In the matter of: Credit Risk Retention Proposed Rule

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DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 43
[Docket No. OCC–2011–0002]
RIN 1557–AD40

FEDERAL RESERVE SYSTEM
12 CFR Part 244
[Docket No. 2011–1411]
RIN 7100–AD–70

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 373
RIN 3064–AD74

FEDERAL HOUSING FINANCE AGENCY
12 CFR Part 1234
RIN 2590–AA43

SECURITIES AND EXCHANGE COMMISSION
17 CFR Part 246
[Release No. 34–64148; File No. S7–14–11]
RIN 3235–AK96

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
24 CFR Part 267
RIN 2501–AD53

Proposal: Require the use of credit scoring models in the QRM Definition in place of the proposed "derogatory factors" to assess credit risk

On April 29, 2011, the OCC, Board, FDIC, Commission, FHFA, and HUD (the "Agencies") proposed rules to implement the credit risk retention requirements of section 15G of the Securities Exchange Act of 1934, as added by section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Proposed Rule"). In response to the Agencies' request for comments on the Proposed Rule, Fair Isaac Corporation (FICO) respectfully submitted comments, which presented comprehensive research that demonstrated the Agencies' "derogatory factors", included in the definition of qualified residential mortgage (QRM), are not sufficiently predictive to accurately assess a mortgage borrower's credit risk for purposes of qualifying for the QRM exemption. The research revealed that the derogatory factors are not an adequate substitute for the use of a credit risk score, which is the method used currently by all mortgage lenders to assess credit risk in the mortgage underwriting process.

In its comment letter, FICO proposed a different approach: mandate the use of credit scoring models on a vendor-neutral basis, within the existing regulatory structure. We recommended that regulators require the use of credit risk models to make the critical credit risk analysis of mortgage applicants, subject to certain constraints. In response to our comment letter, FICO was asked by several of the Agencies to suggest practical ways to implement this approach.

Below are four potential credit history rule solutions, each with its own advantages. Any one of the four solutions would be considerably more predictive than the "derogatory factors" approach in the Proposed Rule, and would therefore be fairer to consumers and lenders alike. By assuring that the QRM exemption applies only to those mortgage originations that present the least credit risk, each of these solutions helps achieve Congress's goal of protecting the securitization market and its investors.

Guiding Principles

The proposed solutions are guided by five principles:

- » *Reliable analytics* – the model must accurately rank order credit risk;
- » *Vendor neutral* – the solution cannot prefer one credit scoring model builder;
- » *Regulatory oversight* – regulators should have the power to assure compliance, but they should not need to frequently calibrate the compliance process;
- » *Simple way to comply* – creditors should be able to comply with minimal burden; and
- » *Minimize market disruption* – the credit model approach works today.

Each proposed solution requires the use of a credit risk model that is "empirically derived, demonstrably and statistically sound" ("EDDSS"), as that phrase is defined in Regulation B, which implements the Equal Credit Opportunity Act. This approach assures quality, consistency, and objective standards by which to judge the effectiveness of the model. EDDSS requirements are well-established, so there would be no need to invent a new test or determine how the regulatory oversight would work. EDDSS requires model validation at inception and "within a reasonable period of time" thereafter.

Such credit scoring models could be subject to standards similar to the Supervisory Guidance on Model Risk Management, OCC 2011-12 and SR Letter 11-7 ("Guidance"), published by Federal Reserve Board and the Office of the Comptroller of the Currency on April 4, 2011. The Agencies could incorporate the Guidance by reference into its rule, or propose a variation of it. The Guidance explains the role of risk models and sets compliance standards; prescribes the need for banks that rely on quantitative analysis and models to demonstrate expertise in model development, implementation, use, and validation; and requires banks to establish a process of governance, policies, and controls over its own models, and those it uses from third party vendors and contractors. The Guidance, which is a compilation and update of past statements by the OCC on model risk management, would not impose new burdens on banks or require a new regulatory structure by the bank regulators and the Consumer Financial Protection Bureau (CFPB) to administer and audit for compliance.

