A WRITTEN STATEMENT OF FAIR ISAAC CORPORATION

ON HELPING CONSUMERS OBTAIN THE CREDIT THEY DESERVE

BEFORE THE UNITED STATES HOUSE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

WASHINGTON, D.C.

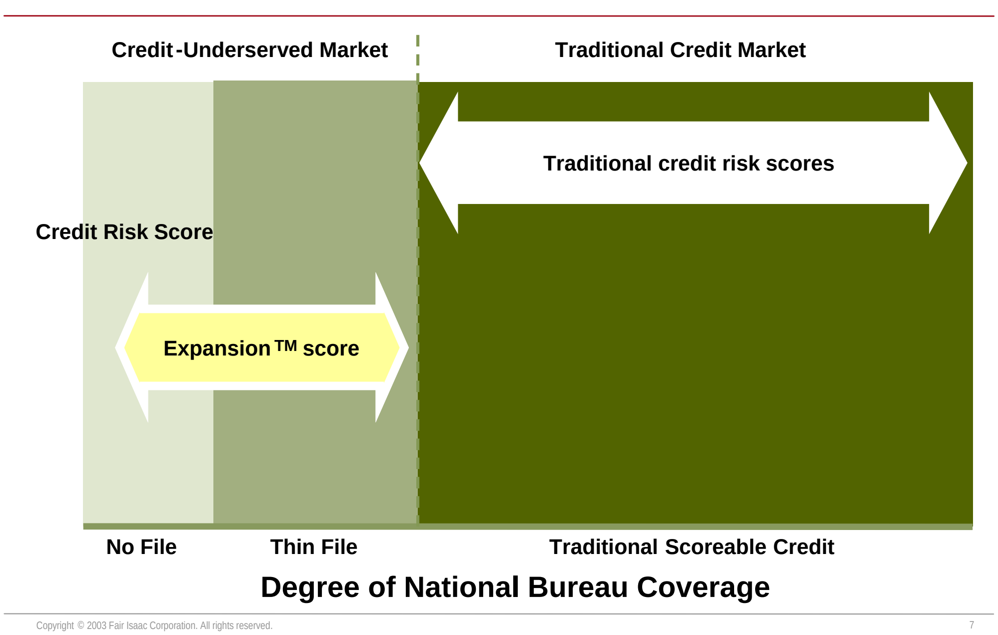
MAY 12, 2005

Introduction. Mr. Chairman and members of the committee, my name is Lisa Nelson. I am the Vice President of Business Operations for Fair Isaac Credit Services, Inc. a subsidiary of Fair Isaac Corporation. Thank you for the opportunity to testify before you today about Fair Isaac's leadership in the utilization of alternative credit data, specifically with respect to the launch of Fair Isaac's new Expansion™ Score.

Fair Isaac Corporation. Fair Isaac Corporation is the preeminent provider of creative analytics that unlock value for people, businesses and industries. Founded in 1956, Fair Isaac helps thousands of companies in over sixty countries reduce fraud and credit losses, lower operating expenses, and make more credit available to more people. Fair Isaac pioneered the development of statistically-based credit risk evaluation systems, commonly called "credit scoring systems," and is the world's leading developer of those systems. Thousands of credit grantors use broad based credit risk scores commonly known as "FICO® scores" generated by Fair Isaac-developed scoring systems implemented at the national credit reporting agencies. 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.

There Are Different Kinds of Credit Risk Scores. The most well known credit risk scores are the broad based credit risk scores developed by Fair Isaac known as classic FICO scores and widely distributed to lenders by the three national credit reporting agencies under the brand names: Beacon from Equifax; FICO® Risk Score Classic, from Trans Union; and, the Experian/Fair Isaac Risk Model from Experian. A FICO credit risk score is a three-digit number that rank-orders consumers according to their credit risk using traditional consumer credit data stored by the three national consumer reporting agencies. This data consists of both positive information, e.g. the consumer has made all payments due on a trade line for ten years, and negative information, e.g. the consumer failed to repay a loan. Other credit risk scores also rely on data from the three national credit reporting agencies, such as credit risk scores developed by each of the three national credit reporting agencies, other third party developers and models developed for specific industries, such as the mortgage, automobile and telecommunications industries.

