

June 17, 2024

MEMORANDUM TO: Board of Directors

FROM: Doreen R. Eberley
Director, Division of Risk Management Supervision

Mark Pearce
Director, Division of Depositor and Consumer Protection

SUBJECT: Final Rule: Quality Control Standards for Automated Valuation Models

Recommendation

Staff recommends that the Federal Deposit Insurance Corporation (FDIC) Board of Directors (Board) adopt and authorize publication in the *Federal Register* of the attached final rule. The final rule would implement quality control standards mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) for the use of automated valuation models (AVMs) by mortgage originators and secondary market issuers in determining the collateral worth of a mortgage secured by a consumer's principal dwelling.

Under the final rule, the FDIC and other agencies¹ would require institutions that engage in certain credit decisions or securitization determinations to adopt policies, practices, procedures, and control systems to ensure that covered AVMs adhere to four specified quality control factors described in detail below. Moreover, pursuant to their statutory authority under the Dodd-Frank Act to account for any other such factor the agencies determine to be appropriate, the agencies are including a fifth factor that requires institutions to adopt policies, practices, procedures, and control systems to ensure AVMs adhere to quality control factors designed to comply with applicable nondiscrimination laws.

CONCUR:

Harrel M. Pettway
General Counsel

¹ Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (FRB); National Credit Union Administration (NCUA); Federal Housing Finance Agency (FHFA); and Bureau of Consumer Financial Protection (CFPB).

Background

Statutory Authority

Section 1473(q) of the Dodd-Frank Act amended title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (title XI)² to add a new section 1125 relating to the use of AVMs in valuing real estate collateral securing mortgage loans (section 1125).³ The term “automated valuation model,” as used in section 1125, describes 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.⁴ The quality control standards in this final rule are applicable only to AVMs used in connection with making certain credit decisions or securitization determinations regarding a mortgage (covered AVMs).

Section 1125 directs the agencies to promulgate regulations to implement quality control standards regarding covered AVMs.⁵ Section 1125 requires that covered AVMs adhere to quality control standards 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; and
- (5) account for any other such factor that the agencies determine to be appropriate.⁶

While advances in AVM technology and data availability have the potential to contribute to lower costs and shorter turnaround times in the performance of property valuations, it is important that institutions using such tools take appropriate steps to ensure the credibility and integrity of the valuations produced by AVMs.⁷

Existing Guidance Relating to the Use of AVMs

Since 2010, the FDIC, OCC, FRB, and NCUA have provided supervisory guidance on the use of AVMs by their regulated institutions in Appendix B to the Interagency Appraisal and Evaluation Guidelines (Guidelines).⁸ The Guidelines recognize that an institution may use a variety of analytical methods and technological tools in developing real estate valuations, provided the institution can demonstrate that the valuation method is consistent with safe and sound banking practices. The Guidelines recommend that institutions establish policies, practices, and procedures governing the selection, use, and validation of AVMs, including steps to ensure the

² 12 U.S.C. 3331 *et seq.*

³ Pub. L. 111-203, 124 Stat. 1376, 2198 (2010), codified at 12 U.S.C. 3354.

⁴ 12 U.S.C. 3354(d).

⁵ 12 U.S.C. 3354(a)-(b).

⁶ 12 U.S.C. 3354(a).

⁷ See, e.g., U.S. Dep’t of Treas., *A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation* 103-107 (July 2018). <https://home.treasury.gov/sites/default/files/2018-08/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financials-Fintech-and-Innovation.pdf>.

⁸ See *Interagency Appraisal and Evaluation Guidelines*, 75 FR 77450, 77468 (Dec. 10, 2010). The Guidelines were adopted after notice and comment.

accuracy, reliability, and independence of an AVM.⁹ In addition to Appendix B of the Guidelines, the FDIC, OCC, and FRB have issued guidance on model risk management practices (Model Risk Guidance) that provides supervisory guidance on validation and testing of computer-based financial models.¹⁰

The FDIC, OCC, and FRB have also provided guidance on managing the risk inherent in the use of third-party service providers, such as outside entities that provide AVMs and AVM services.¹¹ Under this guidance, regulated institutions that make use of third parties are reminded that they remain responsible for ensuring that the third parties performance is in compliance with applicable laws and regulations, including safety and soundness requirements. The guidance addresses the characteristics, governance, and operational effectiveness of a financial institution’s service provider risk management program for outsourced activities.

