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Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
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Attention: 2005-40
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Re: Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance; Domestic Capital Modifications joint advance notice of proposed rule-making

Federal Deposit Insurance Corporation RIN 3064-AC96
Federal Reserve System Docket No. R-1238
OCC RIN 1557-AC95, Docket No. 05-16
OTS RIN 1550-AB98, No. 2005-40

Ladies and Gentlemen:

Fair Isaac Corporation ("Fair Isaac") is pleased to submit comments regarding the proposed guidelines discussed in the joint advanced notice of proposed rule-making of October 20, 2005 (the Risk-Based Capital Guidelines ANPR or "ANPR").

Fair Isaac commends the Agencies for their significant effort to develop sensible and more flexible regulatory capital guidance for the US banking system. We particularly appreciate the Agencies demonstrated willingness to incorporate and react to feedback from industry sources within this process.

Fair Isaac Corporation (NYSE: FIC) is the leading provider of decision management solutions powered by advanced analytics. Fair Isaac was founded in 1956 on the premise that data, used intelligently, can improve business decisions. Today, the company's solutions, software and services automate and improve more than 180 billion smarter business decisions each year for companies worldwide. Most leading banks and credit card issuers rely on Fair Isaac solutions, as

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do insurers, retailers, telecommunications providers, healthcare organizations and government agencies. Through the *www.myfico.com* website, consumers use the company's FICO® scores, the standard measure of credit risk, to manage their financial health.

Fair Isaac's FICO scores are the most used credit bureau scores in the world, powering more than 10 billion decisions a year. Users of FICO scores include virtually every bank, thrift and credit union originating or managing retail consumer and small business credit exposures. Our clients also include half of the top 50 banks in the world, and 22 of the top 25 U.S. small business lenders. About 80% of US credit cards and 65% of the world's credit cards are managed using Fair Isaac adaptive control systems. Falcon™ Fraud Manager protects 85% of US credit card transactions, and 65% of transactions worldwide. Fair Isaac analytics are used in three out of four US mortgage originations. More than half of US residential defaulted loans are serviced using Fair Isaac mortgage solutions.

While we recognize that comments made herein which encourage the use of credit scoring in retail portfolios may be seen as self-serving, we similarly recognize that Fair Isaac is uniquely qualified to comment on the credit risk practices of banks and other financial service entities. This is particularly true where these practices involve the origination and management of retail consumer and small business credit exposures both within the U.S. and on a global scale. We limit our comments to discussion of the general state of retail credit management for US banking institutions in comparison with their international peers, and to specific comment on the possible options and proposed guidelines discussed for mortgages, other retail exposures, loans 90 days or more past due or in non-accrual in a retail context, and small business loans. In particular, we seek to shed light on the degree to which banks of all sizes and scale are currently using credit scoring as a low-cost, low barrier method of risk prediction.

II. Domestic Capital Framework Revisions

Given the key principles guiding the Agencies in their development of the domestic risk-based capital rules, stressing the balancing of safety and soundness, operational feasibility, minimal burden, appropriate incentives, and mitigation of distortions based on organization size, Fair Isaac believes that it is important to understand the high degree of sophistication with which U.S. retail exposures are managed, even among the smallest banks, when compared to non-U.S. peer organizations. U.S. consumer credit grantors report full positive data to the consumer reporting agencies(CRA), unlike many other nations. The U.S. is not encumbered by the same degree of privacy restriction characteristic of many other nations, even including Canada.

As such, the U.S. is alone in the degree of coverage and completeness that the CRA data reflects with respect to consumer credit performance. This has permitted the development of national credit markets and has stimulated competition that has helped to increase credit availability in the U.S.. The advent of credit bureau risk scores in 1989 coincided with a long period of expansion in consumer demand and in credit access and product availability. The use of credit bureau-risk scores has permeated into even the smallest US banks, thrifts and credit unions, based on the low barriers to implementation and low financial investment required for accessing consumer scores. Similarly, the use of consumer credit data for principle owners has proven highly predictive of small business credit risk, and has likewise been embraced given the relatively lower cost and lower barriers to implementation for using solutions like Fair Isaac's Small Business Scoring Service (SBSS) compared against the use of commercial credit data with limited availability, higher barriers to implementation and higher cost.

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D. One-to-Four Family Mortgages: First and Second Liens
The Agencies are seeking to align risk-based capital requirements more closely with risk with one option being considered to base capital requirements for first-lien one-to-four family mortgages on collateral through loan-to-value (LTV) ratio. It is Fair Isaac's belief that use of LTV alone, due to the fluctuation of collateral values over time, would create an assessment dominated by collateral risk, and ignoring borrower risk. In this regard, using LTV alone would also ignore local economic trends with respect to residential housing and property values. For example, a 100% LTV loan in a market with depreciating or stable housing values would represent different risk than a 100% LTV loan in circumstances where housing values were escalating rapidly[1]. Under the proposal, both loans would be assessed at a 100% risk weight, while clearly, a 100% LTV loan in stable conditions would represent risk different than that in an escalating price environment.

