KPMG

Regulatory Alert

Regulatory Insights for Financial Services

June 2023 *(Updated)*

Interagency Proposals: Automated Valuation Models; Reconsideration of Value

KPMG Regulatory Insight:

- *Long-anticipated AVM proposal, of particular note given multiple participating agencies, and the issuance same-day of White House AVM announcement*
- *A growing regulatory expectation in such areas as:*
  - *Antidiscrimination and algorithm bias*
  - *Model risk management practices*
  - *Third party oversight*
  - *"Automated system" risk management program and controls.*

Automated Valuation Models

Six federal agencies jointly released a rule proposal that would implement quality control standards for automated valuation models (AVMs) used by mortgage originators and secondary market issuers to determine the value of mortgage collateral securing a consumer's principal dwelling. (The quality control standards were mandated by Section 1473(q) of the Dodd- Frank Act, which added a new Section 1125 to FIRREA. The participating agencies include the FRB, OCC, FDIC, CFPB, NCUA, and FHFA.)

Quality Control Standards

Under the proposal, entities that engage in covered transactions would be required to adopt and maintain "policies, practices, procedures, and control systems" to ensure that AVMs used in these transactions adhere to quality control standards, or "factors", designed to:

1. ensure a high level of confidence in the estimates produced by AVMs
2. protect against the manipulation of data
3. seek to avoid conflicts of interest
4. require random sample testing and reviews
5. comply with applicable nondiscrimination laws.

Note: The Dodd-Frank Act provided that the agencies could add other factors, as appropriate, to the quality control standards and, for purposes of the current proposal, they have added the standard to "comply with applicable nondiscrimination laws".

The proposed rule would not set specific requirements for how entities are to structure these policies, practices, procedures, and control systems though the agencies expect institutions to establish quality controls based on their size and the risk and complexity of transactions for which they will use AVMs covered by the proposal. The agencies' existing guidance related to AVMs remains applicable.

Applicability

Section 1125(c)(1) requires financial institutions, or subsidiaries owned and controlled by a financial institution and regulated by a Federal financial institution regulatory agency, to comply with regulations issued under the subsection. The proposed rule would:

Apply To:	— AVMs used in connection with making a credit decision (as defined in the proposal) — AVMs used in securitization determinations — AVMs used in the process of preparing "evaluations" that are required for certain transactions that are otherwise exempt from the appraisal rule
Not Apply To:	— AVMs used in the development of an appraisal by a certified or licensed appraiser, nor in the review of the quality of already completed determinations of collateral value (completed determinations). The distinction between appraisals and evaluations reflects that Uniform Standards of Professional Appraisal Practice (USPAP) standards and appraiser credentialing are not required for individuals who prepare evaluations and the more extensive use of, and reliance on, AVMs within the evaluation function.

Comment Period. No later than sixty (60) days after the date of publication in the Federal Register.

Implementation Period. The first day of the calendar quarter following the date that is 12 months after publication in the Federal Register of any final rule based on this proposal.

White House Fact Sheet

The White House simultaneously released a Fact Sheet outlining additional Administration actions to address "potential racial bias in home valuations" based on the Interagency Task Force on Property Appraisal and Valuation Equity (PAVE) Action Plan. The actions included efforts to:

- Promote industry-wide consistency for reconsideration of value (ROV) processes and increase consumers' knowledge about the option to pursue an ROV, including:
  - Federal banking agencies developing proposed guidance on how financial institutions may integrate ROV policies and controls into their current appraisal processes and respond to consumer concerns about appraisal and design policies and controls around ROV requests to appraisers. (See interagency proposal below.)
  - A HUD and FHFA working group intended to increase coordination and develop more consistent standards for the ROV processes of FHA, Fannie Mae, and Freddie Mac lenders.
- Increase data transparency, including FHFA's update to the Uniform Appraisal Dataset (UAD) Aggregate Statistics, and HUD's commitment to make FHA appraisal data available to the public later in 2023.
- Reduce barriers to entry into the appraisal profession, including a dashboard of state education, examination, and experience requirements relative to federal minimum requirements.

Proposed ROV Guidance

In separate but related actions (and as noted by the White House), five federal agencies (FRB, FDIC, OCC, CFPB, and NCUA) jointly released proposed guidance on ROVs (reconsiderations of value) for residential real estate valuations. The agencies state the proposed guidance is intended to highlight risks associated with "deficient valuations" and describe how financial institutions may incorporate ROV processes and controls into established risk management functions.

In particular, the proposed guidance:

- Describes the "deficient valuations" to include "prohibited discrimination; errors or omissions; or valuation methods, assumptions, data sources, or conclusions that are otherwise unreasonable, unsupported, unrealistic, or inappropriate."
- Identifies the risks of "deficient valuations" to include loan losses, violations of law, fines, civil money penalties, payment of damages, or civil litigation.
- Notes that "deficient valuations" may be identified through an institution's valuation review processes or through consumer provided information.
- Outlines applicable statutes, regulations, and existing guidance that govern ROVs and collateral valuations, such as ECOA, Regulation B, Fair Housing Act, Truth-in-Lending Act, Regulation Z, and USPAP.
- Explains how ROV processes and controls can be incorporated into existing risk management functions, such as third-party risk management, appraisal review, and consumer complaint management.
- Provides examples of ROV policies, procedures, and controls that financial institutions may adopt to identify, address, and mitigate the risk of "deficient valuations". Select examples of topics covered in the proposed guidance include:
  - Roles and responsibilities for various business units in processing an ROV request.

- Identification, management, analysis, escalation, and resolution of valuation-related complaints across relevant lines of business and from various channels and sources.
- Informing consumers on how to raise concerns about valuations sufficiently early in the underwriting process for errors or issues to be resolved before a final credit decision is made.
- Ensuring relevant staff, as well as third parties, are trained to identify “deficiencies” throughout the valuation review process.

Comment Period. The agencies are soliciting comments for a period of sixty (60) days following publication in the Federal Register.

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