

November 14, 2014

The Honorable Melvin L. Watt
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20024

Re: Fannie Mae and Freddie Mac policies regarding disputed items on credit reports

Dear Director Watt:

The undersigned consumer, civil rights and advocacy groups write to you today in your role as regulator for Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac). We urge you to address a serious, unfair, and potentially unlawful practice that is caused by the policies of Fannie Mae and Freddie Mac: the denial of mortgages if the applicant's credit report contains a dispute.

We believe that Fannie Mae's and Freddie Mac's current guidelines regarding the treatment of credit reporting disputes impinges on the rights of consumers under the Equal Credit Opportunity Act (ECOA). More importantly, *lenders* who reject applicants because of disputed tradelines because they are unwilling to manually underwrite the loan appear to be directly violating the ECOA.

Currently, Fannie Mae's guidelines state:

When DU [Desktop Underwriter] issues a message stating that DU identified a disputed tradeline and that tradeline was not included in the credit risk assessment, the lender must confirm the accuracy of disputed tradelines reported on the borrower's credit report. If it is determined that the disputed tradeline information is accurate, lenders must ensure the disputed tradelines are considered in the credit risk assessment by either obtaining a new credit report with the tradeline no longer reported as disputed and resubmitting the loan casefile to DU, or manually underwriting the loan.¹

Freddie Mac has a similar policy regarding multiple disputed tradelines.²

In many cases, a disputed tradeline will be the subject of a legitimate disagreement between the consumer and the entity that provided the information (the creditor, debt collector or other "furnisher" of information). The option of obtaining a new credit report with the information corrected is not an option for the consumer if the furnisher refuses to correct the

¹ Fannie Mae Selling Guide, B3-5.3-09, DU Credit Report Analysis, April 15, 2014, p. 492, available at www.fanniemae.com/content/guide/sel102213.pdf (visited Aug. 28, 2014).

² See Freddie Mac, Loan Prospector Feedback Message Cause and Resolution, June 2014, available at www.freddiemac.com/learn/pdfs/uw/lpfm_cr.pdf (stating that Incomplete Status Message 21 means "Multiple disputed tradelines; loan not eligible for L[oan] P[rospector]").

information, no matter how meritorious the consumers' dispute and how much evidence the consumer has to support his/her position. When a consumer lodges a dispute with the nationwide consumer reporting agencies (NCRAs) (i.e., TransUnion, Equifax and Experian), the NCRAs will *always* defer to the furnisher in a dispute.³ The best relief that a consumer can obtain is to have the tradeline marked as disputed, and indeed this remedy is specifically required under the Fair Credit Reporting Act, 15 U.S.C. 1681s-2(a)(3).⁴

These disputed tradelines can potentially harm mortgage borrowers in two different ways. First, it is possible that the mere existence of a disputed tradeline that has been excluded from the credit risk assessment will result in the denial of the mortgage, even if the impact of the tradeline on the consumer's credit score is small and would not have a material impact on the consumer's credit risk. Second, consumers can be wrongly denied a mortgage if a disputed tradeline with a larger impact is erroneous and the furnisher refuses to correct it.

We do recognize that the Fannie Mae guidelines permit another option: manual underwriting. However, the reality is that many lenders will refuse to manually underwrite a mortgage loan.⁵ The lender's refusal to manually underwrite – a reluctance created and incentivized by the Fannie Mae system⁶ and its heavy reliance on automated underwriting⁷ – is not only unfair, but potentially a violation of the Equal Credit Opportunity Act (ECOA).

The right to dispute the accuracy of information in a credit account is a right provided by several laws under the Consumer Credit Protection Act, including:

- The Fair Credit Reporting Act (FCRA): Section 611(a) of the FCRA, 15 U.S.C. § 1681i(a), gives consumers the right to dispute inaccurate or incomplete information on their credit reports with the consumer reporting agencies. Section 623(a)(8) of the FCRA, 15 U.S.C. § 1681s-2(a)(8) gives consumers a similar right to dispute inaccurate information on their credit reports with the furnisher of the information.
- Fair Credit Billing Act (part of the Truth in Lending Act): Section 161 of TILA, 15 U.S.C. § 1666, provides consumers with the right to dispute billing errors in their credit card or other open-end credit accounts. Section 170 of TILA, 15 U.S.C. § 1666i, gives consumers the right to withhold payment from credit card issuers for claims and defenses they have against a merchant.

