TransUnion

ANALYSIS

Tri-Merge to Bi-Merge: A Look at the Repercussions to the Credit Ecosystem

In October 2022, the Federal Housing Finance Agency (FHFA) announced its intention to use only two credit bureaus (bi-merge) instead of three (tri-merge) to determine a borrower's effective credit score when applying for a mortgage. The unintended negative consequences of this decision will be significant for both consumers and the American taxpayer.

Simply put, requiring one less credit report means using less data — knowing less about a consumer's financial position and capacity — to decision, underwrite and fund the largest asset a consumer will acquire. Recent analysis by S&P Global Ratings[1] highlights significant data differences between high and low credit scores across the three bureaus: ~20 points for the high score bucket and ~45 points for the low score bucket. There are various reasons for this, including differing data sources and not all financial institutions report activity to all three bureaus. Eliminating one bureau's score would therefore provide an incomplete picture, increase undisclosed debt and potentially misinform credit granting decisioning.

In May 2023, the FHFA claimed the transition to a bi-merge system would have 'negligible material impact' to the average score of the pool of mortgage applicants. While this may be true, the consumer impact cannot be pooled. When one bureau score is ignored, a consumer's mortgage credit score may move up or down, impacting their eligibility and interest rate. A +45 point and -45 point difference in score with two consumers leads to zero average score impact for the pool but could have material impact on each individual consumer.

The S&P Global Ratings analysis[2] also provided detailed information on data differences that will lead to negative impacts for consumers. TransUnion leveraged this information to simulate the impact of moving to the bi-merge system. At random, one bureau score was dropped to produce the tri-merge to bi-merge score simulation results. These results were extrapolated across the US credit population to determine impacts and variability at an individual loan level.

Two key things were clear from our analysis:

1. **Consumers lose:** Eliminating one bureau from the credit granting process will enhance economic disparity as millions of Americans will either become ineligible or pay more interest on their mortgages. This will disproportionately impact low-income and underserved consumers, stifle their efforts to build wealth and widen the home ownership gap.

2. **Risk amplifies:** A bi-merge credit scoring system will introduce billions of dollars of additional risk to the credit ecosystem, which will likely be subsidized by other mortgage borrowers (i.e., higher interest rates) or taken on by US taxpayers.

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[1] *S&P Global Ratings: Residential Mortgage Credit Score Snapshot: When Three Bureaus Become Two, 8 June 2023*
[2] *S&P Global Ratings: Residential Mortgage Credit Score Snapshot: When Three Bureaus Become Two, 8 June 2023 – Table 3*

Consumers lose

Increasing economic disparity

If only two bureau scores are used, approximately two million consumers currently eligible for a GSE mortgage under the tri-merge may fall below the agency minimum score of 620 and become ineligible. Nearly all affected consumers fall within the 620–659 credit score risk tier, which is disproportionately comprised of low-income and underserved populations. With further decreased homeownership access, the distance between the "haves" and "have nots" will widen.

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More expensive mortgages

The bi-merge standard will save the consumer approximately $10–$20 in credit report and score fees. If 5% of all Americans borrow a new mortgage based on a bi-merge score over the next 12 months,[3] approximately 600,000 of these new mortgages would fall into a more expensive (higher interest rate) credit score bin. At a consumer level, each borrower affected will pay an average of $6,660[4] more in interest over the course of 10 years (average life of a mortgage[5]).

The additional interest amount far outweighs the envisioned consumer cost savings. **Consumers will essentially pay a penalty for having less data to determine their scores** despite them being readily available.

Table 1: Tri-merge to bi-merge simulation results extrapolated across the US credit population: Consumers no longer eligible

Score Range (Bin)	Number of Consumers	Consumers No Longer Eligible When Any One Score Is Randomly Removed
501-599	42,590,161	-
600-619	9,944,119	-
620-639	11,361,400	1,469,022
640-659	17,815,277	382,763
660-679	27,193,214	125,764
680-699	13,331,279	5,330
700-719	14,130,203	-
720-739	18,555,329	-
740-759	21,383,149	-
760-779	20,573,526	-
780+	78,985,997	-
TOTAL	**275,863,654**	**1,982,881**

Source: TransUnion Simulation

~600,000 new mortgages would fall into a more expensive credit score bin[3]

[3] *In-line with the percentage of U.S. residents with scores above 619 that borrow a new mortgage in any one calendar year dating back to 2018*