The proposal further asks whether LTVs should be updated periodically. Experience in New England and California markets in the 1992-1993 period suggests that rapidly plummeting housing values can themselves cause loan default, as economically rational borrowers walk away from negative equity obligations. As such, LTVs should likely be updated annually in "normal" or stable times and quarterly where there is evidence of a destabilization or rapid decrease in housing prices. We recognize that updating collateral valuation estimates may create burden for lenders, and suggest flexibility to permit national lenders to rely on computerized appraisal systems while community institutions should be permitted to rely on appropriate local estimates including newspaper reports reflecting recent sale prices.

The Risk-Based Capital Guidelines ANPR also asks for feedback on the role of private mortgage insurance (PMI). Fair Isaac has no comment in this regard.

The Agencies are also considering combining credit scores with LTV ratios to determine risk-based capital requirements. We support this recommendation, as it addresses both collateral and borrower risk in establishing capital thresholds, and mirrors what we see as common current practice among mortgage lenders. We note that mortgage lenders at time of origination are likely to access all three U.S. credit bureaus and to compare and use a combination of the credit scores associated with each. Once an account is booked, mortgage servicers are known to seek quarterly refreshes of credit bureau scores and to use this information both to help mitigate potential risk and to address amortization concerns relative to securitized portfolios.

The Risk-Based Capital Guidelines ANPR also mentions as a possibility, use of a capacity measure such as debt-to-income ratio. Fair Isaac believes the use of debt-to-income ratio would require potential invasive interaction with consumers, due to the fact that income is dynamic, and is not typically accurately updated on CRA files. This would place an investigative burden on the banking organization that could fall disproportionately on smaller institutions with limited staff, and may prove particularly invasive for mortgage servicing organizations to implement as borrowers are often unaware of the servicing organization's role.

The ANPR is also seeking comment on the impact of the use of credit scores on the availability of credit or prices for lower income borrowers. Historical research by Fair Isaac has shown that credit risk is often independent of income. Information available on the Fair Isaac website

[1] One market with evidence of rapidly escalating housing prices is reputedly Cape May County, New Jersey where housing prices are appreciating at a rate of 20% - 30% annually and where some towns report prices literally increasing by $1000 a day.

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www.myFICO.com observes that mortgage rates do correspond to credit score, with higher scoring (low risk) consumers receiving more favorable pricing. Of the estimated 210 million adults in the U.S., an estimated 160 million have a full credit bureau record on which a FICO score can be generated; while 30 million have a thin credit bureau record that will produce no FICO score and 20 million additional adults have no credit bureau record and are considered credit bureau "no hits" and will receive no score. In 2004, Fair Isaac introduced the FICO® Expansion™ score to address the thin file and no hit populations, and to help underserved market segments gain access to mainstream credit products. FICO Expansion uses alternative data including positive alternative credit data, negative alternative credit data, thin file credit data, public record data, lender verified data, and application data to generate a credit score. Fair Isaac is actively exploring additional data sources to expand the number of adults that can receive a credit score, and to more completely profile the bill paying experience of underserved market segment members. In testing with mainstream lenders, Fair Isaac determined that scoreable rates were over 60% for all retail segments, with mortgage at 80%; installment/auto lending at 95%; credit cards at 82%; and retail cards at 60%. Fair Isaac is currently embarking on an education campaign that is designed to increase public awareness of the relationship between credit behaviors and credit scores, and as evidenced by our work on Expansion score, is specifically seeking to address the availability of credit at reasonable prices for protected class consumers. We note that there is increased competition, with a larger number of vendors now offering both credit-bureau and non-traditional credit scores and that this increased competition reduces barriers to the use of credit scores by providing price competition and by providing banks with a variety of delivery models for accessing credit information and scores.

The Agencies requested comment concerning non-traditional mortgage products such as interest-only mortgages, and particularly on those which permit negative amortization, are non-amortizing, or have LTV greater than 100%. Fair Isaac agrees that these loans suggest greater risk, yet also suspect that these loans are disproportionately in the hands of lower-income and protected class borrowers and may therefore warrant risk-based capital guidelines that are grounded in safety and soundness considerations and which work consistently with Community Reinvestment Act compliance efforts required of the nation's banks in these and other circumstances.

The Agencies are seeking comment on second mortgages and HELOCs held separately from the first mortgage, and specifically seek comment on retaining the current risk weight of 100% where LTV is 90 or less, and over 100% where LTV is higher. We are currently conducting research that may be relevant in discussing the performance of credit card debt when HELOCs are established for debt consolidation but as of yet cannot share concrete findings with the Agencies that would help to support one position over another.

F. Other Retail Exposures

Here, the Agencies seek feedback on risk drivers for other retail exposures including consumer loans, credit cards, and auto loans. In these portfolios, experience has shown that consumer or small business historical performance on a particular obligation is most highly predictive of how that consumer/small business will perform in the future payment of that obligation. As such, larger scale organizations and organizations able to participate in closed consortia have adopted behavior risk scores[2] as part of their risk assessment regimes, particularly in the management of

[2] Behavior scores are computed using account and borrower performance information exclusive to a particular creditor.

credit card and auto loan exposures. In the United States, smaller scale (especially in the more fragmented consumer loan segments) has been a barrier to the use of behavior scores, while in countries other than Canada, the UK and the Republic of South Africa, behavior score rather than credit bureau score has been the predominant predictor of consumer and small business risk for accounts on books.