Two Distinct Approaches

The Proposed Rule should use credit scoring models to more accurately determine which mortgage loans qualify for the QRM exemption from the 5% skin-in-the-game retention requirements. First, however, the Agencies must determine: (1) whether the QRM exemption should apply to all mortgage borrowers whose credit risk profile represents a predetermined **level of credit risk**, irrespective of how many borrowers qualify under that test; or (2) whether the QRM exemption should apply to a predetermined **percentage** of all mortgage borrowers whose credit risk profiles are the least risky of all such borrowers, irrespective of the actual level of credit risk presented by those who qualify for the acceptable percentage. The use of either approach would result in a considerably more accurate assessment of the borrower's credit risk, which would permit the QRM definition to rely less heavily on certain non-credit history criteria such as the borrower's debt-to-income [§(d)(8)], loan-to-value [§(d)(9)], and amount of down payment [§(d)(10)].

<u>Setting a Level of Credit Risk (Options 1-3)</u>. The Agencies would predetermine a specific credit risk *default rate* that would qualify a mortgage loan for QRM status. The default rate would be a permissible ratio that indicated the borrower's *odds-of-default* on the mortgage. The mortgage lender would use an EDDSS credit scoring model that, when the mortgage borrower's credit profile is an input to the model, is capable of rank ordering the credit risk presented by each mortgage borrower over the spectrum of all mortgage borrowers. In order for a certain mortgage loan to qualify for the QRM exemption, a securitizer would be required to demonstrate that the credit risk score on that mortgage borrower produced by the model indicated an odds-of-default ratio that was less than or equal to the Agencies' predetermined odds-of-default ratio.

- The creditor would be required to use a qualified third party's EDDSS model in Option #1, which would be certified annually by the third party.
- The creditor could use either a qualified third party's model or its own proprietary model in Option #2, but the creditor would have to annually validate whatever model it selected on its own book of business.
- The creditor could use either a qualified third party's model or its own proprietary model in Option #3; if the creditor selected the third party model, the creditor could rely on the annual certification by the third party, but if the creditor selected its own proprietary model, that model would have to be annually validated on the creditor's own book of business.

<u>Setting a Percentage of Loans (Option 4)</u>. The Agencies would predetermine a specific *percentage of loans* that qualifies for QRM status—say the least credit risky 20% of all residential mortgages issued by mortgage originators would be targeted for QRM status. The mortgage lender would be required to use a qualified third party's EDDSS credit scoring model that, when the mortgage borrower's credit profile is an input to the model, is capable of rank ordering the credit risk presented by each mortgage borrower over the spectrum of all mortgage borrowers. In order for a certain mortgage loan to qualify for the QRM exemption, a securitizer would be required to demonstrate that the borrower has a credit risk score that places the borrower in the least credit risky 20% of mortgage borrowers.

There is no option presented herein that would allow a mortgage originator to comply with the QRM exemption by relying on its own proprietary EDDSS model. The reason for this is that the percentage approach would result in significantly different results among creditors using their own models, even if the models were EDDSS, due to the regional and lender-by-lender variances in the quality of mortgage loans written by such creditors. Therefore, the only option presented under the percentage approach is to require all mortgage securitizers to use credit scoring models built using data from a consumer reporting agency that compiles and maintains files on consumers on a nationwide basis.

Proposed Credit History Rule Options 1– 3

Option #1 (Setting a Level of Credit Risk): Odds-of-default, certification on national database

A borrower's loan would qualify for the QRM exemption if the borrower's credit score indicated an acceptable odds-of-default credit risk. The mortgage lender would comply by using a qualified third party's EDDSS credit risk model. For QRM purposes, the creditor need not validate the model on its own database, but may rely on the third party's annual certification that the model is still EDDSS and accurately rank orders mortgage credit risk. A recent example of this approach is the Federal Reserve's Risk-Based Pricing Rule, 12 CFR Part 222, which requires credit bureaus and credit scoring model developers to provide the content for certain mandated consumer notices (providing information about the national distribution of credit scores) on an annual basis, and entitles lenders to rely on that information.

This option does not allow creditors to develop and use their own credit scoring models for QRM purposes (see Option #2), but does relieve securitizers from the burden of validation and annual revalidation of the models for QRM purposes. Since all mortgage securitizers under this option must use credit scoring models built by third party credit score developers using data from a consumer reporting agency that compiles and maintains files on consumers on a nationwide basis, this option also adds consistency to the odds-of-default approach.