Discussion of the Proposed Rule

The Notice of Proposed Rulemaking (NPR or proposal) was published in the Federal Register on June 21, 2023, with comments due by August 21, 2023. The agencies received about 50 comments from financial institutions, financial institution trade associations, real estate trade associations, mortgage insurance trade associations, appraiser trade associations, nonprofit advocacy associations, AVM developers, and appraisers. The key issues raised by commenters included:

- Concerns related to the proposed fifth quality control factor regarding nondiscrimination and its relation to current Federal laws and regulations;
- Requests that the agencies issue additional guidance to assist in implementing the final rule requirements, particularly related to the fifth quality control factor; and
- Requests to establish a standards setting organization for AVMs to help improve the quality and comparability of various vendor AVMs.

After careful consideration of all the comments received, the agencies are adopting the rule largely as proposed, but are making two changes in response to the comments received (discussed below in their respective sections):

- Incorporating the full text of the TILA definition of “mortgage originator” with technical edits, rather than simply cross-referencing the TILA definition of mortgage originator as proposed; and
- Correcting the regulatory text for the third quality control factor to match the statutory language, by inserting the phrase “seek to” so that it reads “seek to avoid conflicts of interest.”

⁹ *Id.*

¹⁰ See *Supervisory Guidance on Model Risk Management, Guidance on Model Risk Management*, FDIC FIL-22-2017 (June 7, 2017).

¹¹ See *Interagency Guidance on Third-Party Relationships: Risk Management*, 86 FR 37920 (June 9, 2023).

Discussion of the Final Rule

The final rule would require mortgage originators and secondary market issuers to adopt policies, practices, procedures, and control systems to ensure that AVMs adhere to quality control standards designed to meet specific quality control factors whenever they use covered AVMs in connection with making certain credit decisions or securitization determinations regarding mortgages. The final rule would not set specific requirements for how institutions are to structure these policies, practices, procedures, and control systems. This approach would provide institutions the flexibility to tailor their quality controls for covered AVMs as appropriate based on the size of their institution and the risk and complexity of transactions for which they will use covered AVMs. As modeling technology continues to evolve, this flexible approach would allow institutions to refine their policies, practices, procedures, and control systems as appropriate. The FDIC's existing guidance relating to the use of AVMs would remain applicable.

A. Definitions

The final rule would define several terms applicable to the rulemaking by their standard meaning, including "control systems," "dwelling," "mortgage," "person" and "secondary market issuer." Other terms would be defined specifically for this final rule, including "mortgage originator." For example, the final rule's definition of an AVM is substantively identical to the definition in section 1125,¹² but reflects common terminology and clarifies that the determination of value relates to the dwelling.

The final rule would define "covered securitization determination" to mean a determination regarding (1) whether to waive an appraisal requirement for a mortgage origination in connection with the potential sale or transfer to a secondary market issuer (appraisal waiver decisions), or (2) structuring, preparing disclosures for, or marketing initial offerings of mortgage-backed securitizations. AVMs used to monitor collateral value in mortgage-backed securitizations after they have already been issued would not be covered securitization determinations.

The final rule would apply to AVMs used in connection with making credit decisions or covered securitization determinations because the collateral worth of a mortgage is generally determined, as opposed to monitored or verified, in connection with the types of decisions covered in these definitions. The final rule 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, and would include a decision whether to extend new or additional credit or change the credit limit on a line of credit. The use of AVMs by mortgage originators to monitor the value of the underlying real estate collateral in their loan portfolios would not be a credit decision for the purposes of this final rule.

Under the proposal, the agencies would have defined the term "mortgage originator" in the rule by cross reference to the TILA definition of mortgage originator.¹³ Although commenters

¹² The Dodd-Frank Act defines an AVM 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." 12 U.S.C. 3354(d).

