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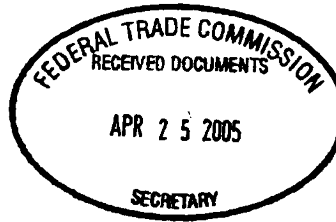


*MasterCard International*

*By Messenger*

April 25, 2005

Office of the Secretary
Federal Trade Commission
Room H-159 (Annex Z)
600 Pennsylvania Avenue, NW
Washington, DC 20580

**Re: FACT Act Scores Study**

To Whom It May Concern:

This letter is submitted on behalf of MasterCard International Incorporated ("MasterCard")[1] in response to the notice and request for public comment ("Notice") relating to the Federal Trade Commission's ("Commission") study of credit scores and the availability and affordability of financial products ("Study"). MasterCard appreciates the opportunity to provide comments for use in connection with the Study.

## In General

The use of credit scores has provided enormous benefits to consumers and lenders for a variety of reasons. Through the use of credit scores, lenders are able to make underwriting decisions efficiently, and with a high degree of confidence. Aside from the improved efficiencies in the underwriting process, consumers also benefit because lenders are able to assess their underwriting risks better, allowing them to make more credit available to more consumers more cheaply than ever before.

## What Is a Credit Score?

A credit score is nothing more than a numeric representation of an assessment of a consumer's creditworthiness. The credit score is derived using a credit score model, or a scorecard, that assigns numerical values, which may be both positive and/or negative, to a variety of variables. For example, a scorecard may include an evaluation of the

[1] MasterCard is an SEC-registered private share corporation that licenses financial institutions to use the MasterCard service marks in connection with a variety of payments systems.

consumer's repayment history, the amount of debt the consumer has, and the types of loans held by the consumer. Depending on the scorecard, the consumer may receive positive points for a solid repayment history, relatively low levels of debt, and having a single mortgage loan. Alternatively, the consumer could receive negative points for delinquent payments, relatively high levels of debt, and having multiple mortgages on his or her house.

It is important to note that there is no one, single credit score. This is because a credit score is a numerical representation of what any given lender assesses a consumer's credit history to be—and not all lenders evaluate creditworthiness using the same variables and models. Therefore, a lender may develop its own scoring model, or hire a company to develop the model on the lender's behalf. Regardless of who develops the model, the scorecard is generally based on statistical analysis of consumer behaviors. The scorecard assimilates such statistical assumptions into an integrated scoring product. Basically, in the quest to develop the most predictive scoring model, lenders will rely on those factors which are available to them and have a statistically significant relationship to the consumer's creditworthiness.

Although there are many credit scores for any given consumer, for simplicity purposes many people refer to a consumer's "FICO score" as *the* credit score relating to a consumer.[2] Reference to FICO scores may be useful in some circumstances when making general statements about consumers' creditworthiness. In reality, however, there are probably hundreds if not thousands of scorecards that can be used by lenders to determine a consumer's creditworthiness. Each of these scorecards represents a different approach to assessing a consumer's creditworthiness, with no particular one being superior in every instance.

We also would like to emphasize the types of information that are *not* considered in a credit score. For example, no information relating to a prohibited basis under the Equal Credit Opportunity Act ("ECOA"), such as race or ethnicity, is included in a credit score. The law prohibits the consideration of such information with respect to extending credit to consumers, regardless of whether the consideration is done on an *ad hoc* basis in a subjective manner or in a more formalized manner as part of a credit score. Therefore, credit scorecards do not include such information.

The Notice specifically asks how records of inquiries are used by credit scoring systems, and whether such use would affect consumers' behavior. Since there is no "standard" credit score, it is not possible to describe with precision how inquiries are used by each credit scoring system. However, we are aware that some scorecards do take inquiries into account when calculating a consumer's credit score.[3] Apparently those who develop such scorecards have determined that the number of applications a consumer has made for different types of loans assists an analysis of that consumer's creditworthiness. There is intuitive logic to this approach—a consumer who has recently applied for several

[2] A FICO score is a credit score calculated using a scorecard developed by the Fair, Isaac Company.

[3] By use of the term "inquiry," we mean a lender's request to a consumer reporting agency for a consumer report in connection with a consumer's application for a loan.

credit cards or personal credit lines may be more likely to be in the process of taking on significantly more credit and thus potentially increasing credit risk or perhaps experiencing financial difficulties. It is also our understanding, though, that the more sophisticated credit scoring models (if not all such models) take steps to avoid "double counting" of inquiries. For example, a consumer who applies to three different mortgage lenders in a short period of time for a purchase money mortgage is not going to obtain three separate purchase money mortgages, but instead is probably "shopping" for a single mortgage. Therefore, the scoring models generally count such behavior as one inquiry for purposes of the model, and not three inquiries. MasterCard is not aware of any indication that consumer behavior is affected by the use of inquiries in credit scoring models.

