475 Anton Blvd.
Costa Mesa, CA 92626

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, NW
Washington, DC 20551

Attention: Docket No. OP-1278

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 1-5
Washington, DC 20219

Attention: Docket No. OCC-2007-0005

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Attention: Comments, FDIC

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Attention: Docket No. 2007-09

Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Attention: Experian's Comments Regarding Proposed Statement on Subprime Mortgage Lending

Re: Proposed Statement on Subprime Mortgage Lending (72 Fed. Reg. 45, 10533 March 8, 2007)

Ladies and Gentlemen:

Experian would like to thank the agencies for the opportunity to comment on this Proposed Statement on Subprime Mortgage Lending. At this tumultuous time in the subprime marketplace, we commend the Agencies' efforts to approach any regulation in a timely and thoughtful manner. At this time, we respectfully submit the following comments:

- *Update Subprime Lending Guidance to Encompass All Scoring Models-* As written in the 2001 Expanded Guidance for Subprime Lending, and referred to in the current Proposed

Statement, the definition of subprime has consistently referred to a single FICO scoring model that does not represent the full range of scoring options available, or necessarily the best scoring option for subprime consumers. A new statement on subprime mortgage lending should correct this long-standing problem, which appears to endorse one model over others.

- *Lenders Should be Using Scoring Models Tailored to Controlling Risk in the Subprime Market* – New technology has led to more precise scoring models in the subprime market. Credit scoring models designed specifically for subprime consumers can provide lenders with a reduced level of risk, and open up new capital for qualified subprime borrowers.
- *Use of Alternative Data Could Help Many Emerging Consumers* – Encouraging utility and telecommunications providers to share payment history information with the credit bureaus would help many emerging consumers to gain access to affordable credit.

Proposed Guidelines Should Be Expanded to Include All Scoring Models

Any proposed guidelines should be expanded to include all possible scoring models that could be used to score subprime borrowers. As currently defined in the Agencies 2001 Expanded Guidance for Subprime Lending, a key characteristic of a "subprime" borrower is a borrower with a FICO score of 660 or below.[1] Experian-Scorex (wholly owned by Experian), has commented on this specific reference to use of a FICO score as a subprime characteristic.[2]

We believe that the reference to a FICO score has had the unintended consequence of causing many lending institutions to believe that the Agencies' reference to the FICO score meant that only the use of a FICO score would meet regulatory requirements. This misperception, although unintentional, has led to the rise of unfair barriers to market competition and is detrimental to consumers and lending institutions alike.

While the Agencies made it clear that they did not endorse any particular scoring model[3] this lingering reference to the use of a FICO score has proven to be a detriment to other credit scoring models that could provide competition to FICO, and that could also prove to be superior in scoring subprime consumers.

In the current Proposed Statement on Subprime Mortgage Lending, the definition of "subprime"[4] continues to refer to the definition provided in the 2001 Expanded Guidance for Subprime

[1] On page 3 of the 2001 Expanded Guidance for Subprime Lending, a subprime borrower was defined as one that will display a list of risk characteristics, including "a credit bureau risk score (FICO) of 660 or below."

[2] In a letter dated 01/24//05, Experian-Scorex President Walt Ramsey addressed this issue in correspondence to the FFIEC, the Federal Reserve Board, the FDIC and the OCC.

[3] In a letter dated 03/17/05 to Experian-Scorex President Walt Ramsey, the Agencies stated that they "do not endorse any particular scoring model" and "financial institutions should conduct appropriate due diligence when selecting analytical tools used to measure, monitor, and manage credit risk."

[4] 72 Fed. Reg. 45, 10534, Part II, Line 4.

Lending. We would ask that this definition be amended to reflect the original intention of the Agencies, in that one credit risk characteristic of a subprime borrower would include a "relatively high default probability as evidenced by, for example, a credit risk score which indicates a high default probability," omitting any reference to a particular credit scoring model or cut-off range.

Advances in scoring technology have continued to increase the effectiveness of credit bureau scoring in predicting risk. Unfortunately, the Agencies' unintentional inclusion of the "FICO 660" reference has led many lenders to believe that this is the only acceptable score that meets regulatory requirements, and has inhibited further competition in the credit scoring market.