¹³ 15 U.S.C. 1602(dd)(2).

generally supported this proposed definition, two commenters asked the agencies to consider making substantive changes to the definition. One commenter requested that the agencies expand the definition of mortgage originator to cover servicing-only servicers in the final rule, and the other commenter noted that the proposed definition of mortgage originator does not align with the proposed changes to the term principal dwelling and the inclusion of business purpose loans. To address this issue, the final rule no longer simply cross references to the TILA definition of mortgage originator, but instead defines the term “mortgage originator” by incorporating the full text of the TILA definition of mortgage originator with several technical revisions.

Title XI generally does not limit its coverage to consumer credit transactions. As a result, the agencies intended the proposal to cover a mortgage, including a home equity line of credit, secured by a consumer’s principal dwelling, even if the mortgage were primarily for business, commercial, agricultural, or organizational purposes.¹⁴ This intent is reflected in the proposal’s discussion of the definition of the term “mortgage” in which the agencies proposed to define the term “mortgage” to cover not only consumer credit transactions, but any transaction in which a mortgage, deed of trust, purchase money security interest arising under an installment sales contract, or equivalent consensual security interest is created or retained in a consumer’s principal dwelling. The agencies’ proposal intended the term “mortgage loan originator” to apply with breadth equal to that of the term “mortgage.”

To address this issue, the final rule defines the term “mortgage originator” by incorporating the full text of the TILA definition of mortgage originator, but then replaces the term “residential mortgage transaction” with the term “mortgage” wherever it appears. The final rule adopts the proposed definition of “mortgage” as described above, and in line with the intent of the proposal, the final rule also applies the term “mortgage loan originator” with breadth equal to that of the term “mortgage”: to any person who, for direct or indirect compensation or gain, or in the expectation of direct or indirect compensation or gain, takes a mortgage application, assists a consumer in obtaining or applying to obtain a mortgage, or offers or negotiates terms of a mortgage. Relatedly, the final rule includes a definition of “person” by cross-reference to the definition of person in TILA, which means “a natural person or organization”. The addition of this definition to the final rule is necessary because otherwise, the term would not be defined under the final rule’s revised definition of “mortgage originator” which was proposed to be defined by a cross-reference. This stand-alone definition of “person” is a technical change only as part of the revisions made to the definition of “mortgage originator.”

Additional minor conforming changes were made to the text of the TILA definition of mortgage originator, as incorporated in the final rule. For example, the agencies are removing the exclusion of seller financiers provided in TILA and replacing that provision with the seller financier exclusions contained in Regulation Z, and are removing the exclusion for creditors in TILA. Finally, the final rule makes minor, nonsubstantive regulatory text changes such as adjustments to paragraph designations and cross references incorporated from the full text of the

¹⁴ *Id.*

TILA definition of mortgage originator as necessary to align the text with the paragraph structure of each agency's final rule.

B. Scope of the Final Rule

The quality control standards in section 1125 of title XI apply to AVMs used by mortgage originators and secondary market issuers to determine the collateral worth of a mortgage secured by a consumer's principal dwelling.¹⁵ The final rule would implement this statutory scope provision by applying the standards when an AVM is used to make a determination of collateral value, as opposed to other uses such as monitoring value over time or validating an already completed valuation. Such determinations of collateral value are generally made in connection with credit decisions or covered securitization determinations, for example, when using an AVM to determine a new value before originating a purchase-money mortgage or placing a loan in a securitization. Other uses of AVMs, such as for portfolio monitoring, do not involve making a determination of collateral value, and thus would not be within the scope of the final rule. Additionally, the rule would not cover AVMs used to develop an appraisal by a certified or licensed appraiser, nor in the review of the quality of already completed determinations of collateral value (completed determinations).

Section 1125(c)(1) provides that compliance with regulations issued under this subsection shall be enforced by—with respect to a financial institution, *or subsidiary owned and controlled by a financial institution and regulated by a Federal financial institution regulatory agency*—the Federal financial institution regulatory agency that acts as the primary Federal supervisor of such financial institution or subsidiary.¹⁶

C. AVMs Used In Connection With Making Credit Decisions

The final rule would apply to AVMs used in connection with making a “credit decision,” which refers to a decision regarding whether and under what terms to originate, modify, terminate, or make other changes to a mortgage. The final rule expressly excludes the use of AVMs in monitoring of the quality or performance of mortgages or mortgage-backed securities. The use of AVMs solely to monitor a creditor's mortgage portfolio would not be a credit decision under the final rule because the credit decision has already been made by the lending institution.