- » The creditor must use a model that:
    - » accurately rank orders mortgage credit risk
    - » is built on a nationwide database of consumers
    - » assigns a cut-off score that represents the predetermined odds-of-default ratio (established by the Agencies) for that model
    - » is periodically revalidated to preserve its status as EDDSS and to determine if the cut-off score needs to change to meet the predetermined odds-of-default ratio
    - » is subject to examination by CFPB
- » Agencies may reset the qualifying odds-of-default ratio

For guidance, the following table generally matches a borrower's odds-of-default with the corresponding FICO 8 score (calculated as of Oct 2008, on performance as of Oct 2010):

Odds-of Default	***FICO 8 Score***
5:1	610
10:1	645

20:1	685
30:1	705
40:1	720
50:1	735
100:1	770

Option #2 (Setting a Level of Credit Risk): Odds-of-default, validation on creditor's own database

Like Option #1, a borrower's loan would qualify for the QRM exemption if the borrower's credit score indicated an acceptable odds-of-default credit risk. Unlike Option #1, Option #2 would allow creditors to develop and use their own credit scoring models for QRM purposes. A creditor would comply either by developing and using its own EDDSS credit risk model or by using a qualified third party's EDDSS credit risk model. In either case, however, the creditor would be required to validate and annually revalidate on its own book of business that the credit risk model selected (either a proprietary model or a model created by the third party) is EDDSS. Unlike Option #1, the creditor cannot rely on the third party's annual certification that the model is still EDDSS and accurately rank orders mortgage credit risk.

- » The creditor must assure that the model it uses:
    - » accurately rank orders mortgage credit risk
    - » assigns a cut-off score that represents the predetermined odds-of-default ratio (established by the Agencies) for that model based on a validation on the creditor's own book of business
    - » is periodically revalidated to preserve its status as EDDSS and to determine if the cut-off score needs to change to meet the predetermined odds-of-default ratio
    - » is subject to examination by CFPB
- » Agencies may reset the qualifying odds-of-default ratio

For guidance, the following table generally matches a borrower's odds-of-default with the corresponding FICO 8 score (calculated as of Oct 2008, on performance as of Oct 2010). Of course, the range of scores and odds-of-default will vary with each model as creditors develop and validate their own credit scoring models.

Odds-of Default	***FICO 8 Score***
5:1	610
10:1	645
20:1	685
30:1	705
40:1	720
50:1	735
100:1	770

Option #3 (Setting a Percentage of Loans): Odds-of-default, validation or certification depending on the option selected by creditor

Like Options #1 and #2, a borrower's loan would qualify for the QRM exemption if the borrower's credit score indicated an acceptable odds-of-default credit risk. Unlike Option #1, but like Option #2, Option #3 would allow creditors to develop and use their own credit scoring models for QRM purposes. A creditor would comply either by developing and using its own EDDSS credit risk model or by using a qualified third party's EDDSS credit risk model. If the creditor chose to use a qualified third party's EDDSS credit risk model, for QRM purposes, the creditor would not need to validate the model on its own database, but could rely on the third party's annual certification that the model is still EDDSS and accurately rank orders mortgage credit risk. If the mortgage lender chose to use it own credit scoring model for compliance, the creditor would be required to validate and annually revalidate on its own book of business that the credit risk model used is EDDSS.

For guidance, the following table generally matches a borrower's odds-of-default with the corresponding FICO 8 score (calculated as of Oct 2008, on performance as of Oct 2010). Of course, the range of scores and odds-of-default will vary with each model as creditors develop and validate their own credit scoring models.

Odds-of Default	***FICO 8 Score***
5:1	610
10:1	645
20:1	685
30:1	705
40:1	720
50:1	735
100:1	770

Option #4 (Setting a Percentage of Loans): Percentage of least risky borrowers, certification on national database

A borrower's loan would qualify for the QRM exemption if the borrower's credit score placed the borrower in the acceptable percentage of least credit risky borrowers. The mortgage lender would comply by using a qualified third party's EDDSS credit risk model to determine the borrower's credit score. For QRM purposes, the creditor need not validate the model on its own book of business, but may rely on the third party's annual certification that the model is still EDDSS and accurately rank orders credit risk. A recent example of this approach is the Federal Reserve's Risk-Based Pricing Rule, 12 CFR Part 222, which requires credit bureaus and credit scoring model developers to provide the content for certain mandated consumer notices (providing information about the national distribution of credit scores) on an annual basis, and entitles lenders to rely on that information.