Lenders Should be Using Scoring Models Tailored to Controlling Risk in the Subprime Market

In scoring subprime borrowers, the traditional "one-size-fits-all" credit scoring model is neither appropriate nor an accurate reflection of a borrower's creditworthiness. Advances in credit scoring technology have led to new scoring models that can accurately score more "thin-file" borrowers, oftentimes moving such borrowers from the subprime to prime categories.

While exact statistics are difficult to obtain, the general industry consensus is that there are as many as 35 to 50 million Americans who do not have enough information in their credit histories to make them scoreable in most credit reporting models. These are oftentimes individuals that do not have lengthy credit histories for various reasons, including: they could be newly arrived immigrants, recently divorced individuals who did not have credit in their own name, young adults starting out new careers or even people who traditionally have chosen to manage their finances on a cash-only basis. Contrary to popular perception, these are not individuals with blemished credit histories, they are simply individuals with little credit history.

One question posed in the Proposed Statement has been whether or not the proposed qualification standards are likely to result in fewer borrowers qualifying for the type of subprime loans addressed in the Statement.[5] If lenders were encouraged to use scoring models more suited for specifically scoring "subprime" borrowers, many former "subprime" borrowers would likely qualify for prime rates.

If substandard lending practices at the loan origination level are truly the crux of the current foreclosure crisis, then encouraging lenders to use scoring models more suited for their borrowers would be the first step in preventing future foreclosures.

Use of Alternative Data Could Help Many "Emerging" Consumers

New credit scoring models have the ability to incorporate previously unavailable data such as utilities and telecommunications payment histories. These kinds of data-intensive scoring models could help move millions of Americans who have been routinely categorized as subprime

[5] 72 Fed. Reg. 45, 10536, Part III, Question 1.

borrowers into mainstream borrowers, making them eligible for less risky products and repayment terms.

A recent study by the Brookings Institution's Urban Markets Initiative found that those outside the credit mainstream (a category into which many subprime borrowers fall) have similar risk profiles as those in the mainstream when including nontraditional data in credit assessments.[6] The same study also found that minorities and the poor benefit the most from the inclusion of nontraditional data sources. In the same study, research showed that using VantageScore and including utility payment data produced a greater lift in scoring previously unscoreable consumers.[7]

About VantageScore

VantageScore is an innovative consumer credit risk score developed by the nation's three largest credit reporting companies, Experian, Equifax and TransUnion. VantageScore reduces credit score variances between the three bureaus by using a constant scoring methodology, producing one consistent score. In addition to providing much-needed consistency, VantageScore has proven to be particularly valuable in producing an accurate score for "emerging" consumers, which includes persons who are establishing credit for the first time, and infrequent credit users.

Consumers with these credit characteristics often fall into the "subprime" category, and subsequently receive higher interest rates and terms than prime consumers. However, in a recent study conducted by Experian[8], using VantageScore to score so-called "subprime" consumers resulted in a significant lift in moving formerly subprime consumers into prime lending categories.

VantageScore is proving to be a successful way of improving accuracy in scoring consumers. Due to its unique scoring methodology, VantageScore is able to effectively score consumers with little credit history or dormant credit activity. Additionally, VantageScore employs a unique segmentation approach that allows lenders the opportunity to refine their risk management strategies for the lower score ranges, while at the same time avoiding a risk policy that is too narrow in its approach and shuts out otherwise good credit risks.[9]

Conclusion

We would like to thank the Agencies for the opportunity to comment on the Proposed Statement on Subprime Mortgage Lending. We understand, and share, the Agencies' goal of ensuring that

[6] *Give Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit When Using Alternative Data* by Michael A. Turner, Alyssa Stewart Lee, Ann Schnare, Robin Varghese, and Patrick D. Walker, December 2006 (http://www.brookings.edu/metro/umi/pubs/20061218_givecredit.htm).
[7] Id., page 25.
[8] See attached, "VantageScore Addresses Deficiencies in Traditional Scores in the Subprime Consumer Sector."
[9] In attached study, Experian found that while analyzing subprime mortgage consumers using VantageScore vs. a traditional credit score model, approximately 20 percent of those consumers originally classified as subprime were re-classified into lower risk categories using VantageScore.

American consumers have access to credit opportunities, while at the same time maintaining vigilance against unscrupulous lenders.

