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Invested in America

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Submitted electronically

Sandra L. Thompson
Acting Director
Federal Housing Finance Agency
400 7th St SW
Washington, DC 20024

Re: Validation and Approval of Credit Score Models

Dear Ms. Thompson,

SIFMA[1] writes as a follow up to our participation in FHFA's March 1, 2022 "Listening Session" on the use of new credit scores by the Enterprises. SIFMA has previously submitted our views on this topic to FHFA in various letters and meetings with FHFA staff.[2] We are sending this brief letter today to summarize the points we raised at the listening session, which are consistent with our previous submissions on this topic.

SIFMA's focus is on the continuation of liquidity in the Enterprises' MBS markets, and in particular, the To-Be-Announced (TBA) market.[3] Our primary concern with respect to this topic is the risk of disruption of market participants' ability to model credit risk and prepayments, which could impact liquidity in the TBA market, and thus have knock-on effects back into the markets for primary mortgage credit. As you know, the TBA market's vast liquidity is enabled by the stability and homogeneity that underpins the MBS, and hundreds of billions of dollars of contracts for securities trade on a daily basis. As with any other initiative, such as UMBS, change in this market must be managed thoughtfully and carefully given its importance and the real-world consequences of mistakes.

The current generation of credit scores and how they relate to prepayments and defaults is well understood, but the new generation is less well understood. In our previous communications, we laid out a few key points that we believe remain true today, and should be reflected in the ultimate decisions made by the GSEs and FHFA with respect to changes in the use of credit scoring models.

First, the Enterprises and FHFA must ensure that secondary market participants have enough data and other information to understand and model the new scores, including with respect to how they relate to existing scores on loans, and to understand how they will impact current Enterprise practices, before changes are

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[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[2] See, e.g., SIFMA letter dated March 29, 2018 available here: https://www.fhfa.gov//AboutUs/Contact/Pages/input-submission-detail.aspx?RFIId=957. SIFMA submitted a similar follow up letter on March 21, 2019.

[3] Our members are also very focused on CRT markets, and the points made herein are applicable to those markets as well.

implemented. This would presumably involve a large sample of loans across a sufficient period of time. If there are contractual or other restrictions in the way of such disclosure, they need to be resolved. Alongside of this, FHFA and the Enterprises must allow sufficient time for lenders, MBS market makers, and investors to adapt to any changes. Lenders and secondary market participants may need significant time to implement the needed operational and technology changes. Furthermore, to the extent the Enterprises will make changes to pricing grids or other standards, this also needs to be understood well in advance of any changes.

Second, the credit scores that are used by the GSEs should be consistent and stable across lenders and pools. The TBA market is premised on homogeneity and market participants having reasonable expectations of consistency across the many thousands of pools that trade in the TBA market. Pools that contain a mix of loans with *either* one *or* another credit score as the sole score are significantly less preferred than issuance of pools that will always have one score as a baseline. This does not mean the Enterprises may only use a single score, but rather that homogeneity will be preserved by the consistent use of one score across pools in addition to any other score that is used. Providing outright optionality to lenders may create the potential for them to game the scores over time, shifting from model to model to maximize origination possibilities, and may provide incentives for credit score providers to lower standards so as to maximize usage. Again, this does not mean that multiple scoring models could not be used – rather it means that there needs to be a consistent baseline score that market participants can compare across pools.

Third, the GSEs should have an aligned approach. As a final note, in the context of the implementation of UMBS and the use of a single TBA delivery contract for both Fannie Mae and Freddie Mac, we believe it is entirely necessary and appropriate for FHFA to align GSE usage of credit scores. The usage and disclosure of credit scores needs to be aligned to ensure UMBS markets function to their best capacity.

We look forward to further discussions with FHFA and the GSEs on this topic and are available at your convenience. Please contact me at 212-313-1126 or ckillian@sifma.org with any questions or for more information.

Sincerely,

Chris Killian
Managing Director
Securitization and Credit Markets