## How Are Credit Scores Used?

Credit scores may be used for a variety of purposes, including credit or insurance underwriting. It is MasterCard's understanding that credit scores are widely used for the underwriting of open-end consumer credit products, such as credit cards. Not only does a credit score allow an issuer to determine the relative risk associated with lending to an individual, it also allows the lender to price for that risk more accurately. This can be done at account opening and throughout the open-end credit relationship with the consumer.

One of the primary benefits of credit scores is the improved accuracy and granularity of credit risk assessments. In the past, a consumer's credit history may have been reviewed by a loan officer or a loan committee. Although knowledgeable in the area of credit underwriting, the loan officer or committee did not necessarily have the ability to quantify precisely a consumer's credit risk. Rather, the consumer was either deemed to be a "good" risk relative to the product offered or a "bad" risk. Those who were "good" were offered the loan. Those who were not were denied. While this was effective for most lenders, the process was relatively inexact and did not necessarily allow for an analysis of more refined gradations of risk.

Credit scoring has provided a level of accuracy and granularity that allows lenders to identify relatively small differences in credit risks. This has had a particularly positive impact on consumers with imperfect credit histories. For example, at one time, a lender may not have had confidence that it could price a loan to a consumer with an imperfect credit history. However, credit scores have allowed lenders to assess a consumer's creditworthiness based on statistically valid assumptions. Therefore, the creditor is in a better position to calculate the risk posed by a particular consumer, and to price the loan to that consumer accordingly. The result is that more lenders are willing to make credit available to consumers with imperfect credit histories because the lenders can evaluate and price for the credit risk. Use of the credit score can also be helpful in determining not only the cost of credit, but how much credit the lender is willing to make available.

Because credit scoring has allowed more lenders to provide loans to a wider range of consumers, competition for such consumers has also increased. Whereas at one time there may have been only a few lenders willing to lend to consumers with imperfect credit histories, today there are a wide variety of lenders competing in this market. This increased competition results in more choices, and ultimately lower costs, for consumers.

For example, the Chairman of the Board of Governors of the Federal Reserve System, Alan Greenspan, recently stated:

> "The widespread adoption of these models [*i.e.*, credit scores] has reduced the costs of evaluating the creditworthiness of borrowers, and in competitive markets cost reductions tend to be passed through to borrowers. These improvements have led to rapid growth in subprime mortgage lending; indeed, today subprime mortgages account for roughly 10 percent of the number of all mortgages outstanding, up from just 1 or 2 percent in the early 1990s."[4]

**Managing Credit Card Accounts**

The majority of credit card loans are open-end, unsecured loans to consumers. Prior to opening an account, a credit card issuer will evaluate the consumer's creditworthiness, many times through use of a credit score, and price the loan accordingly. However, a consumer's creditworthiness can fluctuate over time. Therefore, to manage portfolio risk, credit card issuers may monitor the creditworthiness of their cardholders over time. If a cardholder's creditworthiness deteriorates, the card issuer may need to adjust the price of the open-end loan to the consumer to reflect the increased credit risk. The need to reprice a loan to reflect deteriorating credit risk did not originate with the use of credit scores. However, credit scoring allows card issuers to monitor their portfolios' risk levels more precisely and on a more automated basis.

**Prescreening**

The Notice specifically requests comment on how the use of credit scores has affected prescreening. As discussed above, the use of credit scores has allowed lenders to feel more confident in making credit available to a wider range of consumers. This increased benefit to consumers is not limited to applications passively received by lenders; rather, lenders are also better able to target a wider range of loans to more consumers through the use of prescreening. Whereas, in the past, a card issuer may have sent a firm offer of credit to a select group of people for the only credit card the issuer offered, now a card issuer has an increased variety of credit card options and can send firm offers of credit to individuals who qualify for one or more of those options.

Prescreening represents another area in which credit scores have fostered increased competition. As the prescreening process has become more efficient and precise through use of credit scores, more lenders are able to offer consumers credit cards or other prescreened loan products. This increase in competition has resulted in a myriad of credit card products available to consumers at extremely competitive prices.

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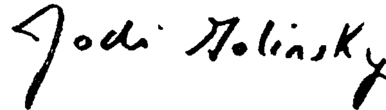
[4] Remarks by Chairman Alan Greenspan at the Federal Reserve System's Fourth Annual Community Affairs Research Conference, Washington, D.C., April 8, 2005.

Once again, we appreciate the opportunity to comment on the Study. If you have any questions concerning our comments, or if we may otherwise be of assistance in connection with this issue, please do not hesitate to call me, at the number indicated above, or Michael F. McEneney at Sidley Austin Brown & Wood LLP, at (202) 736-8368, our counsel in connection with this matter.

Sincerely,



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cc: Michael F. McEneney, Esq.



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