Fair Isaac Credit Services, Inc. has recently released the Expansion score which utilizes alternative credit data rather than relying on the traditional data used by other scores. The Expansion score was developed specifically for the segment of the consumer population that historically has not been eligible for credit because they do not have enough traditional credit data to generate a credit risk score. The Expansion score is similar to other credit risk scores in that it utilizes both positive and negative credit history and relies on the technology on which other Fair Isaac credit risk scores are based. It is much different, however, in that it utilizes alternative credit data collected by credit bureaus other than the three national consumer reporting agencies. The diagram below compares the role played by the Expansion score and by traditional credit risk scores, and the role that data plays in each of them.



With Credit Scoring, More People Get Credit, They Get It Faster, And It's More Affordable. Credit risk scores mean more people have access to credit. More people can get credit regardless of their credit history because credit risk scores allow lenders to safely assess and account for the risk of consumers who have no existing relationship with the lender, who have never entered the lender's branches, and who may have been turned away in the past by other lenders. Lenders use scores not only to evaluate applications, but also to manage the credit needs of existing customers by extending additional credit or helping consumers avoid overextending themselves.

Credit risk scores mean people get credit faster. Credit risk scores are used to provide "Instant credit" at a retailer, an auto dealer, over the phone, or on the Internet. Even mortgage loans that used to take weeks can now be done in minutes. All of this has occurred while lenders have not only preserved but strengthened their visibility and control over their risk exposure.

Credit risk scores mean people pay less for their credit. Scores make credit more affordable by reducing the cost of evaluating applications, reducing loan losses, reducing the cost of managing credit portfolios, reducing marketing costs with prescreening, and cutting the cost of capital with securitization. This efficient flow of credit and capital has a large part to play in the continued robustness of the American economy. By enabling lenders to extend credit quickly while managing their risk, credit reports and credit risk scores have made credit more accessible, at lower rates, to more people.

Until the recent introduction of the Expansion score, many consumers found it hard to enjoy the benefits created by credit risk scores because the credit history used by traditional credit risk scores was insufficient to generate a score. The Expansion score brings the benefits of credit scoring to many in the underserved population by utilizing alternative sources of credit data along with the same technology used by traditional Fair Isaac credit risk scores to generate the Expansion score. As more lenders learn the benefits of the Expansion score and a credit risk score is available for more consumers by virtue of additional sources of alternative credit data, more Americans will be able to get the inexpensive credit they need to buy homes or consumer goods.

A Significant Portion Of Americans Cannot Be Scored Using Traditional Scores.

It is commonly estimated that as many as one-fourth of all credit-eligible consumers in the US either lack traditional credit reports entirely or have traditional credit reports with too little information (known as "thin files") for making a good prediction of credit risk. Perhaps as many as 50 million consumers (roughly 25% of adults living in the U.S.) do not have enough credit data within the national repositories to generate a traditional credit risk score. This group is not only large, it is diverse. No one should assume that this group represents a sub prime lending market. This is a non-homogenous group, including:

- Immigrants
- College students and other young adults
- Recently divorced or widowed people
- Americans that historically have not utilized traditional credit due to cultural influences, the era in which they were raised, or other factors.

While not all of these individuals will seek credit, Expansion scores create <u>access to</u> credit for them, while enabling lenders to make a more informed decision if and when Americans in this population do seek credit.

The availability of a credit risk score to previously unscoreable consumers means:

1. <u>Even more people have access to credit</u>. Lenders are better able to assess risk and tailor credit for each consumer's needs.
2. <u>More Americans are able to get credit faster</u>. Credit risk scores are used to provide "Instant credit" at a retailer, an auto dealer, over the phone, or on the Internet. The Expansion score's use of alternative credit data sources can open

the door to the convenience of instant credit to more people, while lenders maintain visibility and control over their risk exposure.