We strongly believe that credit scoring technology has advanced to a point where potential borrowers can be more accurately scored, and new credit opportunities can open up when borrowers are scored using the proper model. We ask that the Agencies encourage lenders, rating agencies and the securitization market to embrace these new credit scoring models designed for “subprime” borrowers, both to help control risk in the marketplace, and to open up new credit opportunities for the millions of Americans who deserve them.

Sincerely,

Gary Kearns,
President, Experian-Scorex

experian®

VantageScore℠ addresses deficiencies in traditional scores in the subprime consumer sector

White paper

Overview

Over the past six years, the U.S. credit market has experienced a large increase in consumer debt, growing from $6.9 trillion to $12.8 trillion. This dramatic rise has been driven largely by mortgage and home equity financing, which grew by $4.9 trillion dollars over the same period, an increase of more than 100 percent from year-end 2000 to year-end 2006.

During this time, credit grantors have sought innovative ways to continue to grow market share — in large part by attracting and acquiring a broader array of consumers. The strong growth in mortgage lending within the subprime consumer sector illustrates this point. From the first quarter of 2003 to the fourth quarter of 2006, the subprime sector realized a 60 percent increase in new mortgage originations.

As subprime lending has grown more prevalent, it has become clear that new scoring tools are required to create a more granular view of a creditworthy and viable population. The necessity for credit risk scores that more accurately predict risk across the consumer base using advanced segmentation techniques has become increasingly evident as the lending market slows and delinquencies increase, specifically on debt associated with consumers in the subprime risk sector. These consumers are classified as those within the lowest-scoring intervals — typically the bottom 20 percent scored —using the Experian Risk Score .

Historical methodologies employed in traditional credit risk score development have characteristically impacted the subprime consumer sector in three specific ways:

- **Scoreability:** Consumers with very little credit history or dormant credit activity were excluded from the "scoreable" population. This function of the traditional credit risk score precluded lenders from visibility to the entire subprime population while increasing the size of a consumer segment that had been limited in its access to the credit markets.
- **Accurate risk assessment:** Traditional credit risk model development methodologies typically classified consumers into a subprime risk segment using historical delinquent and derogatory payment behaviors as a key indicator of future payment behaviors, thereby eliminating the ability to separate relatively low-risk subprime candidates from the relatively high-risk subprime candidates (i.e., consumers who are most likely to drive delinquency and bad debt in the portfolio).
- **True score representation:** There is a portion of subprime credit seekers who are manipulating, or "gaming," the traditional credit risk model methodologies for access to credit otherwise unavailable to them. Traditional credit risk models do not suppress authorized user tradelines (i.e., a consumer added to the account of a cardholder as a user). A subset of low-score or no-score consumers are using this loophole to artificially present themselves to credit grantors as prime prospects. This group of consumers is gaining access to increased credit extension amounts and favorable rates when, in fact, their risk score without these authorized user trades would suggest a higher-risk profile. This aspect of traditional credit risk scores is creating a cottage industry on the Internet and an opportunity for "would-be" credit gamers, increasing the risk in the lending portfolios of financial institutions. While this practice is not illegal, its manipulative and exploitive undertones are concerning and may be best categorized as abuse that borderlines fraudulent behavior.

The development and launch of VantageScore℠ in March 2006 provided the opportunity to address the challenges posed by historical credit risk score methodologies. This paper details the findings of a recent study by Experian® that examined the impact of VantageScore in the subprime mortgage consumer segment in each of these three areas. Specifically, it demonstrates how VantageScore can expand the universe of

[1] According to the Federal Reserve Bureau of Statistics Z.1 report released March 8, 2007
[2] Data for comparison with VantageScore℠ was derived from or is representative of Experian's National Risk Model. The terms "Experian Risk Score," "traditional credit risk score" or "traditional credit risk model" are used to refer to this Experian proprietary model and data representative of its performance.

creditworthy and viable consumers, improve risk assessment through more granular separation of creditworthiness across the subprime consumer segment, and minimize new risks that are emerging in today's online economy by excluding authorized users from credit risk score calculations.

I. Universe expansion with VantageScore

Organic growth through new account acquisition is a key goal to maintaining financial institution health and overall return on equity to the organization. Ensuring that the pool of consumers being targeted for a specific lending facility balances the business objectives of maximum approval rates while managing to acceptable bad debt is the cornerstone of every institution. However, with the use of traditional credit risk scores, lenders have been limited in their ability to see the full array of consumer prospects available for marketing purposes, specifically as it relates to emerging consumers or those with very little credit history. To overcome these limitations, VantageScore was developed using an analytical approach that provides lenders with access to a larger pool of scoreable consumers to market to while maintaining accuracy in risk assessment. VantageScore provides predictive and accurate scoring of a consumer population previously unscoreable under traditional credit risk scoring models, thus expanding the universe of scoreable consumers.

