BETTER MARKETS

August 21, 2023

Chief Counsel's Office
Attention: Comment Processing, Docket ID OCC–2023–0002
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E–218
Washington, DC 20219

Melane Conyers-Ausbrooks
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314–3428

Ann Misback
Secretary
Attention: Docket No. R–1807
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Comment Intake—CFPB–2023–0025
Consumer Financial Protection Bureau
c/o Legal Division Docket Manager
1700 G Street NW
Washington, DC 20552

James P. Sheesley
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Attention: Comments/Legal OES (RIN 3064–AE68)
Federal Deposit Insurance Corporation
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Clinton Jones
General Counsel
Attention: Comments/RIN 2590–AA62
Federal Housing Finance Agency
400 Seventh Street SW
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Washington, DC 20219

Re: Quality Control Standards for Automated Valuation Models – OCC Docket ID OCC–2023–0002; Board Docket No. R–1807 and RIN No. 7100 AG60; FDIC RIN 3064–AE68; NCUA Docket Number NCUA–2023–0019 and RIN 3133–AE23; CFPB Docket No. CFPB–2023–0025; FHFA RIN 2590–AA62; 88 Fed. Reg. 40638 (Jun. 21, 2023)

Dear Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the above-captioned Proposed Rule ("Proposal") issued by the Office of the Comptroller of the Currency ("OCC"), Board of Governors of the Federal Reserve System ("Fed"), Federal Deposit Insurance Corporation

[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies – including many in finance – to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

("FDIC"), National Credit Union Administration ("NCUA"), Consumer Financial Protection Bureau ("CFPB"), and Federal Housing Finance Agency ("FHFA"), collectively ("Agencies").[2]

The Proposal, if adopted, would establish a rule to implement quality control standards as mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") for the use of automated valuation models ("AVMs") to determine the value of mortgage collateral.[3] This rule would only apply to the use of AVMs for lender credit decisions or mortgage securitization decisions (covered decisions); it would not apply to other activities such as portfolio monitoring, the development of an individual appraisal by a certified or licensed appraiser, or the review of completed appraisals. While the rule sets the expectation that quality control standards will be followed, it does not provide any specific guidelines to explain how institutions are to structure policies, practices, procedures, and control systems. The stated reason for this missing information is to allow flexibility for institutions to tailor requirements to the size, risk, and complexity of their operations.

We applaud the Agencies for the proposed rule, but detail why it needs to be expanded to include a description of minimum acceptable levels for the quality control standards. While it is true that the rule applies to a broad range of entities and will be implemented by many Agencies, specifying minimum standards for quality controls is nonetheless necessary to ensure that borrowers are protected and financial stability is maintained.

BACKGROUND

Computerization, digitalization, and automation have affected many aspects of American life, and the process of obtaining a mortgage is no exception. While the use of individual human appraisers is still common and appropriate for many real estate transactions (if done appropriately not to discriminate or otherwise violate the law), the availability of data and computer programs have increasingly allowed for the automation of the real estate appraisal process. 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."[4]

AVMs have many benefits relative to human appraisers, including increased speed, lower cost, reduced chance of error, and the inclusion of a larger number of data points in the decision process. Of course, AVMs also have disadvantages relative to appraisers, namely the reliance on a specific data set. The data set itself may contain incomplete or incorrect data, it may be

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2 Quality Control Standards for Automated Valuation Models; RIN 1557-AD87, RIN 2590-AA62, RIN 3064-AE68, RIN 3133-AE23, RIN 3170-AA57, RIN 7100-AG60; 88 Fed. Reg. 40638 (Jun. 21, 2023), https://www.federalregister.gov/documents/2023/06/21/2023-12187/quality-control-standards-for-automated-valuation-models.

3 Public Law No. 101–73, title XI, §1125, as added Public Law No. 111–203, title XIV, §1473(q) 124 Stat. 2198 (July 21, 2010).

4 *Id.*

insufficient to provide a valuation for a rural or unique property, or it may contain information that reflects decades and generations of racial bias and discriminatory practices.[5] Given these serious deficiencies, it is imperative that financial institutions assess the inputs and outputs of AVMs using appropriate quality control standards to protect borrowers as well as the broader safety and soundness of the financial system. This responsibility extends not only to the need for ensuring that AVM data, modeling techniques, and output is accurate for determining collateral value for a real estate transaction, but also for ensuring that it does not perpetuate or worsen discrimination.[6]

Since 2010, the OCC, Fed, FDIC, and NCUA have had ***supervisory guidance*** related to the use of AVMs.[7] This guidance outlines the Agencies' expectations for financial institutions' appraisal and evaluation programs in support of safe and sound real estate lending. However, turning this guidance into a rule as reflected in the Proposal will make it stronger and more effective.[8]

SUMMARY OF THE PROPOSAL

The Proposal states that institutions using AVMs for covered decisions must adopt policies, practices, procedures, and control systems to:

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5 Academic and industry studies show evidence of racial bias in AVM results and attributes the finding to underlying bias in the data itself. *See* Michael Neal, Linna Zhu, & Caitlyn Young, *Why Automated Home Valuation Technology Errors Disproportionately Affect Majority-Black Neighborhoods*, URBAN INSTITUTE: URBAN WIRE (Mar. 5, 2021), https://www.urban.org/urban-wire/why-automated-home-valuation-technology-errors-disproportionately-affect-majority-black-neighborhoods.