Further, limiting the scope of the rule to credit decisions and covered securitization determinations reflects the statutory definition of AVM, which focuses on the use of an AVM by mortgage originators and secondary market issuers to *determine* the collateral worth of a mortgage secured by a consumer's principal dwelling.¹⁷ The final rule would distinguish

¹⁵ 12 U.S.C. 3354(d).

¹⁶ See 12 U.S.C. 3354(c)(1) (emphasis added). The term “Federal financial institutions regulatory agencies” means the FRB, the FDIC, the OCC, the former OTS, and the NCUA. 12 U.S.C. 3350(6). Title III of the Dodd-Frank Act provides that the OCC is now the Federal financial institutions regulatory agency for Federal savings associations. Title III of the Dodd-Frank Act also provides that the FDIC is the Federal financial institutions regulatory agency for State savings associations. Finally, the Dodd-Frank Act provides that the FRB is responsible for regulation of savings and loan holding companies. The term “financial institution” means an insured depository institution as defined in 12 U.S.C. 1813 or an insured credit union as defined in 12 U.S.C. 1752. See 12 U.S.C. 3350(7).

¹⁷ 12 U.S.C. 3354(d) (emphasis added).

between using AVMs to determine the value of collateral securing a mortgage versus using AVMs to monitor, verify, or validate a previous determination of value (e.g., the final rule would not cover a computerized tax assessment used to verify the valuation made during the origination process).¹⁸ The final rule focuses on those aspects of mortgage and securitization transactions where the value of collateral is typically determined.

In addition, the final rule would cover the use of AVMs in deciding whether to change the terms of an existing mortgage even if the change does not result in a new mortgage origination, as long as a “mortgage originator” or “secondary market issuer,” or servicers that work on their behalf, use an AVM to determine the value of a mortgage secured by a consumer’s principal dwelling. The final rule also would cover AVMs used to decide whether or to what extent to reduce or suspend a home equity line of credit.

D. AVMs Used by Secondary Market Issuers

Since secondary market issuers are referred to in the statute, and the primary business of secondary market issuers is to securitize mortgage loans and to sell those mortgage-backed securities to investors, the final rule would cover AVMs used in securitization determinations. As mentioned above, the final rule would define “covered securitization determination” to include determinations regarding, among other things, appraisal waiver decisions. Under the final rule, a secondary market issuer that uses AVMs in connection with making appraisal waiver decisions would be required to have policies, practices, procedures and control systems in place to ensure that the AVM supporting those appraisal waiver decisions adhere to the rule’s quality control standards. In contrast, a mortgage originator that requests an appraisal waiver decision from a secondary market issuer would not need to ensure that the AVM used to support the waiver meets the final rule’s quality control standards because the secondary market issuer would be using the AVM to support the appraisal waiver decision in this context, not the mortgage originator.

For example, because the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, the GSEs) use their AVMs to determine whether the mortgage originator’s estimated collateral value or the contract price meets acceptable thresholds for purposes of obtaining a waiver for a GSE required appraisal, the final rule would require the GSEs, as secondary market issuers, to maintain policies, practices, procedures, and control systems designed to ensure the GSEs’ use of such AVMs adheres to the quality control standards. On the other hand, when a mortgage originator submits a loan to determine whether a GSE will offer an appraisal waiver, the mortgage originator would not be making a “covered securitization determination” under the final rule because the GSE would be using its AVM to make the appraisal waiver decision in this context. As a result, the mortgage

¹⁸ Many secondary market transactions by regulated entities require an appraisal unless an appraisal consistent with regulatory standards was obtained at the time of origination. *See* 12 CFR 323.3(a)(8).

originator would not be responsible for ensuring that the GSE's AVMs comply with the final rule's quality control standards.

The final rule would also define "covered securitization determination" to include determinations regarding, among other things, structuring, preparing disclosures for, or marketing initial offerings of mortgage-backed securitizations.¹⁹ However, AVMs used to monitor collateral value in mortgage-backed securitizations after they have already been issued would not be covered. The final rule would also cover AVM usage if and when a secondary market issuer uses an AVM as part of a new or revised value determination in connection with covered securitization determinations.

