

WRITTEN STATEMENT OF FAIR ISAAC CORPORATION

CREDIT SCORING MODELS AND CREDIT SCORES

BEFORE THE U.S. HOUSE OF REPRESENTATIVES  
COMMITTEE ON FINANCIAL SERVICES  
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

WASHINGTON, D.C.

JULY 29, 2008

**Introduction.** Mr. Chairman and members of the subcommittee, my name is Tom Quinn. I am the Vice President of Global Scoring Solutions for Fair Isaac Corporation. Thank you for the opportunity to testify before you today regarding consumer education issues involving credit scores and credit scoring models, including: (1) use of credit scores in underwriting, (2) development of credit score models, and (3) consumer access to credit scores.

**Scoring Models**

Fair Isaac Corporation is the leading provider of analytics and decision management technology. Founded in 1956, Fair Isaac has customers in more than sixty countries who use our analytic models and technology to make credit available to people, to reduce fraud and credit losses, and to make smarter decisions. Fair Isaac pioneered the development of statistically based credit risk evaluation systems, commonly called “credit scoring systems.” Thousands of U.S. credit grantors use “FICO® scores” generated using Fair Isaac-developed scoring systems, which are implemented at the national credit reporting agencies Equifax, Experian and TransUnion LLC. Fair Isaac also has developed a version of its FICO scoring model for use by credit bureaus outside of the U.S. This model is now in use or being installed in 16 countries in Europe, Asia, the Middle East, Central and South America.

Fair Isaac created the way credit scoring systems are developed. Creating the FICO scoring model requires two samples of credit reports two years apart for the same randomly selected depersonalized set of consumers, provided by one of the national credit reporting agencies. Our analytic scientists then analyze the data in the earlier data set to isolate and prioritize factors that consistently predict the credit account performance noted two years later in the later data set. Those factors found to be most powerful and consistent in predicting credit performance, individually and in combinations, form the basis for a complex mathematical algorithm which becomes the predictive scoring model. The traditional FICO scoring model evaluates five types of data elements from consumer credit reports: 1) payment history, 2) outstanding debts, 3) length of credit history, 4) pursuit of new credit, and 5) mix of types of credit. The contribution of each type of data element to a typical consumer’s FICO score is approximately: payment history (35%), outstanding debt (30%), length of credit history (15%), pursuit of new credit (10%), and mix of types of credit (10%). These factors have been published on Fair Isaac public websites since June 6, 2000. On March 19, 2001, Fair Isaac and Equifax launched the first product for consumers that contained their FICO score.

Fair Isaac has also developed custom scoring systems for hundreds of the nation’s leading banks, credit card issuers, finance companies, retailers, insurance companies, and telecommunication providers. Some form of credit scoring is now used in the majority of consumer credit decisions, and the most widely used credit scores in the U.S. today are FICO scores. A FICO score is a 3-digit number within the 300-850® range that tells lenders how likely a borrower is to repay as

agreed. FICO scores use information from consumer credit reports to provide a snapshot of credit risk at a particular point in time. Scores change over time, as that credit risk prediction reflects changes in underlying behaviors and factors present on a consumer's credit report.

### **Fair Isaac Works to Serve the Market's Needs**

FICO scores were first introduced to the marketplace in 1989 and have been consistently redeveloped and updated through the years to ensure their predictive strength. A redevelopment project is currently underway, called FICO® 08, which is being rolled out this summer and fall. FICO 08 has been developed with up-to-date data from the credit bureaus and incorporates our latest technical enhancements.

In addition to renewing the FICO score, Fair Isaac works to serve the marketplace with other credit-related programs and analytics. For example, Fair Isaac has recently developed a new tool to assess a consumer's ability to take on more debt given the consumer's present financial circumstances. This tool, called the **Credit Capacity Index™**, can be used by financial institutions along with the FICO Score to assess a potential borrower's ability to take on more debt. The Index identifies consumers best able to repay incremental debt, increases lenders' control over loss exposure and reserves, and facilitates responsible lending practices

Fair Isaac also pioneered the use of alternative data to assist in credit decisions for consumers with thin credit files or no credit files. Fair Isaac launched its **FICO® Expansion® Score** in August 2004, to address the estimated 30-50 million consumers for whom insufficient credit history data exists at the credit reporting agency to calculate a traditional FICO score. The FICO Expansion model evaluates nontraditional credit history information provided by specialized credit bureaus including payment performance records for purchases such as furniture bought on lay-away, verified bill payment information, membership account performance at retail vendors, and selected performance involving bank deposit accounts such as the propensity to overdraw checking accounts. The FICO Expansion score is designed to have a very similar odds-to-score ratio as the FICO score. The FICO Expansion score includes programs to assist in building credit such as one Fair Isaac announced in 2007 with Pay Rent Build Credit (PRBC). Consumers can submit bills to PRBC which are then verified and posted, thereby allowing consumers without traditional credit to establish their own credit history. A PRBC Credit Report could then be used with a FICO Expansion Score to enable lenders to assess the risk of applicants who have little or no traditional credit history.