Like Option #1 above, this option does not allow creditors to develop and use their own credit scoring models for QRM purposes, but does relieve securitizers from the burden of validation and annual revalidation of the models for QRM purposes. Since all mortgage securitizers under this option must rely on credit scoring models built by third party credit score developers using data from a consumer reporting agency that compiles and maintains files on consumers on a nationwide basis, this option also adds consistency to the odds-of-default approach.

- The creditor must use a model that:
  - accurately rank orders mortgage credit risk
  - is built on a nationwide database of consumers
  - assigns a cut-off score that represents the acceptable percentage of least credit risky borrowers (established by the Agencies) for that model
  - is periodically revalidated to preserve its status as EDDSS and to determine if the cut-off score needs to change to meet the acceptable percentage of least credit risky borrowers for that model
  - is subject to examination by CFPB
- Agencies may reset the qualifying percentage of least risky borrowers

For guidance, the following table generally matches the percentage of mortgage borrowers who achieved certain FICO 8 scores, as calculated as of October 2008, on performance as of October 2010:

Percentage of Population	***FICO 8 Score***
10%	815
20%	795
30%	770
40%	740
50%	710
60%	675
70%	625
80%	570
90%	520

Proposed Credit History Rule -- Option #1

<u>DELETE</u>:

Subpart D—Exceptions and Exemptions, §__.15 Exemption *for qualified residential mortgages,* subsection (d)(5):

(d)(5) *Credit history*—(i) *In general.* The creditor has verified and documented that within ninety (90) days prior to the closing of the mortgage transaction:
(A) The borrower is not currently 30 days or more past due, in whole or in part, on any debt obligation;
(B) Within the previous twenty-four (24) months, the borrower has not been 60 days or more past due, in whole or in part, on any debt obligation; and
(C) Within the previous thirty-six (36) months:
(*1*) The borrower has not been a debtor in a case commenced under Chapter 7, Chapter 12, or Chapter 13 of Title 11, United States Code, or been the subject of any Federal or State judicial judgment for the collection of any unpaid debt;
(*2*) The borrower has not had any personal property repossessed; and (*3*) No one-to-four family property owned by the borrower has been the subject of any foreclosure, deed-in-lieu of foreclosure, or short sale.
(ii) *Safe harbor.* A creditor will be deemed to have met the requirements of paragraph (d)(5)(i) of this section if:
(A) The creditor, no more than 90 days before the closing of the mortgage transaction, obtains a credit report regarding the borrower from at least two consumer reporting agencies that compile and maintain files on consumers on a nationwide basis;
(B) Based on the information in such credit reports, the borrower meets all of the requirements of paragraph (d)(5)(i) of this section, and no information in a credit report subsequently obtained by the creditor before the closing of the mortgage transaction contains contrary information; and
(C) The creditor maintains copies of such credit reports in the loan file for the mortgage transaction.

<u>REPLACE</u> subsection (d)(5) with the following:

(d)(5) *Credit history*—(i) *In general.* The creditor has verified and documented within ten (10) days prior to the closing of the mortgage transaction that the borrower has a credit risk score that indicates the borrower's odds-of-default on the mortgage are [X] to 1 or higher. The credit risk score shall be the product of an empirically derived, demonstrably and statistically sound credit scoring model based on data from a consumer reporting agency that compiles and maintains files on consumers on a nationwide basis, as defined in 15 U.S.C. 1681a(p). The credit scoring model shall be capable of rank ordering the credit risk presented by a borrower over the spectrum of all mortgage borrowers.

(A) *Empirically derived and other credit scoring models.* A credit scoring model is a model that evaluates a borrower's creditworthiness mechanically, based on key attributes of the borrower and aspects of the transaction, and that determines, alone or in conjunction with an evaluation of additional information about the borrower, whether the borrower is deemed creditworthy. To qualify as an empirically derived, demonstrably and statistically sound, credit scoring model for purposes of this section (d)(5), the model must be:
(I) based on data that are derived from an empirical comparison of sample groups or the population of creditworthy and noncreditworthy applicants who applied for credit within a reasonable preceding period of time;
(II) developed for the purpose of evaluating the creditworthiness of consumer applicants for credit, and applicable to mortgage applicants;
(III) developed and validated using accepted statistical principles and methodology; and
(IV) periodically revalidated by the use of appropriate statistical principles and methodology and adjusted as necessary to maintain predictive ability.