6 While it may be hard to quantify, there is reason to believe that discrimination in real estate appraisals is widespread and significant. *See, e.g.*, Debra Kamin, *Home Appraised With a Black Owner: $472,000. With a White Owner: $750,000.*, N.Y. TIMES (Aug. 18, 2022), https://www.nytimes.com/2022/08/18/realestate/housing-discrimination-maryland.html; *see also Our America: Lowballed*, ABC Owned Television Stations (2022), https://abc7news.com/feature/our-america-lowball-home-appraisal-racial-bias-discrimination/12325606.

7 *See* Interagency Appraisal and Evaluation Guidelines, 75 FR 77450, 77468 (Dec. 10, 2010).

8 On September 11, 2018, the Fed, FDIC, OCC, CFPB, and NCUA issued a joint statement that greatly limited supervisors' use of guidance to address a bank's risky conduct even if it threatened safety and soundness or financial stability unless it also broke a specific law or rule. *See* Joint Press Release, *Agencies issue statement reaffirming the role of supervisory guidance* (Sept. 11, 2018), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180911a.htm.

Better Markets warned of the damaging nature of weakening the enforceability of supervisory guidance in a comment letter filed to the agencies in 2021, but the rule was ultimately finalized nonetheless, effective May 10, 2021, with few changes. *See* Better Markets Comment Letter, *Role of Supervisory Guidance, Notice of Proposed Rulemaking* (Jan. 4, 2021), https://bettermarkets.org/sites/default/files/Better%20Markets%20Comment%20Letter%20on%20Notice%20of%20Proposed%20Rulemaking%20-%20Role%20of%20Supervisory%20Guidance.pdf.

See also Final Rule, *Role of Supervisory Guidance*, 88 Fed. Reg. 18173 (Apr. 8, 2021), https://www.govinfo.gov/content/pkg/FR-2021-04-08/pdf/2021-07146.pdf.

(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) Comply with applicable nondiscrimination laws.

The first four components of the Proposal are taken directly from the requirements specified in the Dodd-Frank Act.[9] The Dodd-Frank Act includes a fifth component that states that AVM models shall "adhere to quality control standards designed to . . . account for any such factor that the agencies . . . determine to be appropriate."[10] The fifth component in the Proposal, related to compliance with nondiscrimination laws, clearly falls within that statutory authority and is appropriate if not mandated in light of the increasing evidence of discrimination with regard to appraisals.

The Proposal acknowledges that existing nondiscrimination law already applies to institutions' use of AVMs, and provides several reasons for its inclusion in the rule:

- To heighten if not ensure awareness among lenders of the applicability of nondiscrimination laws to AVMs;

- To further mitigate discrimination risk in lenders' use of AVMs by having an independent requirement for institutions to establish policies, practices, procedures, and control systems to specifically address nondiscrimination;

- To increase confidence in AVM estimates and support well-functioning AVMs; and

- To help protect against potential safety and soundness risks, such as operational, legal, and compliance risks, associated with failure to comply with nondiscrimination laws.

The proposed rule ***would only*** apply to the use of AVMs for covered decisions. It ***would not apply*** to other activities such as portfolio monitoring, the development of an individual appraisal by a certified or licensed appraiser, or the review of completed appraisals.

Furthermore, the Proposal ***does not*** set specific requirements for how institutions are to structure policies, practices, procedures, and control systems. It says that institutions should set quality controls ***that are appropriate for the size of the institution and the risk and complexity of***

9 *Supra* note 3.

10 12 U.S.C § 3354(a).

covered decisions for which the AVM will be used. It also says that modeling technology is evolving and endeavors to allow for the flexibility in and evolution of the quality controls.[11]

SUMMARY OF COMMENTS

The Agencies' Proposal to implement a rule for quality control standards for AVMs is long overdue and necessary to ensure that all Americans are protected and treated equitably in the pursuit of the American Dream of homeownership. While the Proposal is a step in the right direction, it must be strengthened to correct the serious shortcoming of a lack of specificity on minimum acceptable standards before it is finalized.

Our comments are summarized as follows:

- Formalizing ***prior guidance*** on quality control standards for AVMs ***as a rule*** protects borrowers and the financial system because it will incontestably empower Agencies, examiners, and other agency staff to enforce the provisions. In 2018, the Agencies said that "supervisory guidance does not have the force and effect of law, and that the agencies do not take enforcement actions based on supervisory guidance."[12] Therefore, this rule will establish the necessary regulatory enforcement power that the American people deserve.

- Application of the rule across the spectrum of mortgage lenders and securitizers, including banks and non-banks, will strengthen the entire financial system. As of 2022, non-bank lenders originated more than half of the annual residential real estate loan volume,[13] so they should be held to the same quality control standards for AVMs as banks.

