

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date: May 22, 2023
To: Board of Governors
From: Staff¹
Subject: Proposed rule to implement quality control standards for the use of automated valuation models

ACTIONS REQUESTED: Approval of the attached draft notice of proposed rulemaking to implement quality control standards for the use of automated valuation models (AVMs) by mortgage originators and secondary market issuers. The proposal would be issued jointly with the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, National Credit Union Administration, Federal Housing Finance Agency, and Consumer Financial Protection Bureau, in consultation with the staff of the Appraisal Subcommittee of the Federal Financial Institutions Examination Council (ASC) and the Appraisal Standards Board of the Appraisal Foundation (ASB).² Staff also seeks authority to make technical or minor changes to the attached materials prior to publication in the Federal Register.

EXECUTIVE SUMMARY:

- The proposal would implement section 1473(q) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which mandated that the Board and the other agencies issue quality control standards for the use of certain AVMs.
- The proposal would require Board-regulated institutions that use AVMs to determine collateral value in connection with certain mortgage-related transactions to adopt policies, practices, procedures, and control systems designed to:
 - Ensure a high level of confidence in the estimates produced;
 - Protect against the manipulation of data;

¹ Michael Gibson, Art Lindo, Andrew Willis, Carmen Holly, and Susan Ali (Division of Supervision and Regulation); Mark Van Der Weide, Jay Schwarz, Derald Seid, Matthew Suntag, Trevor Feigleson and David Imhoff (Legal Division); Eric Belsky, Amy Henderson, Mandie Aubrey, and Katrina Blodgett (Division of Consumer and Community Affairs).

² Pursuant to statutory requirement, agency staff consulted with the staff of the ASC and ASB in connection with this proposed rulemaking.

- Avoid conflicts of interest;
- Require random sample testing and reviews; and
- Comply with applicable nondiscrimination laws.
- The proposal would not set specific requirements for how institutions are to structure these policies, practices, procedures, and control systems, but would set expectations for institutions to tailor their approaches as appropriate to the risk and complexity of transactions for which AVMs will be used and the size of the institution.

DISCUSSION:

I. Background

Section 1473(q) of the Dodd-Frank Wall Street Reform and Consumer Protection Act amended Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (Title XI)³ to add a new section 1125 governing the use of AVMs in mortgage lending.⁴ AVMs are defined in Title XI as any computerized model used by mortgage originators and secondary market issuers to determine the collateral worth of a mortgage secured by a consumer's principal dwelling.⁵

Section 1125 directs the agencies to issue regulations requiring that AVMs used by regulated institutions adhere to quality control standards designed to: (1) ensure a high level of confidence in the estimates the AVM produces; (2) protect against the manipulation of data; (3) seek to avoid conflicts of interest; and (4) require random sample testing and reviews. The statute also permits the agencies to account for any other factor that they determine to be appropriate.⁶ The proposal would implement the statutorily required quality control factors and

³ 12 U.S.C. 3331 *et seq.*

⁴ Pub. L. 111-203, 124 Stat. 2198 (2010), codified at 12 U.S.C. 3354.

⁵ 12 U.S.C. 3354(d).

⁶ 12 U.S.C. 3354(b).

the agencies would exercise their statutory authority to add a fifth factor that would require regulated institutions using covered AVMs to adopt policies, practices, procedures, and control systems to ensure that their use of these AVMs complies with applicable nondiscrimination laws.⁷

II. Proposed Rule

The proposal would implement the five quality control standards discussed above for the use of AVMs and would apply to all Board-regulated entities that are mortgage originators or secondary market issuers as defined in the proposal.⁸ The proposal would require these institutions to adopt policies, practices, procedures, and control systems designed to meet the five quality control standards with respect to AVMs used to determine the value of a consumer's principal dwelling in connection with making a credit decision regarding a mortgage or making a covered securitization determination regarding a mortgage-backed security.

The proposal focuses on aspects of mortgage and securitization transactions where the value of collateral is typically determined. Accordingly, the proposal would define "credit decision" to mean a decision regarding whether and under what terms to originate, modify, terminate, or make other changes to a mortgage, including whether to extend new or additional credit or change the credit limit on a line of credit. Further, the proposal would define a "covered securitization determination" to include determinations regarding, among other things,

⁷ These laws would include the Equal Credit Opportunity Act, 42 U.S.C. 3605, and the Fair Housing Act, 15 U.S.C. 1691(a).

⁸ Mortgage originator would be defined to have the meaning given the term in section 103 of the Truth in Lending Act, 15 U.S.C. 1602, which is used elsewhere in the Board's appraisal regulations. Secondary market issuer would be defined to mean any party that creates, structures, or organizes a mortgage-backed securities transaction.

selecting loans for, structuring, preparing disclosures for, or marketing initial offerings of mortgage-backed securities. A “covered securitization determination” would also include a decision regarding whether to waive an appraisal requirement for a mortgage loan being considered for a securitization.⁹

The use of an AVM by a certified or licensed appraiser in developing an appraisal would not be covered by the proposal since such appraisers are required by law and professional standards to make a valuation conclusion that is independently supportable and does not rely on an AVM to determine the value of the underlying collateral. In addition, AVMs used to monitor the collateral value of mortgage loans after origination would not be covered by the proposal because the monitoring of collateral value is not a new credit decision or securitization determination. Similarly, AVMs used in reviews of appraisals and evaluations would not be covered by the proposal. These reviews serve as a separate and independent quality control function.¹⁰

The proposal would not set specific requirements for how institutions are to structure the requisite policies, practices, procedures, and control systems. This approach would allow institutions to tailor their quality controls for AVMs as appropriate to the risk and complexity of

⁹ The Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation are the predominant issuers of appraisal waivers in the current mortgage market. Under the proposal, a secondary market issuer that uses AVMs in the appraisal waiver process would be required to maintain policies, practices, procedures, and control systems designed to ensure that their use of an AVM adheres to the proposal’s requisite quality control standards. The proposal would not require mortgage originators receiving appraisal waivers to ensure that the secondary market issuer’s AVM complies with the quality control standards.

¹⁰ Appraisals are subject to appropriate review under the appraisal regulations. *See* 21 CFR 225.64(c) (Board); 12 CFR 34.44(c); (OCC); 12 CFR 323.4(c) (FDIC); 12 CFR 722.4(c) (NCUA). While these reviews are independent of, and subsequent to, the underlying appraisals, the reviews generally take place before the final approval of a mortgage loan.

transactions for which the AVM will be used and the size of the institution. The proposed quality control standards are consistent with practices that many regulated institutions involved in mortgage lending already follow and guidance previously provided by the Board to many regulated institutions that would be subject to this rule. The Board's existing guidance relating to AVMs and other applicable guidance, such as guidance related to model risk and third-party risk management, would remain in effect.

RECOMMENDATIONS:

For the reasons discussed above, staff recommends that the Board (1) approve the attached proposed rule; and (2) authorize staff to make technical or minor changes to the attached materials prior to publication in the Federal Register.

Attachment