MORTGAGE BANKERS ASSOCIATION

May 19, 2017

Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, D.C. 20552

RE: CFPB Request for Information Regarding Use of Alternative Data and Modeling Techniques in the Credit Process (Docket No. CFPB-2017-0005)

Dear Ms. Jackson,

The Mortgage Bankers Association (MBA)[1] appreciates this opportunity to respond to the Consumer Financial Protection Bureau's (CFPB; Bureau) Request for Information (RFI) regarding the use of alternative data and modeling techniques in the credit process.

The stated purpose of the RFI is to educate the CFPB about the past, current and potential uses of alternative data and modeling techniques. In particular, the Bureau is interested in learning more about:

- the specific types of alternative data and modeling techniques used for various decisions in the provision of credit;
- the policies and procedures in place to ensure the responsible use of alternative data and methods; and
- how the use of alternative data and modeling techniques compares and contrasts with the use of traditional data and modeling techniques for similar credit decisions.

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's web site: www.mba.org.

MBA greatly appreciates the CFPB's efforts to better understand the roles of alternative data and modeling techniques. Although it is important to understand individual practices, the publication of the RFI makes clear that there is an emerging need for the CFPB to develop a fair and transparent framework that creates opportunities for market participants and other stakeholders to research and innovate safely.

Such a framework should include near-term and long-term steps that involve reconsideration and revision of existing policies as well as the development of new policies.

The Need for a Framework

Alternative data and modeling techniques hold the promise of changing the way that some financial services companies do business. Such data and modeling techniques could expand the number of individuals who are served by the mainstream credit system and enable others to obtain more favorable pricing based on more refined assessments of their risk profiles. Of course, alternative data and modeling techniques also bring new and as yet undefined sources of risk. Some data sources and analytic techniques may introduce inaccuracies and biases that could lead to detrimental effects, including unintended outcomes for low-income and underserved populations.[2]

Fear and uncertainty about regulatory risks are major impediments to companies pursuing the development of innovative approaches to credit-related indicators. Concern is especially high for innovators trying to serve populations that do not currently have access to many financial products. Successfully navigating the intersection of data usage, data analysis, innovation, safety and soundness and consumer protection will be an iterative process. It will therefore be critical for regulators to foster a permissive environment in which experimentation can occur.

Fortunately, in the past two years several models for just this type of framework—commonly described as a "sandbox"—have been developed around the world, including in the United Kingdom, Hong Kong, Singapore, Switzerland and Thailand, with many others currently in development.[3]

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[2] Federal Trade Commission, Big Data: A Tool for Inclusion or Exclusion?, January 2016.

[3] These existing sandboxes include the UK's "Project Innovate," which allows firms to test new products that regulators deem are truly innovative and potentially beneficial to consumers. The Financial Conduct Authority (FCA) also requires firms to have appropriate consumer safeguards, such as the wherewithal to compensate consumers who are harmed if the pilot project goes awry. The Hong Kong Monetary Authority (HKMA) launched a Fintech Supervisory Sandbox to allow banks to test innovative Fintech products and initiatives within a live, controlled environment before they are fully compliant. The model is only available to authorized institutions and to start-ups and other unlicensed businesses. The Monetary Authority of Singapore (MAS) recently published a paper outlining the guidelines for a regulatory sandbox. In August 2015, the MAS formed a Financial Technology and Innovation Group to create the Smart Financial Centre initiatives. Switzerland's Federal Department of Finance has been instructed to prepare a consultation paper with the intention of reducing barriers to market entry for financial technology providers and increasing legal certainty for the sector. Specifically, the Federal Council has

While each model has unique components, in general sandboxes provide an opportunity for market participants to test new ideas with some degree of regulatory protection, including the temporary waiving of certain rules or limits on enforcement actions. Most often, companies have assurances that they will not be assessed fines or other penalties, as these are better directed at bad actors rather than companies acting in good faith that are developing a product or innovation that could yield greater consumer benefits. Strong consumer protection measures can remain in place, including requirements for informed consent and voluntary participation, as well as mechanisms to deal with complaints and withdrawals.

MBA encourages the CFPB to look to guidelines already used in other countries in developing its own framework for financial technology. Moreover, the process should continually include outreach and solicitation of feedback from the public. And while strong communication with market participants is critical, the development of a vibrant financial technology ecosystem also requires close collaboration among many government entities.

Near-Term Considerations

Notably, the CFPB already has some mechanisms in place that could be built on to facilitate marketplace innovation, as discussed below. Relevant policies and programs that may be useful include the No-Action Letter (NAL) policy specifically targeting marketplace innovations, as well as Project Catalyst, an incubator to facilitate experimentation and new product development. To date, the NAL policy has not been implemented in a way that maximizes its utility, which has in turn hindered the progress achieved through Project Catalyst. The CFPB will therefore need to reconsider and revise its NAL policy to support efforts to address the ongoing surge in financial technology development. When considering alternative data, the CFPB should also establish a broader spectrum of data categories to better distinguish between existing data, new uses of existing data and data that has not yet been collected or considered as a potential factor in the credit process.