Experian analysis findings

To determine the implications of the use of VantageScore for universe expansion purposes, Experian® conducted an analysis using a random sample of subprime mortgage consumers from Experian's master file of consumer credit data, File One.℠ The analysis held the bad rate, defined as 90 days or more past due on the mortgage tradeline, constant for each scoreable population within a defined score interval.

The following table illustrates the lift in scoreable consumers using VantageScore over traditional credit risk scoring models that have exclusion criteria that typically left between 5 percent and 10 percent of the overall population without a valid score — largely due to their status as "thin" file or inactive credit file consumers — and up to 20 percent of the subprime consumer population without a valid score.

Population of consumers with a mortgage tradeline and valid risk scores

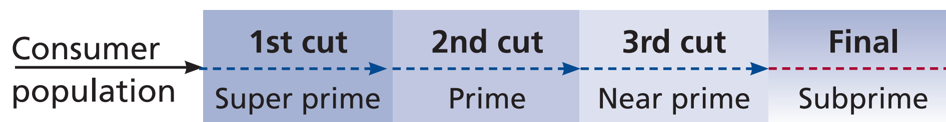
	Experian Risk Score score intervals	VantageScore scored population	Experian Risk Score scored population	Lift in percent scored
	< 840	37,200,879	35,650,730	4.3%
	< 710	20,770,817	19,222,143	8.1%
	< 690	18,905,850	17,361,704	8.9%
	< 675	16,443,381	14,992,740	9.7%
	< 660	14,743,723	13,403,763	10.0%
	< 645	13,008,548	11,738,798	10.8%
Subprime {	< 620	37,200,879	10,746,894	11.4%
	Total	**133,041,358**	**123,116,772**	**8.1%**

While the overall lift in scored consumers using VantageScore versus traditional credit risk scoring tools, keeping delinquency rates constant for the population in each score interval and below, is at 8.1 percent, the lift in the subprime score interval increased to more than 11 percent.

Although risk tolerance is different for every lending institution, the analysis clearly identifies the opportunity to score and subsequently lend to a larger consumer population while keeping risk to an acceptable level within lenders' credit policies. Furthermore, it should be noted that additional consumers are being scored in the higher score intervals, allowing for consumers who were initially considered high risk to be more accurately assessed as more conventional borrowers.

As shown below, the innovative attribute and score-based segmentation approach provides substantial focus on all consumer credit profiles, including the subprime sector. Narrow credit policies have the potential for negative impact on the portfolio, either through customer attrition from adverse account treatment (high fees/low line extensions) or from discounting the portfolio too deeply for secondary market consumption.

How traditional credit policy segmentation works today



II. Improved risk assessment — more granular segmentation of subprime consumers with VantageScore

Lenders who regularly rescore their existing customers do so to assess the risk to the overall portfolio based on the score distributions of every score refresh cycle. As such, policies regarding risk and loss management are defined using the score value as well as some additional attributes and behavioral elements. That subset of the portfolio deemed subprime, using traditional credit risk scores, groups all consumers into one classification, traditionally high-risk. However, in reality there are clear opportunities to segment relatively low-risk subprime consumers in these lower scoring ranges from relatively high-risk subprime consumers to allow for a more granular view of the population as well as migrate a portion of this segment out of the traditionally defined subprime grouping.

The segmentation approach used in the development of VantageScore provides lenders with the opportunity to refine risk-management strategies for the lower score ranges in their portfolio and to avoid a risk policy that is too narrow in its approach (For additional information, see white paper titled "Segmentation for Credit Based Delinquency Models" on www.vantagescore.com).

The population remaining after initial scoring cuts are made is somewhat homogeneous when using traditional credit risk models because of the way historical methodologies defined delinquent consumer behaviors and incorporated them into the final algorithm. VantageScore changes the way consumer behaviors are weighted in a credit risk model and provide a more refined separation of consumers in lower score intervals. This allows lenders to identify pockets of relatively low-risk subprime consumers over those subprime consumers who will eventually drive increased loss rates.