[4] *Monthly payments were determined using the free mortgage monthly payment calculator offered by Google. Our interest expense projections assumed a $516,500 home in Illinois financed with a 30-year mortgage, $8,264 in annual property taxes and insurance, 20% down and mortgage interest rates as of July 14, 2023 according to Google*

[5] *The amount of interest owed declined each month in accordance with typical mortgage amortization schedules*

Amplified risk

Miscalculating consumer affordability

Omitting underwriting due diligence by removing a credit report with vital information not visible in the other two could result in millions of consumers being put into homes they may not be able to afford. The lack of accurate and complete consumer information was one of the underlying causes of the Global Financial Crisis, and its bailout was ultimately funded by taxpayers. Consumers who lost their homes to foreclosure during the Great Recession took many years to financially recuperate. Just 10% of prime borrowers reattained their pre-delinquency credit scores within two years and only 33% within five years.[8]

Assuming 10% of the American population seeks a new mortgage over the next 12 months,[4] TransUnion's findings estimate approximately 200,000 consumers currently ineligible for an agency mortgage under the tri-merge could become eligible under the bi-merge requirement (Table 2). These consumers will be put into homes they may not be able to manage and affordability would become an increasing concern in times of economic stress..

Insufficient risk coverage

If 5% of all Americans borrow a new mortgage based on a bi-merge score over the next 12 months, approximately 580,000 new mortgages will move into a higher credit score tier and qualify for a lower interest rate. While it appears favorable, these new borrowers would pay approximately $750 less per year in monthly interest expenses[5] equating to an estimated $4 billion less in interest fees collected over the life of the loan[6] (just for these new mortgages that year[7]). GSEs will lose out on collecting risk premiums meant to make them whole for their projected losses. Other — "safer" — mortgage borrowers may need to pay higher fees to offset this.

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Table 2: Tri-merge to bi-merge simulation results extrapolated across the US credit population: Consumers newly eligible

Score Range (Bin)	Number of Consumers	Newly Eligible Consumers When Any One Score Is Randomly Removed	Newly Eligible Consumers Granted a Mortgage They May Not Be Able to Manage (10% of the US population)
501–599	42,590,161	406,390	40,639
600–619	9,944,119	1,371,141	137,114
620–639	11,361,400	-	-
640–659	17,815,277	-	-
660–679	27,193,214	-	-
680–699	13,331,279	-	-
700–719	14,130,203	-	-
720–739	18,555,329	-	-
740–759	21,383,149	-	-
760–779	20,573,526	-	-
780+	78,985,997	-	-
TOTAL	**275,863,654**	**1,777,532**	**177,753**

Source: TransUnion Simulation

[4] In-line with the percentage of U.S. residents with scores above 619 that seek a new mortgage in any one calendar year dating back to 2018
[5] Monthly payments were determined using the free mortgage monthly payment calculator offered by Google. Our interest expense projections assumed a $516,500 home in Illinois financed with a 30-year mortgage, $8,264 in annual property taxes and insurance, 20% down and mortgage interest rates as of July 14, 2023 according to Google
[6] The amount of interest owed declined each month in accordance with typical mortgage amortization schedules
[7] What's The Average Mortgage Length? | Hall Financial (callhallfirst.com)
[8] Have Borrowers Recovered from Foreclosures during the Great Recession? - Federal Reserve Bank of Chicago (chicagofed.org)

Adverse Impacts of Move to Bi-Merge

Consumers lose		Amplified risk	
No longer eligible	Moves into a higher risk tier	Becomes eligible but can't afford mortgage	Moves into a lower risk tier
Can't get mortgage	Homeowner pays more	Can't keep up with monthly payments	Pays less; risk not adequately mitigated
Up to 2 million denied access to homeownership, increasing economic disparity	**$7,000** additional interest paid over the life of a mortgage	**200,000** at higher risk of default and foreclosure	**$4 billion** less interest collected, to be made up by US taxpayers or lower-risk borrowers

Recommendation

We applaud the FHFA's decision to postpone implementation of the bi-merge requirement to allow for robust public engagement. To ensure holistic and constructive feedback, we respectfully recommend the following:

Distribute implementation rules and legal guidelines addressing the treatment of adverse action codes and fair lending implications.

Conduct ongoing dialogue and provide more thorough and transparent analyses with the industry, consumer groups and government.

Release industry data for independent examination to determine impacts.

Allocate ample time for stakeholders to review and respond.

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