The CFPB Should Revise its No-Action Letter Policy

When the CFPB finalized its NAL policy in 2016, it stated that:

> The Proposed Policy is intended to facilitate consumer access to innovative financial products that promise substantial benefit to consumers, taking into account other marketplace offerings, and also to enhance compliance with applicable federal consumer financial laws. By furnishing a dedicated mechanism through which substantial regulatory uncertainty can be reduced, the

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proposed developing a financial technology license, an innovation sandbox, and an extension of the maximum holding period on settlement accounts. The Bank of Thailand recently issued a consultation paper on Fintech Regulatory Sandbox Guidelines.

> Proposed Policy is also intended to discourage the offering of innovative consumer-harmful financial products in such circumstances.[4]

Although the CFPB conceived of this policy to accommodate a limited number of applications per year, the rapid expansion, availability and accessibility of data and analysis suggests that—with a more comprehensive framework—the number of applications and the demands on the CFPB could increase, particularly were the NAL policy improved.

The current NAL policy should be improved in critical respects. For example, currently a NAL would not be binding on any state or federal regulator and would not provide protection against any private rights of action. It also would not be truly binding on the CFPB since NALs are subject to modification or revocation at virtually any time. These flaws in the NAL policy have in large measure prevented it and the CFPB's Project Catalyst from fostering innovation.

In sum, MBA recommends that while the CFPB develops a broader framework for addressing innovation, it reconsider and revise its current NAL policy to better align with the standards and protections that exist in the international sandbox models. It should be emphasized that strong legal protections are the most critical component to be addressed, and those protections should extend to foreclosing claims of unfair, deceptive, or abusive acts and practices (UDAAPs).

There is a Need to Better Define Data Categories

For purposes of this RFI, the CFPB has chosen to define key terms including "traditional data" and "alternative data." The CFPB defines "traditional data" as the data assembled and managed in the core credit files of the nationwide consumer reporting agencies, which includes trade line information and credit inquiries, as well as information from public records relating to civil judgments, tax liens and bankruptcies. It also refers to data customarily provided by consumers as part of applications for credit, such as income and length of time in residence.

The CFPB defines "alternative data" as any data that are not "traditional." Before moving forward, MBA urges the CFPB to revisit these definitions and add one or more categories. While the definition of "traditional data" is mostly sound, the category of "alternative data" is far too broad. The common meaning of "alternative data" today encompasses data points that are currently available and have already been considered and in some cases adopted as underwriting criteria. Examples include monthly rent payments and utility bill payments.

As the CFPB notes, however, increased computing power and expanded use of machine learning could potentially identify additional data points that have not been discoverable through traditional methods. Accordingly, MBA urges the CFPB to

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[4] 79 Fed. Reg. 62120 (Oct. 16, 2014).

develop a broader spectrum of data categories, including at least a new category of "experimental data" in addition to "traditional" and "alternative" data. "Experimental data" would include data not yet tested in underwriting, data that has not been available for collection or testing through a full credit cycle, including periods of stress, or data that does not yet exist.

Developing a Framework for Long-Term Success

The near-term approaches discussed above are important, but it will also be necessary for the CFPB to develop a sustainable, long-term framework that can be responsive to technologies not yet developed. As part of this process, we would urge the CFPB to work with stakeholders to take a holistic approach to facilitate experimentation.

In a recent white paper, the Federal Trade Commission (FTC) described the life cycle of data as having four phases: 1) collection; 2) compilation and consolidation; 3) analysis; and 4) use.[5] It is clear already that, with respect to alternative data and modeling techniques, the CFPB will need to address many questions pertaining to each phase.

For example, with respect to collection, compilation, consolidation and analysis, will the CFPB publish authoritative written rules or guidance for participants as to how to safely go about collecting and analyzing data? Will there be any flexibility for the CFPB to create ad-hoc authoritative guidance? Will a company's entire portfolio be protected by privilege or otherwise for analysis purposes so that a company can safely compare and learn from data?

With respect to uses of data, what will the CFPB's approach be to responding to new findings? Is a reasonably successful experiment sufficient or does a particular type of analysis need to be performed through all portions of the credit cycle? Will the findings be made public or can results be treated as proprietary? Will the CFPB work with secondary market actors to ensure that a viable marketplace exists for loans using alternative data and analytic methods? Will the CFPB guarantee that any discovery of a new and improved model not create any liability under standards that pertain to older models?

This is only a sample of questions, but it highlights the importance of the need for a carefully conceived engagement process to ensure the development of a framework that truly facilitates innovation.

As alternative data or modeling techniques become more commonly used in the credit process, it will be critical that the CFPB and other regulators clearly articulate how alternative data and modeling techniques should adhere to safety and soundness principles, as well as other regulatory and legal requirements, such as fair lending standards. This will serve to both better protect consumers and provide greater certainty to lenders.

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[5] Federal Trade Commission, Big Data: A Tool for Inclusion or Exclusion?, January 2016.

Finally, if innovative developments lead to opportunities to expand the credit box in a safe, sustainable way, the Ability-to-Repay rule and Qualified Mortgage standards should accommodate these developments.

MBA welcomes this opportunity to work with the CFPB on the use of alternative data and modeling techniques in the credit process. Should you have questions or wish to discuss these comments, please contact Ken Markison, Vice President and Regulatory Counsel, at (202) 557-2930 or kmarkison@mba.org or Dan Fichtler, Associate Director of Secondary and Capital Markets, at (202) 557-2780 or dfichtler@mba.org.

Again, we greatly appreciate the CFPB's attention to this important subject.

Sincerely,

Pete Mills
Senior Vice President
Residential Policy and Member Engagement