Experian analysis findings

To better understand the implications and opportunities in the subprime consumer segment leveraging the new segmentation techniques employed in the development of VantageScore, a sample of subprime consumers with a mortgage tradeline was analyzed to determine where lift existed in separating lower-risk accounts from higher-risk accounts. For comparison purposes, Experian's traditional credit risk score was used as the contrast score in the analysis.

When the analysis isolated consumers who were initially classified as subprime using the Experian traditional credit risk score, VantageScore provided additional separation of those consumers who had lower bad rates — defined as 60 days past due or worse on the mortgage trade — or could be

classified as "good" subprime consumers over the traditional risk model. This new scoring tool provides lenders with an opportunity for fine-tuning a policy that may have previously treated an entire portion of the portfolio in the same manner but now can be segmented for different risk-management practices.

The following tables highlight the clumping and inconsistent rank-ordering of delinquent or "bad" accounts associated with subprime consumers using a traditional credit risk score versus the relatively monotonic distribution of bad accounts with VantageScore. The stronger rank-ordering of accounts is attributed to the segmentation techniques used in the development of VantageScore and demonstrates the intrinsic benefits of changing the way this consumer segment is scored and assessed for risk. It is especially interesting to note that approximately 20 percent of those consumers originally classified as subprime using Experian's traditionally developed credit risk score now are classified into lower-risk categories using VantageScore.

Subprime population percentages and bad rates

Experian Risk Score — Kolmogorov-Smirnov statistic (KS) = 11.2

Subprime consumers

Percent total	Percent bad	Interval bad rate	Cumulative bad rate
10.0%	9.9%	9.8%	9.8%
22.0%	17.8%	6.8%	8.2%
32.0%	25.5%	8.0%	8.1%
41.0%	34.1%	9.3%	8.4%
51.0%	41.3%	7.5%	8.2%
60.0%	52.1%	12.0%	8.8%
71.0%	63.2%	10.0%	9.0%
80.0%	73.9%	12.0%	9.3%
90.0%	100%	14.0%	10.0%
100.0%	**100.0%**	**14.0%**	**10.0%**

Subprime

VantageScore — KS = 15.7

Subprime consumers

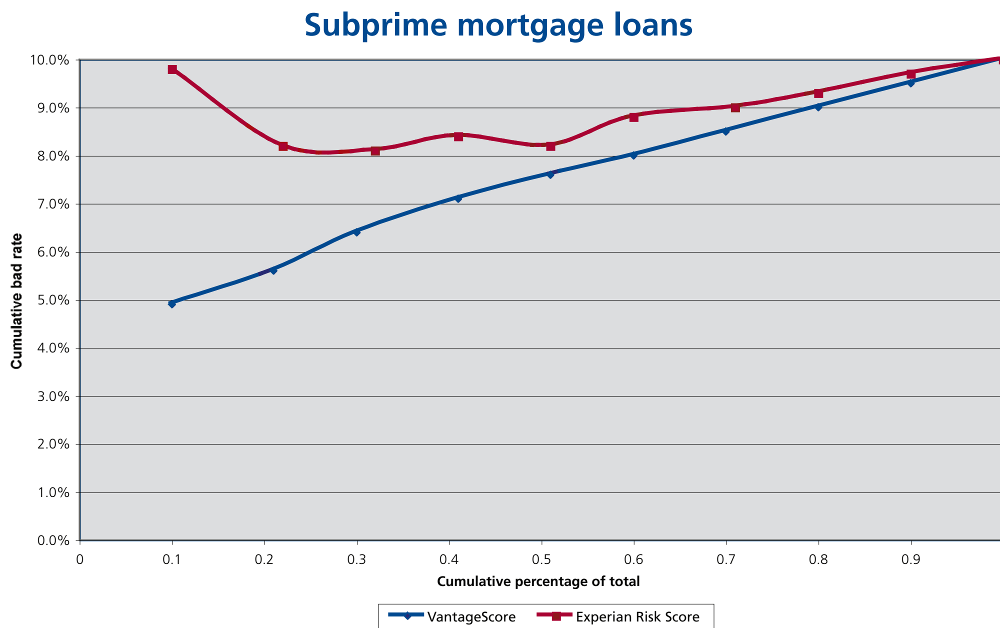
Percent total	Percent bad	Interval bad rate	Cumulative bad rate
10.0%	5.0%	4.9%	4.9%
21.0%	11.5%	6.3%	5.6%
30.0%	19.1%	8.2%	6.4%
41.0%	28.6%	9.2%	7.1%
51.0%	37.8%	9.2%	7.6%
60.0%	47.6%	10.0%	8.0%
70.0%	59.1%	12.0%	8.5%
80.0%	71.6%	13.0%	9.0%
90.0%	84.8%	13.0%	9.5%
100.0%	**100.0%**	**16.0%**	**10.0%**

