

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date: June 17, 2024
To: Board of Governors
From: Staff¹
Subject: Final rule to implement quality control standards for the use of automated valuation models

ACTIONS REQUESTED: Approval of the attached draft final rule to implement quality control standards for the use of automated valuation models (AVMs) by mortgage originators and secondary market issuers (draft final rule). The draft final rule 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.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 draft final rule would implement section 1473(q) of the Dodd-Frank Wall Street Reform and Consumer Protection Act by requiring Board-regulated institutions that use certain AVMs³ 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;

¹ Michael Gibson, Art Lindo, Andrew Willis, Matthew McQueeney, and Devyn Jeffereis (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 Appraisal Subcommittee and Appraisal Standards Board of the Appraisal Foundation in connection with this proposed rulemaking.

³ AVMs are defined in Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act 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. See 12 U.S.C. 3354(d).

- Protect against the manipulation of data;
- Seek to avoid conflicts of interest;
- Require random sample testing and reviews; and
- Comply with applicable nondiscrimination laws.
- The draft final rule would not set specific requirements for how institutions are to structure these policies, practices, procedures, and control systems. Institutions would be permitted to adapt quality controls for AVMs as appropriate to the risk and complexity of transactions for which the AVM would be used and the size of the institution.
- The draft final rule generally reflects the proposed rule, with targeted changes to clarify the proposed definition of mortgage originator.

DISCUSSION:

I. Background and proposed rule

Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (Title XI)⁴, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, 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.⁵ The draft final rule would implement the statutorily required quality control factors,⁶ and add a fifth factor that would require regulated institutions using covered AVMs to adopt policies, practices,

⁴ 12 U.S.C. 3331 *et seq.*

⁵ Pub. L. 111-203, 124 Stat. 2198 (2010), codified at 12 U.S.C. 3354.

⁶ The statute also permits the agencies to account for any other factor that they determine to be appropriate.

procedures, and control systems to ensure that their use of these AVMs complies with applicable nondiscrimination laws (nondiscrimination factor).⁷

The proposal would have applied to all Board-regulated institutions (institutions) that are mortgage originators or secondary market issuers as defined in the proposal.⁸ The proposal would have required 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 would not have set specific requirements for how institutions were to structure the requisite policies, practices, procedures, and control systems, thus allowing institutions flexibility to adapt their quality controls for AVMs as appropriate to the risk and complexity of transactions for which the AVM would be used and the size of the institution.⁹ The proposal would not have covered the use of AVMs by certified or licensed appraisers in developing an appraisal, AVMs used to monitor the collateral value of mortgage loans after origination, or AVMs used in reviews of appraisals and evaluations.¹⁰

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

⁸ Mortgage originator would be defined to closely track the meaning given to 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.

⁹ The proposal would not have set specific standards based on the size of the institution.

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.

II. Overview of comments and draft final rule

Commenters generally recognized that quality control standards for AVMs are required by Title XI and are important to the safety and soundness of mortgage lending and mortgage securitization. Most commenters supported the proposed flexibility for mortgage originators and secondary market issuers to adopt policies, practices, procedures, and control systems to implement the quality control standards based on size, complexity, and risk profile of the institution and the transactions for which they would use AVMs, while some commenters recommended a more prescriptive approach. Some commenters requested additional guidance regarding the nondiscrimination factor, additional standards for testing AVMs for compliance with the control factors, or that the agencies apply the rule to AVM developers and vendors. While many commenters supported the nondiscrimination factor, some commenters opposed it, asserting that it would impose burden and would pose compliance challenges.

The draft final rule would generally adopt the rule as proposed, with targeted changes to clarify the definition of mortgage originator. These changes respond to a comment identifying an inconsistency between the proposal's definition of mortgage originator, which cross-referenced a definition in the Truth in Lending Act (TILA), and language included in other definitions in the proposal. The changes to the definition of mortgage originator in the draft final rule would resolve this inconsistency by importing the previously cross-referenced TILA definition to the rule text and making targeted modifications to conform it to the scope of the draft final rule. The draft final rule also imports TILA's definition of "person," which is referenced in the definition of mortgage originator, for clarity.

The first four quality control factors in the draft final rule are required by statute, while the nondiscrimination factor is important for addressing increasing concerns about the potential

for AVMs to produce property estimates that reflect discriminatory bias. Existing nondiscrimination laws already apply to an institution's use of AVMs; the nondiscrimination factor would heighten awareness among lenders to this requirement and impose an independent requirement for institutions to establish policies, practices, procedures, and systems to ensure compliance with nondiscrimination laws. The flexible approach to implementing the quality control standards provided by the draft final rule would limit regulatory burden and allow the implementation of the standards to evolve along with changes in AVM technology. This approach would also allow institutions to set quality control standards for covered AVMs as appropriate based on the size, complexity, and risk profile of the institution and the transactions for which AVMs are used. Further, existing guidance already addresses many of the elements and additional details requested by commenters and can be used to assist in implementation, including guidance on model risk, third-party risk, AVMs, and nondiscrimination.

RECOMMENDATIONS:

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

Attachment