E. AVM Uses Not Covered By The Final Rule

The final rule would not cover use of an AVM by a certified or licensed appraiser in developing an appraisal. While appraisers may use AVMs in preparing appraisals, they must achieve credible results in preparing an appraisal under the Uniform Standards of Professional Appraisal Practice (USPAP) and its interpreting opinions. As such, an appraiser must make a valuation conclusion that is supportable independently and does not rely on an AVM to determine the value of the underlying collateral. In the final rule, the agencies note that it would be impractical for mortgage originators and secondary market issuers to adopt policies, procedures, practices, and control systems to ensure quality control for AVMs used by the numerous independent appraisers with whom they work.

However, the final rule would cover AVMs used in the process of preparing evaluations.²⁰ This distinction between appraisals and evaluations reflects that USPAP standards and appraiser credentialing are not required for individuals who prepare evaluations. The final rule's coverage of AVMs used in the process of preparing evaluations also reflects the more extensive use of, and reliance on, AVMs within the evaluation function.

AVMs used in reviews of completed determinations (*e.g.*, appraisals and evaluations) also would not be covered by the final rule, given that the underlying appraisal or evaluation determines the value of the collateral, rather than the appraisal or evaluation review. The appraisal review serves as a separate and independent quality control function.²¹ In the final rule, the agencies do not make distinctions based on the amount of time between the completed determination and the

¹⁹ See, *e.g.*, *Asset Backed Securities*, 70 FR 1505, 1544 (Jan. 7, 2005) (examples of asset characteristics that are "material" include LTV ratios); *Appraisals for Higher-Priced Mortgage Loans*, 78 FR 78519, 78533 (Dec. 26, 2013) ("The credit risk holder of the existing obligation might obtain a valuation . . . to estimate LTV for determining the appropriate securitization pool for the loan.").

²⁰ The appraisal regulations issued by the OCC, FRB, and FDIC, provide certain exceptions from the requirements to obtain an appraisal. However, lenders regulated by those agencies are required to obtain "evaluations" for certain transactions that fall within the exceptions in the appraisal regulations. See 12 CFR 34.43(b) (OCC); 12 CFR 225.62(c) (Board); and 12 CFR 323.3(b) (FDIC); see also *Interagency Appraisal and Evaluation Guidelines*, 75 FR at 77460 (discussing transactions that require evaluations under the appraisal rules and providing recommendations for evaluation development). Evaluations must be consistent with safe and sound banking practices.

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

subsequent review; if an AVM is solely being used to review the completed determination, such AVM use would not be covered by the final rule regardless of how soon the AVM is used after that determination.

F. Statutory Quality Control Standards

The final rule would require 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, to adopt policies, practices, procedures, and control systems to ensure that AVMs used in these transactions adhere to quality control standards designed to: (1) ensure a high level of confidence in the estimates produced; (2) protect against the manipulation of data; (3) seek to avoid conflicts of interest; and (4) require random sample testing and reviews. This approach would allow mortgage originators and secondary market issuers the flexibility to tailor their quality control standards for covered AVMs as appropriate based on the size of their institution and the risk and complexity of transactions for which they will use covered AVMs. The agencies decided against a more prescriptive rule as different policies, practices, procedures, and control systems may be appropriate for institutions with different business models and risk profiles, and a more prescriptive rule could unduly restrict institutions' efforts to tailor their risk management practices accordingly.

Further, the four specified statutory quality control factors are consistent with practices that many participants in the mortgage lending market already follow. These quality control factors are also consistent with the guidance described above that applies to many regulated institutions that would be subject to this rule, including the previously referenced Model Risk Guidance. As noted earlier, guidance is already in place to assist regulated institutions in using AVMs in a safe and sound manner, and institutions that are not regulated by the agency or agencies providing the guidance may still look to the guidance for assistance with compliance. Accordingly, a rule requiring institutions to develop policies, practices, procedures, and control systems designed to satisfy the requirement for quality control standards may more effectively carry out the purposes of section 1125 than a more prescriptive rule.