For smaller U.S. institutions, historical delinquency severity coupled with a refreshed credit bureau risk score have been the primary determinants for risk assessment. For larger institutions with behavior score availability, a matrixing of credit bureau and behavior score is used to define treatments and to assess risk band.

Fair Isaac feels that the presence of a refreshed credit bureau score along with a delinquency indicator (where behavior score is not present) would provide both an internal and external view of consumer and small business risk, and as such, would provide a more accurate assessment than factors like internal risk grades, LTV ratios and collateral evaluation.

Ideally, all factors that can assist in obtaining a 360–degree view of customer risk should be utilized. Today, most U.S. banks utilize credit bureau risk scores to assess external customer risk, and some combination of LTV ratios, collateral evaluation and internal risk grades or behavior scores to assess risk. Flexibility in allowing the use of either behavior scoring or delinquency severity indicators may be one possible accommodation for smaller scale institutions that cannot avail themselves of behavior models or access adaptive control systems.[3]. By contrast, international banks are more likely to assess risk at the borrower level than are U.S. institutions, and create borrower-level behavior scores based on the combination of consumer product offerings that an individual consumer may hold. U.S. banks are beginning to show increased interest in these borrower scoring practices; while their counterparts in Canada, South Africa, the UK, Northern Europe and several other countries have evidenced significantly greater sophistication in this regard.

Finally, bankers which support revolving portfolios have unique access to transaction level detail that has proven highly predictive of risk, and which facilitates earlier recognition of risk than is possible using cycle-based data and information that is characteristic of behavior scores. An increasing number of credit card issuers, including banks, are using transaction data and scores to further fine-tune their risk assessments on these portfolios. The use of transaction scoring is spreading to international markets, and is a technique which appears to have barriers to entry for smaller scale institutions similar to those barriers associated with adaptive control systems.. For smaller U.S. bankcard issuers, these barriers to entry have largely been overcome through the presence of third-party processors, and the availability of consortia (pooled) models including both behavior and transaction scoring models.

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[3] Adaptive control systems are software that enable the implementation of behavior scoring models and which all support test and control strategy experimentation on selected groups of consumers within specific product lines. As noted previously, Fair Isaac adaptive control systems actively manage over 80% of US credit card accounts and over 65% of global credit card accounts. In the US, banks have also adopted Fair Isaac adaptive control systems for managing loan, auto, small business, HELOC/home equity and residential mortgage portfolios.

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H. Loans 90 Days or More Past Due or in Non-Accrual

The Agencies here seek feedback regarding the appropriate risk-weighting of exposures that are 90 days or more past due and those in non-accrual status, offset by any reserves directly allocated to cover potential losses on that exposure. Here, the 90 day threshold would appear largely appropriate as "the point of no return" for the majority of retail exposures. However, in practice, 90 days is likely more liberal than the trigger point for repossession, foreclosure and write-off for many if not the majority of collateral-backed retail products. To the extent that collection scores can be utilized to predict collection payment potential or recovery potential, more sophisticated retail lenders can fine tune their cash flow and reserve projections to a high degree of accuracy. We note, however, that retail collection practices remain resistant to the use of factors beyond intense contact and collateral recovery for managing and forecasting risk.

J. Small Business Loans

Among other possibilities, the Agencies seek comment on lower risk weights for loans with less than $1 Million exposure, which fully amortize within 7 years, perform according to contractual provisions, and have full protection through collateral. Underwriting would need to include an acceptable assessment of collateral and of borrower credit risk/financial condition. The Agencies propose reducing risk weight from 100% to 75% on such exposures. Alternatively the Agencies seek insight into assessment of the business principals' credit risk, especially where the principal(s) guarantee the loan. Here, we note the rapid and prevalent adoption of Fair Isaac Small Business Scoring Service ("SBSS"), which enables banks to utilize consumer credit bureau data, small business application data, financial statement data and commercial credit data in combination to assess the creditworthiness of the principals of a small business and of the small business ability to make repayment on credit obligations up to $750,000 in size. Our experience has shown a willingness and ability by even the smallest institutions (fewer than 100 credit applications annually) to adopt and utilize SBSS for improved lending efficiency and stronger risk assessment, and these institutions have not felt limited by economic or implementation burden. We note that there is an increased competition between commercial credit data providers, systems vendors and scoring vendors that will further diminish any perceived barriers to adoption for the use of credit scoring in small business lending by banks, thrifts and credit unions.

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Fair Isaac appreciates the opportunity to provide comment on the Risk-Based Capital Guidelines ANPR and again commends the Agencies for their achievements and for their willingness to consider industry feedback. Questions about this matter and our comments can be directed to me via any of the contact methods identified below.

Sincerely,

s/Janice Horan

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