two primary numerical factors: a tri-merged FICO score and a loan-to-value ratio.

There is often no documentation or verification of the borrower's income, employment, debt-to-income service ratio, residence, or even identity. While this approach to underwriting provides greater access to less creditworthy applicants who are willing to pay the price through risk-based pricing models, it has also increased the number of identity thefts, bankruptcies, delinquencies, charge offs, and mortgage foreclosures.[1] Investors who securitize these mortgages are also willing to accept higher default and foreclosure rates through

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[1] As evidenced by the recent study of mortgage foreclosure filings in Pennsylvania conducted by the *Reinvestment Fund for the Pennsylvania Department of Banking* that investigated a sharp increase in the number of foreclosures in certain Pennsylvania counties and its disproportionate effect on moderate income and minority neighborhoods.

the use of risk-based pricing models that are based, in part, on the analytics of FICO scores at both the transaction and portfolio level.

Credit Scores and Accuracy of Consumer Data. Although the broad use of scoring models may be statistically sound and empirically derived based on the colossal range of data *available* in addition to the complex analytics used in the process, my experience tells me that the credit reporting agencies have not yet accomplished a high degree of accuracy in the data that is being supplied to them by the credit reporters. This data becomes the basis for the score and therefore influences the credit decision and, ultimately, the price that the consumer will pay.

In its solicitation for public comments concerning the FACTA Identity Theft Rule in 2004, the Commission received numerous letters from industry experts expressing concern about the ability of unscrupulous people and organizations to manipulate credit reports by exploiting the protections afforded under the FCRA and FACTA. The ability to delete negative but *accurate* information from consumer reports has a direct correlation on the numerical credit score that is routinely used to make credit decisions. The ability of consumers to artificially inflate their credit score by abusing the dispute process will lead to the deterioration of the integrity of consumer reports and the scores that are relied upon in making automated and manual underwriting decisions. This not only increases the cost of credit as less creditworthy borrowers are approved and inappropriately priced for the true risk, but this will continue to compromise the safety and soundness of financial institutions.

Credit Scores in Mortgage Servicing. Credit scores are also widely used as a predictive tool by rating agencies, investors, and mortgage servicing companies to determine the potential loss ratios for individual mortgage portfolios. In addition, credit scores have been used as one of the many variables used to by investors to establish the risk rating and price for mortgage portfolios, and a loan servicer's performance may be gauged through the evaluation of the average FICO score that is rising or falling over a period of time in a particular loan portfolio.

It is also not uncommon for mortgage servicers to determine what work out options is offered to the borrower based on a credit score. If a borrower's credit score is in the low 500's due to chronic delinquency and default on other obligations, it is unlikely that any long term work out arrangement granted by the loan servicer will be honored.

Impact on Default and Foreclosures. The Commission's request for comment poses a question (#7) as to whether the use of credit scores has impacted default rates of mortgages and whether the effects have been estimated and *reported*. The answer to the first part of the question is a definitive ***yes***…the use of credit scores *has* had a direct impact on default rates for the reasons described above.

Rubber-stamped approval of an applicant with a blemished credit or an unreliable income stream that is primarily based on a credit score that has been artificially inflated combined with an overstated property value resulting from rampant appraisal fraud has a direct effect on default rates and foreclosures – not to mention on the financial performance of mortgage-backed securities.

The answer to the second part of the question as to whether this effect has been estimated and reported…the answer is ***no***. To whom does the Commission think these statistics and facts are reported? Particularly in the sub prime market where there is no government-sponsored entity, such as Fannie Mae or Freddie Mac, controlling the quality of origination and servicing standards.

The increase in default and mortgage foreclosures has been examined and blamed on a number of both factual and emotional reasons, including alleged *predatory servicing practices*. The fact is, credit is increasingly extended to individuals who either purposely obtains credit devoid of intention to repay or who lack basic financial management and budgeting skills, and to individuals who are unable to handle the responsibilities of homeownership. These individuals are extended credit through automated and instant decisioning systems that use credit scores and other collateral value calculations without any regard to the consumer's true intent or ability to repay.

I appreciate the opportunity to comment on this important issue. It is my hope that the Commission will continue to work toward a credit reporting system that will protect the rights of consumers providing non-discriminatory access to credit and protections against identity theft while ensuring that the protections are not abused to manipulate negative but accurate information that will render consumer reports and credit scores inaccurate and therefore less predictive.

Sincerely,

Robbie Frye
Certified Regulatory Compliance Manager