(B) *Odds-of-default.* The odds-of-default shall be defined as the ratio of non-delinquent borrowers to delinquent borrowers. Delinquent borrowers shall be defined as those with a mortgage delinquency of 90 days past due or worse over the 24 month period following the origination of the loan; non-delinquent borrowers shall be defined as those with no mortgage delinquency of 90 days past due or worse over the same 24 month period following the origination of the loan.

(C) *Annual Certification.* For purposes of compliance with subsection (d)(5)(i), a creditor may rely on the annual written certification of the person that developed the empirically derived, demonstrably and statistically sound credit scoring model that the model has been validated within a reasonable period of time on a national database of scoreable individuals with recent data from a consumer reporting agency that compiles and maintains files on a nationwide basis, as defined in 15 U.S.C. 1681a(p), and that the [X] to 1 odds-of-default credit risk threshold is represented by a specific credit score produced by such model, as determined through the validation process.

(D) *Model Risk Management.* The credit scoring models used by creditors pursuant to this section (d)(5) shall be developed and actively managed in accordance with the Supervisory Guidance on Model Risk Management promulgated by the Federal Reserve Board and the Office of the Comptroller of the Currency (SR Letter 11-7 and OCC 2011-12). The credit scoring model developers shall verify their methodology for calculating the relationship between their credit scoring model and the scoreable individuals' odds-of-default, as defined in this section (d)(5). Creditors shall retain satisfactory evidence of compliance with these requirements for examination purposes.

(ii) *Resetting the Minimum Odds-of-Default.* The Agencies shall have the authority to alter or amend the definition of odds-of-default, or adjust the minimum acceptable odds-of-default, in order to effect the purposes of the QRM exemption.

Proposed Credit History Rule -- Option #2

DELETE:

Subpart D—Exceptions and Exemptions, §__.15 Exemption *for qualified residential mortgages,* subsection (d)(5):

(d)(5) *Credit history*—(i) *In general.* The creditor has verified and documented that within ninety (90) days prior to the closing of the mortgage transaction:
(A) The borrower is not currently 30 days or more past due, in whole or in part, on any debt obligation;
(B) Within the previous twenty-four (24) months, the borrower has not been 60 days or more past due, in whole or in part, on any debt obligation; and
(C) Within the previous thirty-six (36) months:
(*1*) The borrower has not been a debtor in a case commenced under Chapter 7, Chapter 12, or Chapter 13 of Title 11, United States Code, or been the subject of any Federal or State judicial judgment for the collection of any unpaid debt;
(*2*) The borrower has not had any personal property repossessed; and (*3*) No one-to-four family property owned by the borrower has been the subject of any foreclosure, deed-in-lieu of foreclosure, or short sale.
(ii) *Safe harbor.* A creditor will be deemed to have met the requirements of paragraph (d)(5)(i) of this section if:
(A) The creditor, no more than 90 days before the closing of the mortgage transaction, obtains a credit report regarding the borrower from at least two consumer reporting agencies that compile and maintain files on consumers on a nationwide basis;
(B) Based on the information in such credit reports, the borrower meets all of the requirements of paragraph (d)(5)(i) of this section, and no information in a credit report subsequently obtained by the creditor before the closing of the mortgage transaction contains contrary information; and
(C) The creditor maintains copies of such credit reports in the loan file for the mortgage transaction.

REPLACE subsection (d)(5) with the following:

(d)(5) *Credit history—(i) In general.* The creditor has verified and documented within ten (10) days prior to the closing of the mortgage transaction that the borrower has a credit risk score that indicates the borrower's odds-of-default on the mortgage are [X] to 1 or higher. The credit risk score shall be the product of an empirically derived, demonstrably and statistically sound credit scoring model. The credit scoring model shall be capable of rank ordering the credit risk presented by a borrower over the spectrum of all mortgage borrowers.