G. Fifth Nondiscrimination Quality Control Factor

Section 1125 provides the agencies with the authority to account for any other such factor they determine to be appropriate.²² Based on this authority, the agencies proposed to include a fifth factor that would require mortgage originators and secondary market issuers to adopt policies, practices, procedures, and control systems to ensure that AVMs used in connection with making credit decisions or covered securitization determinations adhere to quality control standards designed to comply with applicable nondiscrimination laws.

Commenters raised concerns about this proposed fifth quality control factor by noting the existence of several Federal laws and regulations in place to ensure nondiscrimination. While the commenters raised valid concerns and the agencies carefully considered all the issues and arguments made to remove this fifth quality control factor, the agencies ultimately decided to

²² 12 U.S.C. 3354(b).

adopt the fifth quality control factor as proposed. The agencies noted in the preamble to the NPR that they are aware institutions have a preexisting obligation to comply with Federal nondiscrimination laws,²³ and compliance with applicable nondiscrimination laws with respect to the use of AVMs may be indirectly reflected within three of the first four statutory quality control factors. Ensuring a high level of confidence in the estimates produced includes ensuring they are not the result of unlawful discrimination. While existing nondiscrimination laws apply to the use of AVMs, the agencies decided to include a fifth quality control factor relating to nondiscrimination in the final rule to heighten awareness among lenders of the applicability of nondiscrimination laws to the use of AVMs. Specifying a fifth quality control factor on nondiscrimination would create an *independent* requirement for institutions to establish policies, practices, procedures, and control systems to address nondiscrimination specifically, thereby further mitigating discrimination risk in their use of AVMs. The agencies' view is that specifying a nondiscrimination factor would increase confidence in AVM estimates and support well-functioning AVMs. In addition, specifying a nondiscrimination factor could help protect against potential safety and soundness risks, such as operational, legal, and compliance risks, associated with failure to comply with nondiscrimination laws.

While most commenters recognized the importance of ensuring that AVMs used by mortgage originators and secondary market issuers do not violate fair lending laws, a number of commenters expressed concern about how to implement the proposed quality control standards, particularly the fifth quality control factor on nondiscrimination, and suggested that additional guidance from the agencies may be needed in the future. Some commenters suggested that the rule should apply to AVM developers and vendors, rather than lending institutions, given that mortgage originators have no control over how AVMs are created. A number of commenters recommended that the agencies work with the private sector to develop a standard setting organization (SSO) for AVMs and an independent third-party entity responsible for testing AVMs for compliance with the proposed quality control standards.

As with models more generally, there are concerns about the potential for AVMs to discriminate, such as by replicating historical patterns of discrimination. Models may discriminate because of the data used or other aspects of a model's development, design, implementation, or use.²⁴ Attention to data is particularly important to ensure that AVMs do not rely on data that may create discrimination risks. Because AVMs typically involve less human discretion than appraisals, AVMs have the potential to reduce human bias. Yet without adequate attention to ensuring compliance with Federal nondiscrimination laws, AVMs also have the potential to

²³ See e.g., Equal Credit Opportunity Act (15 U.S.C. 1691(a)) and Fair Housing Act (42 U.S.C. 3605).

²⁴ In other contexts, models and data have the potential to be a source of bias and may cause consumer harm if not designed, implemented, and used properly. See generally, Federal Trade Commission, *Big Data: A Tool for Inclusion or Exclusion? Understanding the Issues* (Jan. 2016), available at <https://www.ftc.gov/system/files/documents/reports/big-data-tool-inclusion-or-exclusion-understanding-issues/160106big-data-rpt.pdf>; Reva Schwartz et al., *A Proposal for Identifying and Managing Bias in Artificial Intelligence*, Nat'l Inst. of Standards & Tech., U.S. Department of Commerce (June 2021), available at <https://nvlpubs.nist.gov/nistpubs/SpecialPublications/NIST.SP.1270-draft.pdf>. See also Andreas Fuster et al., *Predictably Unequal? The Effects of Machine Learning on Credit Markets*, 77 J. of Fin. 5 (Feb. 2022), available at <https://doi.org/10.1111/jofi.13090>; Emily Bembeneck, et al., *To Stop Algorithmic Bias, We First Have to Define It*, Brookings Inst. (Oct. 21, 2021), available at <http://brookings.edu/research/to-stop-algorithmic-bias-wefirst-have-to-define-it/>.

introduce associated discrimination risks. Moreover, if models such as AVMs lead to discrimination, the resulting harm could be widespread because of the high volume of valuations that even a single AVM can process.