3. Borrowers pay less for their credit. Credit risk scores make credit more affordable by reducing the cost of evaluating applications, reducing loan losses, reducing the cost of managing credit portfolios, reducing marketing costs with prescreening, and cutting the cost of capital with securitization. As the Expansion score market develops, consumers for which credit risk score were previously unavailable should see less costly credit. Moreover, it is logical to expect that as the efficiencies and lower risks associated with scoring reach a larger portion of the borrowing population by virtue of the use of alternative credit data, lender's overall costs will drop and all Americans will enjoy credit that costs even less than it does today.

The Expansion Score Utilizes Alternative Credit Data And Fair Isaac Scoring Technology To Create Credit Risk Scores For Americans In The Traditionally Credit Underserved Market.

A FICO credit risk score is a 3-digit number that tells lenders how likely it is a borrower will repay as agreed. The Expansion score is a credit risk score based upon non-traditional consumer credit data (in other words, data from sources other than the traditional credit files of the major national credit reporting agencies). The purpose of the Expansion score is to predict the credit risk of consumers for whom a traditional credit risk score is unavailable. Like traditional credit risk scores, the Expansion score provides a snapshot of credit risk at a particular point in time. Credit grantors who cannot obtain a traditional credit bureau risk score for a consumer due to insufficient history for that consumer in traditional databases can now, for many of those consumers, obtain an Expansion score from Fair Isaac Credit Services, Inc.

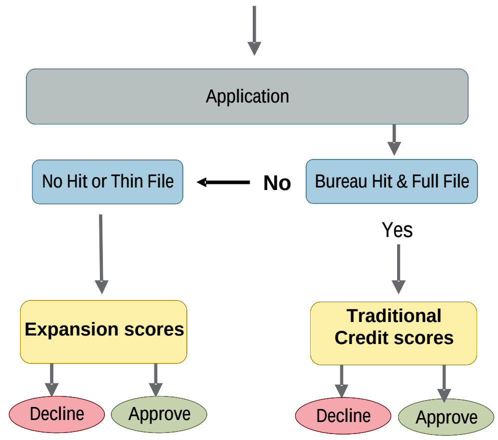
The FICO® Expansion 300-850™ credit risk scores are in the same range used by the classic FICO credit risk scores. As with traditional credit risk scores, consumers with higher scores are more likely to repay creditors as agreed. Also similar to the traditional credit risk scores, the Expansion Score rank-orders consumers by the likelihood that they will become severely delinquent (90 days or more past-due) on a credit account in the 12 months following scoring. Also like traditional credit risk scores, Expansion scores can change over time, as subsequent credit risk predictions reflect changes in underlying behaviors.

Fair Isaac developed the Expansion score model using the statistical approach used to develop the classic FICO score. In developing the Expansion score, Fair Isaac analyzed anonymous <u>alternative</u> credit data to statistically determine what factors are most predictive of future credit performance. Factors that do not have predictive value and factors that by law cannot be used in the credit decision are excluded from consideration. The Expansion score meets all requirements of Regulation B of the Equal Credit Opportunity Act. The Expansion score models are built based on a combination of empirically derived and expert-based capabilities, producing a strong ability to rank-order consumers based on future risk. As with any generally available broad-based credit risk score, the lender is obligated to track usage over time to validate the score's performance on their loans and demonstrate that the score rank-orders risk on the lender's unique book of business.

Please see the diagram below to understand how the Expansion score fits within the lender's decision making process.

Work flow considerations

Application Review Work



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Once the lender has been approved for access to the Expansion score, a variety of channels are available to that lender for getting Expansion score reports on applicants including web entry, a system-to-system interface and batch delivery.

Early Results Conclude The New Expansion Score Enables Lenders To Score And Underwrite A High Proportion Of The Growing, Credit-Underserved Market.

To test the effectiveness of the Expansion score, Fair Isaac analyzed data from multiple lenders in mortgage financing, automotive lending and bank cards. Across the various vertical applications, early results showed a scorability rate as high as 80%, meaning that of applications that resulted in no-hits or thin files when traditional credit risk scores were requested, eight out of every ten received an Expansion score.