### **Authorized Users**

Since it was first introduced, the traditional FICO scoring model has calculated a score using information about any authorized user credit accounts present on the credit report available to the scoring algorithm. Fair Isaac regularly updates the FICO scoring model in a rigorous process called model redevelopment. On June 5, 2007, Fair Isaac announced that with our next model update which we called FICO 08, authorized user accounts would no longer be included in the calculation of the scores. Fair Isaac was trying to protect lenders and consumers from a new type of credit repair practice known as "piggybacking" or "tradelines renting", which has received national attention from news media since March 2007. Piggybacking is an attempt to artificially inflate consumers' FICO scores and deliberately misrepresent consumers' credit history to potential lenders, by paying consumers with good FICO scores to add strangers with poor FICO scores to their credit card accounts as authorized users.

After consulting with the Federal Reserve Board and the Federal Trade Commission earlier this year, Fair Isaac has decided to include consideration of authorized user tradelines present on the

credit report in the FICO 08 model. Our scientists have devised a method to consider these tradelines while materially reducing the negative impact that could arise from piggybacking.

### **Federal Regulatory Oversight**

Fair Isaac is regulated at the federal level by the Federal Trade Commission. We have a regular, ongoing dialogue with the FTC in which we explain our products and practices. We recently trained 30 new FTC attorneys and examiners on a basic understanding of FICO scoring. In addition, in the past year, Fair Isaac has met with senior officials and provided training sessions for examiners at the Federal Reserve Board, the Office of Thrift and Supervision, the Federal Deposit Insurance Corporation, the Office of Management and Budget, the Federal Housing Administration, and the GSEs (Freddie Mac and Fannie Mae). We regularly speak with many state attorneys general and other government officials.

### **Fair Isaac's Commitment to Financial Literacy**

Fair Isaac has been a pioneer in consumer education about credit scores and credit scoring models. In the past year, we have participated in consumer financial literacy forums provided by the Greater Washington Urban League, Corporation for Enterprise Development, and Brookings Institute. We were active members of President Bush's Advisory Council on Financial Literacy, the Committee on the Underserved.

On March 19, 2001, Fair Isaac launched its score explanation website for consumers, [www.myFICO.com](http://www.myFICO.com), which has become a central source of information for consumers interested in learning about credit scoring. At myFICO.com, the consumer obtains their FICO score, the underlying credit report on which it was generated as well as a detailed explanation of the score, score range, how the consumer's score compared with the scores of consumers nationally as well as primary reasons why their score was not higher. The price of Score Power was \$12.95 in 2001 when first introduced and it has increased over seven years to \$15.95, for an average annual rate of increase of 3.3%. Score Power was made available to consumers at both [www.myFICO.com](http://www.myFICO.com) and [www.Equifax.com](http://www.Equifax.com). During the past seven years Fair Isaac has introduced additional products to help consumers monitor their credit scores and credit reports, and products that provide coaching on credit management from nationally recognized author and expert Ms. Suze Orman. [www.myFICO.com](http://www.myFICO.com) is the only place where consumers can get their FICO scores calculated from Fair Isaac's scoring model at all three of the national credit reporting agencies. To date, approximately 20 million FICO scores have been delivered to consumers from [www.myFICO.com](http://www.myFICO.com), [www.Equifax.com](http://www.Equifax.com), and affiliates. By using myFICO, consumers have taken steps to control their credit lives and help improve and protect their overall financial health.

myFICO also has added abundant educational materials about credit scoring to [www.myFICO.com](http://www.myFICO.com). This includes the original list of all the credit factors that are assessed by the FICO scoring model with explanations, what information the model ignores, how consumers can take action to improve their scores over time, how to prepare for a loan, and much more. myFICO created an 18-page booklet for consumers titled "Understanding Your FICO Score" which is available through the website. myFICO also has partnered with the Consumer Federation of America on a pamphlet for consumers titled "Your Credit Scores" which has been distributed to consumers nationwide by both organizations and the Federal Citizens Information Center. This pamphlet is now being updated for re-release. Most recently, myFICO created a permanent, public online discussion group called FICO Forums for any consumers interested in discussing and comparing notes on credit scores and related subjects.

In addition, Fair Isaac is working with lenders to develop programs in which bank customers can see their current credit scores when they access their accounts electronically. This **Scores on Statements**<sup>™</sup> program presents consenting consumers with free FICO scores monthly, along with score explanations and extensive credit management educational content via participating lenders' secure banking websites. The score-tracking feature shows consumers how responsible use of credit results in score improvements over time.

I thank you for the opportunity to share with you Fair Isaac's expertise and experience in this important area.