Requiring institutions using covered AVMs to adopt fair lending compliance policies and practices would be consistent not only with current law but also with well-established fair lending guidance. The OCC, FRB, FDIC, NCUA, FHFA, and CFPB have issued statements and other materials setting forth principles the agencies will consider to identify discrimination.²⁵ The OCC, FRB, FDIC, NCUA, and CFPB have further underscored the importance of robust consumer compliance management to prevent consumer harm in the Interagency Policy Statement on the Use of Alternative Data in Credit Underwriting (Alternative Data Policy Statement).²⁶

Because the agencies have already provided guidance on implementing policies, practices, procedures, and control systems relating to model risk, third-party risk, AVMs, and nondiscrimination, as long as institutions adopt and maintain policies, practices, procedures, and control systems to ensure that AVMs adhere to the rule's requisite quality control standards—and consistent with the flexibility to set their quality control standards as appropriate based on the size, complexity, and risk profile of the institution and the transactions for which they would use AVMs—institutions should be able to work with AVM providers to assist them with their compliance obligations under the final rule. For these reasons and after considering the comments, the agencies believe that additional guidance is not needed at this time and recommend that institutions review and apply existing guidance in establishing and implementing appropriate policies, practices, procedures, and control systems for AVM quality control.

In addition, the agencies recognize that one or more SSOs and third-party AVM testing entities could be beneficial to effective compliance with the AVM rule. The agencies noted in the final

²⁵ See, e.g., Interagency Task Force on Fair Lending, *Policy Statement on Discrimination in Lending*, 59 FR 18266 (Apr. 15, 1994), available at <https://www.govinfo.gov/content/pkg/FR-1994-04-15/html/94-9214.htm>; *Interagency Fair Lending Examination Procedures (Aug. 2009)*, available at <https://www.ffiec.gov/PDF/fairlend.pdf>; Bureau of Consumer Financial Protection, *Examination Procedures - ECOA* (Oct. 2015), available at https://files.consumerfinance.gov/f/documents/201510_cfpb_ecoa-narrative-and-procedures.pdf; Federal Housing Fin. Agency, *Policy Statement on Fair Lending*, 86 FR 36199 (July 9, 2021), available at <https://www.govinfo.gov/content/pkg/FR-2021-07-09/pdf/2021-14438.pdf>.

²⁶ In the Alternative Data Policy Statement, the agencies emphasized that “[r]obust compliance management includes appropriate testing, monitoring and controls to ensure consumer protection risks are understood and addressed.” *Id.* *Interagency Statement on the Use of Alternative Data in Credit Underwriting* (Dec. 2019), available at https://files.consumerfinance.gov/f/documents/cfpb_interagency-statement_alternative-data.pdf; Consumer Fin. Prot. Bureau, *Supervisory Highlights: Summer 2013*, 5-11 (Aug. 2013), available at https://files.consumerfinance.gov/f/201308_cfpb_supervisory-highlights_august.pdf (discussing the pillars of a well-functioning CMS). See also Federal Financial Institutions Examination Council (FFIEC), *Notice and Final Guidance, Uniform Interagency Consumer Compliance Rating System*, 81 FR 79473 (Nov. 14, 2016), available at https://www.ffiec.gov/press/PDF/FFIEC_CCR_SystemFR_Notice.pdf (“in developing the revised CC Rating System, the Agencies believed it was also important for the new rating system to establish incentives for institutions to promote consumer protection by preventing, self-identifying, and addressing compliance issues in a proactive manner. Therefore, the revised rating system recognizes institutions that consistently adopt these compliance strategies.”).

rule that as long as financial institutions meet the obligations stated in the final rule, they are free to work with third parties to assist them with their compliance obligations.

Comment Period and Effective Date

Staff recommends issuing this final rule with an effective date of the first day of the calendar quarter 12 months after publication in the Federal Register.

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