(A) *Empirically derived and other credit scoring models.* A credit scoring model is a model that evaluates a borrower's creditworthiness mechanically, based on key attributes of the borrower and aspects of the transaction, and that determines, alone or in conjunction with an evaluation of additional information about the borrower, whether the borrower is deemed creditworthy. To qualify as an empirically derived, demonstrably and statistically sound, credit scoring model for purposes of this section (d)(5), the model must be:
(I) based on data that are derived from an empirical comparison of sample groups or the population of creditworthy and noncreditworthy applicants who applied for credit within a reasonable preceding period of time;
(II) developed for the purpose of evaluating the creditworthiness of consumer applicants for credit, and applicable to mortgage applicants;
(III) developed and validated using accepted statistical principles and methodology; and
(IV) periodically revalidated by the use of appropriate statistical principles and methodology and adjusted as necessary to maintain predictive ability.

(B) *Odds-of-default.* The odds-of-default shall be defined as the ratio of non-delinquent borrowers to delinquent borrowers. Delinquent borrowers shall be defined as those with a mortgage delinquency of 90 days past due or worse over the 24 month period following the origination of the loan; non-delinquent borrowers shall be defined as those with no mortgage delinquency of 90 days past due or worse over the same 24 month period following the origination of the loan.

(C) *Model Validation and Compliance.* A creditor may use an empirically derived, demonstrably and statistically sound, credit scoring model obtained from another person, if such model is based on a national database of scoreable individuals with recent data from a consumer reporting agency that compiles and maintains files on a nationwide basis, as defined in 15 U.S.C. 1681a(p); or a creditor may develop its own credit risk model if the model is capable of rank ordering the credit risk presented by each borrower over the spectrum of the creditor's mortgage borrowers, and the model satisfies the criteria set forth in paragraphs (A)(I) through (IV) of this section (d)(5). The creditor shall validate the model it uses at least annually, based on its own credit experience in accordance with paragraphs (A)(I) through (IV). A model that fails this validity test is no longer an empirically derived, demonstrably and statistically sound, credit scoring model for that creditor.

(D) *Model Risk Management.* The credit scoring models used by creditors pursuant to this section (d)(5) shall be developed and actively managed by creditors in accordance with the Supervisory Guidance on Model Risk Management promulgated by the Federal Reserve Board and the Office of the Comptroller of the Currency (SR Letter 11-7 and OCC 2011-12). Pursuant to these regulatory standards, creditors shall validate the accuracy of their credit scoring models and verify their methodology for calculating the relationship between their credit scoring model and their borrowers' odds-of-default, as defined in this section (d)(5). Creditors shall retain satisfactory evidence of compliance with these requirements for examination purposes.

(ii) *Resetting the Minimum Odds-of-Default.* The Agencies shall have the authority to alter or amend the definition of odds-of-default, or adjust the minimum acceptable odds-of-default, in order to effect the purposes of the QRM exemption.

Proposed Credit History Rule -- Option #3

DELETE:

Subpart D—Exceptions and Exemptions, §__.15 Exemption *for qualified residential mortgages,* subsection (d)(5):

(d)(5) *Credit history*—(i) *In general.* The creditor has verified and documented that within ninety (90) days prior to the closing of the mortgage transaction:
(A) The borrower is not currently 30 days or more past due, in whole or in part, on any debt obligation;
(B) Within the previous twenty-four (24) months, the borrower has not been 60 days or more past due, in whole or in part, on any debt obligation; and
(C) Within the previous thirty-six (36) months:
(*1*) The borrower has not been a debtor in a case commenced under Chapter 7, Chapter 12, or Chapter 13 of Title 11, United States Code, or been the subject of any Federal or State judicial judgment for the collection of any unpaid debt;
(*2*) The borrower has not had any personal property repossessed; and (*3*) No one-to-four family property owned by the borrower has been the subject of any foreclosure, deed-in-lieu of foreclosure, or short sale.
(ii) *Safe harbor.* A creditor will be deemed to have met the requirements of paragraph (d)(5)(i) of this section if:
(A) The creditor, no more than 90 days before the closing of the mortgage transaction, obtains a credit report regarding the borrower from at least two consumer reporting agencies that compile and maintain files on consumers on a nationwide basis;
(B) Based on the information in such credit reports, the borrower meets all of the requirements of paragraph (d)(5)(i) of this section, and no information in a credit report subsequently obtained by the creditor before the closing of the mortgage transaction contains contrary information; and
(C) The creditor maintains copies of such credit reports in the loan file for the mortgage transaction.

