Regulatory Alert

Regulatory Insights for Financial Services

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Automated Valuation Models (AVMs): Interagency Final Rule

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.

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