Subprime

By rescoring the initially classified subprime population with VantageScore, the analysis demonstrated the score's ability to better separate good accounts from bad accounts (see chart below). This is evident by the percentage of bad accounts captured at each 10 percent interval, showing a gradual increase in the cumulative bad rate as the population scores into the lower percentiles, as well as the 40 percent lift in overall KS, a metric of the separation between good accounts and bad accounts.

consumers may appear as subprime borrowers. While a large portion of authorized users are legitimate, i.e., children on the accounts of their parents or a spouse being added to an existing account, there is a subset of consumers who are now using the loophole to gain access to credit they otherwise could not secure.

As discussed at the beginning of this paper, many lenders had embraced more liberal lending policies over the past few years. However, in the current lending environment marked by



The cumulative percentage of bad accounts compared to the percentage of the total population for each credit risk score.

III. Minimizing new risks in today's online economy — excluding authorized user tradelines with VantageScore

Credit seeking "gamers" are capitalizing on a current loophole that exists in traditional credit risk scoring tools for new account acquisitions. Since most traditional credit risk models take into account authorized user tradelines, credit risk scores for individuals with authorized users may represent them as lower-risk prospects. However, without the inclusion of authorized user tradelines in the final score calculation, these same

increased delinquencies and defaults in the subprime mortgage sector, regulators are scrutinizing lending practices and lenders are tightening their credit policies. Companies are rushing to fill the void for subprime consumers seeking new credit or wishing to refinance. These consumers are finding it more difficult to gain access to credit in the current environment of more conservative underwriting practices. Internet sites advertising the ability to "lease" good credit histories in the role of an authorized user are becoming more prevalent because the

practice is legal today. The situation lends itself to widespread abuse in a credit market environment that is slowing down and growing more risk averse.

The use of traditional credit risk scores that take authorized user tradelines into account for underwriting purposes has downstream delinquency implications for lenders as subprime borrowers who presented themselves as prime or low-risk prospects can no longer afford the debt extended to them at loan origination. Even more troubling is the prospective use of this practice to defraud an organization, whereby fraudulent credit seekers use anonymous good credit profiles to load up on authorized user tradelines to secure access to lines of credit with no intention to pay.

In light of this loophole and the potential threat it poses to lenders, a decision was made during the development of VantageScore to exclude authorized user tradelines, both with good and bad payment histories reported on them, from the final score algorithm. This approach was taken to ensure the risk assessment of a potential borrower provided by a credit risk model represents the true credit risk of the prospect and not that of the actual borrower with whom the authorized tradeline is associated. This true credit score will allow lenders to make accurate risk decisions during the underwriting process and ensure new account originations align with internal risk policies and do not pose a threat to the overall financial health of the portfolio once acquired.

Conclusions

As lenders seek new ways to continue to grow their portfolios while managing acceptable delinquency rates, they will require new tools to identify qualified prospects and manage risk within a portfolio more effectively. Experian's study highlights deficiencies in traditional credit risk scores in the subprime consumer segment and demonstrates how VantageScore can be used by lenders to:

- Expand the universe of creditworthy and viable consumers by as much as 11 percent in the subprime population
- Improve risk assessment through more granular separation of relatively lower-risk and relatively higher-risk subprime consumers
- Minimize new risks that are emerging in today's online economy by excluding authorized users from credit risk score calculations

As Experian's findings indicate, the use of VantageScore can play a significant role when lending in the subprime segment and, as such, represents a powerful new tool that can be leveraged to achieve the core goals of any financial institution. As the use of these new tools becomes more widespread in the lending marketplace, both financial institutions and consumers will benefit from a more accurate representation of the credit-seeking consumer base across industries and risk segments.

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475 Anton Blvd.
Costa Mesa, CA 92626
888 414 1120

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