REPLACE subsection (d)(5) with the following:

(d)(5) *Credit history*—(i) *In general.* The creditor has verified and documented within ten (10) days prior to the closing of the mortgage transaction that the borrower has a credit risk score that indicates the borrower's odds-of-default on the mortgage are [X] to 1 or higher. The credit risk score shall be the product of an empirically derived, demonstrably and statistically sound credit scoring model. The credit scoring model shall be capable of rank ordering the credit risk presented by a borrower over the spectrum of all mortgage borrowers.

(A) *Empirically derived and other credit scoring models.* A credit scoring model is a model that evaluates a borrower's creditworthiness mechanically, based on key attributes of the borrower and aspects of the transaction, and that determines, alone or in conjunction with an evaluation of additional information about the borrower, whether the borrower is deemed creditworthy. To qualify as an empirically derived, demonstrably and statistically sound, credit scoring model for purposes of this section (d)(5), the model must be:
(I) based on data that are derived from an empirical comparison of sample groups or the population of creditworthy and noncreditworthy applicants who applied for credit within a reasonable preceding period of time;
(II) developed for the purpose of evaluating the creditworthiness of consumer applicants for credit, and applicable to mortgage applicants;
(III) developed and validated using accepted statistical principles and methodology; and
(IV) periodically revalidated by the use of appropriate statistical principles and methodology and adjusted as necessary to maintain predictive ability.

(B) *Odds-of-default.* The odds-of-default shall be defined as the ratio of non-delinquent borrowers to delinquent borrowers. Delinquent borrowers shall be defined as those with a mortgage delinquency of 90 days past due or worse over the 24 month period following the origination of the loan; non-delinquent borrowers shall be defined as those with no mortgage delinquency of 90 days past due or worse over the same 24 month period following the origination of the loan.

(C) Annual Certification; Model Validation; and Compliance. A creditor may use an empirically derived, demonstrably and statistically sound, credit scoring model obtained from another person, if such model is based on a national database of scoreable individuals with recent data from a consumer reporting agency that compiles and maintains files on a nationwide basis, as defined in 15 U.S.C. 1681a(p). For purposes of compliance with subsection

(d)(5)(i), a creditor may rely on the annual written certification of such other person that the [X] to 1 odds-of-default credit risk threshold is represented by a specific credit score produced by such model, as determined through the validation process.

For purposes of compliance with subsection (d)(5)(i), a creditor may develop its own credit model if that model is capable of rank ordering the credit risk presented by each borrower over the spectrum of the creditor's mortgage borrowers, and the model satisfies the criteria set forth in paragraphs (A)(I) through (IV) of this section (d)(5). The creditor shall validate the model it uses at least annually, based on its own credit experience in accordance with paragraphs (A)(I) through (IV). A model that fails this validity test is no longer an empirically derived, demonstrably and statistically sound, credit scoring model for that creditor.

(D) *Model Risk Management.* The credit scoring models used by creditors pursuant to this section (d)(5) shall be developed and actively managed in accordance with the Supervisory Guidance on Model Risk Management promulgated by the Federal Reserve Board and the Office of the Comptroller of the Currency (SR Letter 11-7 and OCC 2011-12). The credit scoring model developers shall verify their methodology for calculating the relationship between their credit scoring model and the scoreable individuals' odds-of-default, as defined in this section (d)(5). Creditors shall retain satisfactory evidence of compliance with these requirements for examination purposes.

(ii) *Resetting the Minimum Odds-of-Default.* The Agencies shall have the authority to alter or amend the definition of odds-of-default, or adjust the minimum acceptable odds-of-default, in order to effect the purposes of the QRM exemption.

