

VantageScoresm vs. FICO

I. Summary

We do not expect any immediate effect on securitizations from the introduction of the VantageScoresm consumer credit scoring system by the three national credit bureaus. Traditional FICO scores have become the universal standard for gauging consumer credit quality in securitizations. FICO scores feed into rating agency models and into GSE automated underwriting systems.

For many lenders, FICO scores have the primary role of facilitating loan pricing and securitization. Scores that do not accomplish those functions cannot effectively replace FICO scores. In fact, for many lenders, the fact that FICO scores measure risk is incidental because the lenders do not retain credit exposure on their loans.

So far, neither Moody's nor S&P's rating models can use VantageScores in place of FICO scores. Likewise, neither of the GSE automated underwriting systems can do so. Unless and until that happens, we expect VantageScore to raise only a trifling challenge to FICO's dominance.

II. Discussion

On 14 March 2006, the three major consumer credit bureaus released their jointly developed credit scoring product, called VantageScore. The credit bureaus seemingly want their new product to compete against FICO scores. All three of the national credit bureaus – Equifax, Experian, and TransUnion – participated in the development of the VantageScore product and they jointly own it.

Like FICO scores, the VantageScore product is optimized for a two-year time horizon. It attempts to rank the likelihood that a consumer will become delinquent by 90 days or more on any account. However, unlike FICO scores, which use a scale from roughly 300 to 900,¹ VantageScore uses a scale from 501 to 990.

The credit bureaus claim that VantageScore "limits score variability across credit reporting companies." They imply that variations in a consumer's FICO score calculated at the three credit bureaus are due primarily to model differences rather than data differences. This seems unlikely. Fair Isaac is very good at what it does. The company periodically updates and improves the FICO score models. We doubt that Fair Isaac actually has left much room for further improvement in

¹ There are many conflicting reports about the exact range of the FICO score scale. Most reports place the low end of the range around 300 to 350 and the high end of the range around 850 to 900. See *What Is the Credit Score Range* <<http://www.creditscoring.com/pages/funwithnumbers.htm>>.

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wringing better predictions from the available data. We expect data differences account for the vast majority of variations in any given consumer's scores at the three bureaus.

The sudden introduction of the VantageScore product – without involvement of the GSEs and the rating agencies – calls into question whether the credit bureaus really understand how the market uses credit scores. The credit bureaus seem to have ignored the role of securitization. The credit bureaus seem to have forgotten that lenders sell much of their production through securitization. In today's environment, a scoring product cannot succeed without meeting the needs of securitizers and, through them, institutional investors. In our view, VantageScore cannot replace FICO scores for securitization lenders unless GSE automated underwriting systems and the rating agencies' risk models can use them. As far as we can tell, the credit bureaus failed to reach out to the securitization community in connection with developing the product.

If the credit bureaus had focused on securitizers and intuitional investors, they might have found an opportunity to seize. For example, from an investor's perspective, FICO's two-year time horizon and delinquency orientation arguably are weaknesses. The credit bureaus might have crafted a product that uses losses/charge-offs instead of delinquencies and that uses a four- or five-year performance window. Such a scoring product arguably would have been better suited to investors' needs than FICO scores. Such a product might have favorably differentiated itself. As it is, VantageScore does not.

In our opinion, VantageScore faces a tough, uphill fight. The credit bureaus will need to reach out to the rating agencies, the GSEs, securitizers, and investors. Unless those entities embrace it, the outlook for VantageScore is bleak.

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