Fair Isaac Is Committed To Finding And Using The Best Available Non-Traditional Credit Data Within The Expansion Score.

One distinction between Expansion scores and traditional credit risk scores is the source and nature of the credit data used to generate the credit risk score. The Expansion score analyzes non-traditional credit data from third party data providers. Examples of such data include deposit account records, check writing behaviors, telephone and purchase payment plan performance. Fair Isaac Credit Services, Inc. obtains and resells data from a number of consumer reporting agencies that collect the data from the furnishers. This ensures that the Expansion Score will use the best alternative credit data available (i.e. the most predictive) and will be immune from any tendency to rely on data simply because it is part of a database controlled by Fair Isaac Credit Services, Inc. Moreover, the Expansion Score is designed to utilize new sources of credit data as the data becomes available and research shows adding it will improve the predictiveness of the score. This approach allows Fair Isaac to be data agnostic, and we continue to explore business relationships with all reputable and compliant consumer reporting agencies that aggregate alternative credit data.

What fuels the Expansion Score now and going forward

- Positive Alternative Credit
- Negative Alternative
- Thin File Credit
- Public Record
- Third Party Verified
- Application Data

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The availability of both positive and negative alternative credit data is important to the performance of the Expansion Score. Fair Isaac seeks out both kinds of credit data. By utilizing multiple sources of both positive and negative alternative credit data, the Expansion Score is typically able to find data and score as high as 80% of the applications provided to us by lenders.

The broad, nationwide data coverage and extensive use of technology positions the Expansion score as a leading edge solution for the needs of the lending community.

Existing Regulation Adequately Protects Consumers And Allows For The Use Of Alternative Credit Data To Expand The Availability Of Credit.

The Expansion Score uses credit data. This means Fair Isaac Credit Services, Inc. and all of the companies that provide the data for the Expansion Score operate as consumer reporting agencies, comply with the Fair Credit Reporting Act (as amended by FACTA), and are therefore regulated by the FTC. This means that even though the credit data used is different than that used by traditional credit risk scores, consumers are protected by an existing and proven regulatory scheme. For example, consumers have the right to obtain a copy of the credit report underlying the Expansion Score and can exercise their FCRA rights to correct errors in the data. Furnishers of credit data have an obligation to respond to questions about the accuracy of data furnished just like banks that provide trade line information to the national CRA's must respond to such questions.

Lenders that become subscribers of the Expansion score service are put through a review process to determine that they are a legitimate entity and have permissible purpose to obtain an Expansion score. This process includes but is not limited to utilizing public records to confirm the entity's existence and standing, obtaining information about the organization's past business practices, including whether they are known to be an existing user of credit risk scores, verification of contact person's employment status with the entity, and in some instances on-site visits.

Participating in the system by furnishing data to credit bureaus is voluntary and should remain so because the free market is the most efficient means to find new sources of data. Furnishers of alternative credit data work with a data aggregator that is able to use the data from the furnisher to deliver an economic benefit to the furnisher within the furnisher's industry. The benefit the furnisher gets from the aggregator acts as the economic incentive needed for the furnisher to undertake the burden of complying with FCRA imposed furnisher obligations. Further regulatory burdens are unnecessary and will decrease participation. The Expansion Score and the providers of the alternative credit data it utilizes operate in compliance with the existing regulatory framework and further regulation is not required.

Everyone Benefits From Alternative Credit Data And The Credit Risk Scores It Supports.

The Credit underserved market is a non homogenous group of people; many of whom need access to credit to fulfill their dreams. Although lenders want to enlarge their market and extend credit to such consumers, they need a tool to manage their risk and costs. Fair Isaac Credit Services, Inc. combines both positive and negative alternative credit data with the strength of Fair Isaac analytics to generate the Expansion score that is easily assimilated into lender processes and decision making. The Expansion Score offers consumers access to financial services by enabling lenders to safely expand their markets within the context of an existing regulatory scheme that has proven to be safe and effective for consumers, lenders and the economy.