KPMG

Regulatory Alert

Regulatory Insights for Financial Services

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Final Interagency Actions: Automated Valuation Models (AVMs), Reconsideration of Value

KPMG Insights:

— ***Model Anti-bias/Trust:*** *Long-awaited rule adds to evolving regulations for anti-bias and trust in model/algorithm development and use.*

— ***Quality Controls:*** *Focus on quality control factors (including estimate confidence and fair lending considerations), in areas of model risk management, third party oversight and "automated system" risk management.*

— ***Hurdles Notwithstanding:*** *Despite potential difficulties to accessing a model's data and design and/or the use of third parties, regulators will expect sound anti-bias/anti-discrimination in the institution's model risk management controls.*

— ***Institutions Responsible:*** *Regulators will expect institutions that utilize AVMs to "own the risk".*

Six federal agencies jointly release a final rule to implement quality control standards for automated valuation models (AVMs) used by mortgage originators and secondary market issuers (each as defined in the rule) to determine the value of mortgage collateral securing a consumer's principal dwelling.

The final rule is substantially the same as proposed in June 2023. It will become effective the first day of the calendar quarter following the date that is 12 months after publication in the Federal Register. The FDIC and OCC are the first of the six participating agencies (FRB, OCC, FDIC, CFPB, NCUA, and FHFA) to adopt the final rulemaking.

Note: The quality control standards are mandated by Section 1473(q) of the Dodd- Frank Act, which added a new Section 1125 to FIRREA.

Quality Control Standards

Under the final rule, mortgage originators and secondary market issuers that engage in credit decisions or covered securitization determinations themselves, or through or in cooperation with a third-party or affiliate, must 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:

— Ensure a high level of confidence in the estimates produced by AVMs.

— Protect against the manipulation of data.

— Seek to avoid conflicts of interest.

— Require random sample testing and reviews.

— 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 rule, they have added the standard to "comply with applicable nondiscrimination laws".

The final rule does 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 rule. The agencies' existing guidance related to AVMs remains applicable.

Applicability

Section 1125 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 as appropriate. For these purposes, AVMs are defined as "any computerized model used by mortgage originators and secondary market issuers to determine the value of a consumer's principal dwelling collateralizing a mortgage." The quality control standards apply as follows:

Apply To:	— AVMs used in connection with making a "credit decision", defined to include: – Whether and under what terms to originate, modify, terminate, or make other changes to a mortgage. – Whether to extend new or additional credit or change the credit limit on a line of credit. — AVMs used in "covered securitization determinations", meaning determinations regarding: – Whether to waive an appraisal requirement for a mortgage origination in connection with its potential sale or transfer to a secondary market issuer. – Structuring, preparing disclosures for, or marketing initial offerings of mortgage-backed securitizations. — AVMs used in the process of preparing "evaluations" that are required for certain transactions that are otherwise exempt from the appraisal rules.
Not Apply To:	— AVMs used in the development of an appraisal by a certified or licensed appraiser, or in the review of the quality of already completed determinations of collateral value (completed determinations). The distinction between appraisals and evaluations reflects that 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. — Monitoring of the quality or performance of mortgages or mortgage-backed securities.

Reconsiderations of Value - Final Guidance

In separate but related actions, five federal agencies (FRB, FDIC, OCC, CFPB, and NCUA) jointly release final guidance on ROVs (reconsiderations of value) for residential real estate valuations. The agencies state the final guidance, which has been adopted "largely as proposed", 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 final guidance:

- Clarifies that the scope of the guidance is limited to real estate-related transactions secured by single 1-to-4 family residential property.
- 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". Examples of topics include:
  - Roles and responsibilities for business units processing an ROV request.

- Processes for identifying, managing, analyzing, escalating, and resolving valuation-related complaints and inquiries across relevant lines of business and from various channels and sources.
- Consumer communication 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.
- Training, for relevant staff and third parties, to identify "deficiencies" throughout the valuation review process.

Effective Date. The guidance is final upon publication in the Federal Register.

For more information, contact Amy Matsuo, Todd Semanco, or Adam Levy.

Contact the author:

Amy Matsuo
Principal and National Leader
Regulatory Insights
amatsuo@kpmg.com