Proposed Credit History Rule -- Option #4

DELETE:
Subpart D—Exceptions and Exemptions, §__.15 Exemption *for qualified residential mortgages,* subsection (d)(5):

(d)(5) *Credit history*—(i) *In general.* The creditor has verified and documented that within ninety (90) days prior to the closing of the mortgage transaction:
(A) The borrower is not currently 30 days or more past due, in whole or in part, on any debt obligation;
(B) Within the previous twenty-four (24) months, the borrower has not been 60 days or more past due, in whole or in part, on any debt obligation; and
(C) Within the previous thirty-six (36) months:
(*1*) The borrower has not been a debtor in a case commenced under Chapter 7, Chapter 12, or Chapter 13 of Title 11, United States Code, or been the subject of any Federal or State judicial judgment for the collection of any unpaid debt;
(*2*) The borrower has not had any personal property repossessed; and (*3*) No one-to-four family property owned by the borrower has been the subject of any foreclosure, deed-in-lieu of foreclosure, or short sale.
(ii) *Safe harbor.* A creditor will be deemed to have met the requirements of paragraph (d)(5)(i) of this section if:
(A) The creditor, no more than 90 days before the closing of the mortgage transaction, obtains a credit report regarding the borrower from at least two consumer reporting agencies that compile and maintain files on consumers on a nationwide basis;
(B) Based on the information in such credit reports, the borrower meets all of the requirements of paragraph (d)(5)(i) of this section, and no information in a credit report subsequently obtained by the creditor before the closing of the mortgage transaction contains contrary information; and
(C) The creditor maintains copies of such credit reports in the loan file for the mortgage transaction.

REPLACE subsection (d)(5) with the following:

(d)(5) *Credit history*—(i) *In general.* The creditor has verified and documented within ten (10) days prior to the closing of the mortgage transaction that the borrower has a credit risk score that places that borrower in the least credit risky [X]% of mortgage borrowers. The credit risk score shall be the product of an empirically derived, demonstrably and statistically sound credit scoring model, based on data from a consumer reporting agency that compiles and maintains files on consumers on a nationwide basis, as defined in 15 U.S.C. 1681a(p). The credit scoring model shall be capable of rank ordering the credit risk presented by a borrower over the spectrum of all mortgage borrowers.

(A) *Empirically derived and other credit scoring models.* A credit scoring model is a model that evaluates a borrower's creditworthiness mechanically, based on key attributes of the borrower and aspects of the transaction, and that determines, alone or in conjunction with an evaluation of additional information about the borrower, whether the borrower is deemed creditworthy. To qualify as an empirically derived, demonstrably and statistically sound, credit scoring model for purposes of this section (d)(5), the model must be:
(I) based on data that are derived from an empirical comparison of sample groups or the population of creditworthy and noncreditworthy applicants who applied for credit within a reasonable preceding period of time;
(II) developed for the purpose of evaluating the creditworthiness of consumer applicants for credit, and applicable to mortgage applicants;
(III) developed and validated using accepted statistical principles and methodology; and
(IV) periodically revalidated by the use of appropriate statistical principles and methodology and adjusted as necessary to maintain predictive ability.

(B) *Odds-of-default.* The odds-of-default shall be defined as the ratio of non-delinquent borrowers to delinquent borrowers. Delinquent borrowers shall be defined as those with a mortgage delinquency of 90 days past due or worse over the 24 month period following the origination of the loan; non-delinquent borrowers shall be defined as those with no mortgage delinquency of 90 days past due or worse over the same 24 month period following the origination of the loan.

(C) *Annual Certification.* For purposes of compliance with subsection (d)(5)(i), a creditor may rely on the annual written certification of the person that developed the empirically derived, demonstrably and statistically sound credit scoring model that the model has been validated within a reasonable period of time on a national database of scoreable individuals with recent data from a consumer reporting agency that compiles and maintains files on a nationwide basis, as defined in 15 U.S.C. 1681a(p), and that the [X]% credit risk threshold is represented by a specific credit score produced by such model.

(D) *Model Risk Management.* The credit scoring models used by creditors pursuant to this section (d)(5) shall be developed and actively managed in accordance with the Supervisory Guidance on Model Risk Management promulgated by the Federal Reserve Board and the Office of the Comptroller of the Currency (SR Letter 11-7 and OCC 2011-12). The credit scoring model developers shall verify their methodology for calculating the relationship between their credit scoring model and the percentage of individuals who qualify under this section (d)(5). Creditors shall retain satisfactory evidence of compliance with these requirements for examination purposes.

(ii). *Resetting the Percentages of Qualifying Mortgages.* The Agencies shall have the authority to adjust the percentage of loans that qualify under this section (d)(5) for the QRM exemption.