³ See Chi Chi Wu et al., National Consumer Law Center, Automated Injustice: How a Mechanized Dispute System Frustrates Consumers Seeking to Fix Errors in Their Credit Reports (2009)

⁴ See *Saunders v. Branch Bank & Trust Co.*, 526 F.3d 142 (4th Cir. 2008) (if a consumer has a meritorious dispute, furnisher must report tradeline as disputed).

⁵ Terry Clemans, Executive Director, National Credit Reporting Association, Statement for the Record to the House Financial Services Subcommittee on Financial Institutions and Consumer Credit re Hearing Entitled: "An Overview of the Credit Reporting System" September 10, 2014 (noting that manual underwriting "means higher costs and tougher underwriting guidelines and many lenders refuse to fund loans under these conditions" citing Bigger Pockets, February 24, 2014, What is a "manual underwrite" loan, at http://www.biggerpockets.com/blogs/4790/blog_posts/35026-what-is-a-manual-underwrite-mortgage-loan.)

⁶ *Id.* (noting that many lenders refuse to manually underwrite mortgages because "they require additional work and are more prone to audits by Fannie Mae, Freddie Mac, or Ginnie Mae.")

⁷ While we recognize that automated underwriting can limit disparate treatment of applicants and level the playing field, any automated system has its limits when issues requiring special attention arise, such as disputed tradelines. In such cases, lender should be required to take the time and care to engage in manual underwriting.

- Fair Debt Collection Practices Act (FDCPA): Section 809 of the FDCPA, 15 U.S.C. § 1692g(b), gives consumers the right to seek verification of a debt from a debt collector.

When consumers send a dispute pursuant to these Acts, the tradelines on the consumer's credit are marked as disputed by the credit reporting agencies. **This denotation is required by most of these laws.** *See, e.g.*, 15 U.S.C. § 1666a (FCBA); 15 U.S.C. § 1681s-2(a)(3)(FCRA).

Under the ECOA, 15 U.S.C. § 1691(a)(3), a creditor may not discriminate against an applicant for credit because that person has exercised, in good faith, any right under the Consumer Credit Protection Act. This includes the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, and the Fair Credit Billing Act/Truth in Lending Act. The intent of this ECOA provision is to protect consumers from retaliation in the form of credit denials when the consumers exercise their legal rights.

We believe that the policies of Fannie Mae and Freddie Mac are in direct contravention of Section 1691(a)(3) of the ECOA. They penalize or discriminate against consumers who have exercised their legal rights by disputing errors in their credit accounts.

We realize that Fannie Mae and Freddie Mac might not be considered "creditors" under the ECOA because they do not grant the mortgage, but rather agree to purchase it. However, it certainly violates the intent and spirit of the ECOA to deny a mortgage based on the existence of a disputed credit report tradeline. More importantly, the lenders who refuse to process a mortgage because the application involves a disputed item and thus requires manual underwriting in order to treat that item properly are considered creditors under the ECOA, and appear to be directly in violation of Section 1691(a)(3).

We urge you, as the regulator for Fannie Mae and Freddie Mac, to require Fannie and Freddie to revise their policies on disputed tradelines. Disputed tradelines should be excluded from consideration.⁸ In the alternative, Fannie Mae and Freddie Mac should be required to institute a policy that prohibits lenders from refusing to manually underwrite a mortgage when there is a credit reporting dispute.

If you have any questions about this letter, please contact Chi Chi Wu at cwu@nclc.org or 617-226-0326. Thank you for your attention to this matter.

Sincerely,

National Consumer Law Center (on behalf of its low-income clients)
Americans for Financial Reform
Anderson, Ogilvie & Brewer LLP
Center for Responsible Lending
Community Service Society of New York
Consumer Action

⁸ If the dispute is not meritorious, i.e., it is frivolous or irrelevant, the tradeline does not need to be marked as disputed. See National Consumer Law Center, Fair Credit Reporting § 6.10.6.2 (8th ed. 2013), *updated at* www.nclc.org/library

Consumers Union
Empire Justice Center
NAACP
National Association of Consumer Advocates
National Council of La Raza
National Housing Resource Center
Philadelphia Unemployment Project
Reinvestment Partners
U.S. PIRG