- The addition of specific minimum standards for the quality control factors is critical and must be done before the rule is finalized. Allowing individual lenders to determine appropriate levels for compliance with quality control standards and expecting multiple agencies to coordinate and assess compliance is impractical and dangerous. The American people deserve to receive the same level of protection during the mortgage lending process whether they are obtaining a loan from a large mortgage originator or a smaller bank. Some lenders may be incentivized to implement few or inadequate controls if they lead to less loan volume or less profit. Additionally, some lenders, particularly smaller banks, may not have the capabilities or resources to create their own suite of metrics and controls to assess

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11 *Supra* note 2.

12 Joint Press Release, *Agencies issue statement reaffirming the role of supervisory guidance*, *supra* note 8.

13 *See* Rica Dela Cruz & Gaby Villaluz, *Nonbank Lenders Shed Mortgage Market Share as Originations Plummet in 2022,* S&P GLOB. MKT. INTELLIGENCE (July 13, 2023), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/nonbank-lenders-shed-mortgage-market-share-as-originations-plummet-in-2022-76481554#:~:text=Nonbanks%20accounted%20for%2050.9%25%20of%20funded%20loans%20in,which%20booked%20%241.126%20trillion%20in%20mortgages%20in%202022.

lending. Having a standard set of metrics that are approved for all AVMs will not only better protect borrowers, but could also reduce the cost for taxpayers, streamline the regulatory process, and ease the burden on lenders. Done right, this really can be a win-win-win.

- Agencies and the American people should not assume or conclude that the requirement for compliance with nondiscrimination laws will eliminate bias from AVMs or the mortgage lending process; indeed, AVMs could actually make discrimination more difficult to detect. AVMs, by their very nature, rely on a set of historic data to operate and produce output. Numerous studies have shown that historical data on home prices, one of the key inputs to an AVM, are influenced by racial and other types of bias, including many decades of redlining. While it is certainly a worthwhile pursuit to eliminate discrimination from AVMs, determining that lenders have succeeded is a difficult task. In fact, as AVMs employ more and more data, and become more and more complex, the presence of bias becomes more challenging to detect. Agencies must ensure that they have the appropriate skills and resources on staff to assess AVMs accurately.

COMMENTS

I. FORMALIZING PRIOR GUIDANCE ON QUALITY CONTROL STANDARDS FOR AVMS AS A RULE PROTECTS BORROWERS AND THE FINANCIAL SYSTEM.

During the Trump administration, there was a broad and sustained effort to weaken the supervision of banks by specifically stating that supervisory guidance was not enforceable.[14] Strong and enforceable rules are necessary to protect consumers and the financial system. Therefore, this Proposal, ***which converts prior guidance to a rule*** will remove any doubt that the Agencies have the necessary regulatory authority that the American people deserve.

II. APPLICATION OF THE RULE ACROSS THE SPECTRUM OF MORTGAGE LENDERS AND SECURITIZERS, INCLUDING BANKS AND NON-BANKS, WILL STRENGTHEN THE ENTIRE FINANCIAL SYSTEM.

While banks are often thought of as the primary providers of mortgage lending in the United States, non-banks and other lenders have been steadily gaining market share. All market

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[14] For an analysis of the broad deregulatory push during the Trump Administration, see Better Markets, *Road to Recovery: Protecting Main Street from President Trump's Dangerous Deregulation of Wall Street* (Sept. 15, 2020), https://bettermarkets.com/sites/default/files/documents/BetterMarkets_Road_To_Recovery_Sept_15_2020.pdf; *see also* Better Markets, *Federal Reserve Actions Under the Trump Administration Have Significantly Weakened Post-Crisis Banking Protection Rules* (Dec. 3, 2020), https://bettermarkets.com/sites/default/files/Better_Markets_WhitePaper_Fed_Actions_Under_Trump_Administration_12-03-2020.pdf.

participants using AVMs should be held to the same standards for quality controls so that consumers are protected equally. Furthermore, at the time of origination, a lender may not know whether a mortgage loan will be held in portfolio or sold to the GSEs, so having a standard set of quality control standards is essential to ensure the mortgage market can function smoothly.

Non-banks' share of the residential mortgage market has steadily increased in recent decades and the latest data shows that they now exceed banks' share for several metrics.[15] For example, in 2007, non-banks accounted for only about 20 percent of residential mortgage origination in the United States.[16] But by 2017, non-banks accounted for more than half of residential mortgage origination, surpassing banks' share for the first time.[17] Through 2022, even with the drop in overall mortgage origination that occurred as interest rates increased, non-banks continued to provide more than half of the origination volume nationwide.[18]

III. THE ADDITION OF SPECIFIC MINIMUM STANDARDS FOR THE QUALITY CONTROL FACTORS IS CRITICAL AND MUST BE DONE BEFORE THE RULE IS FINALIZED.

Allowing thousands of individual lenders to determine appropriate levels for compliance with quality control standards and expecting multiple agencies to coordinate and assess compliance is impractical and dangerous.[19] The American people deserve to receive the same level of protection during the mortgage lending process whether they are obtaining a loan from a large mortgage originator that handles a large volume of complex loans or a community bank that handles a smaller volume of standard loans. Furthermore, having each lender develop their own separate quality control standards will result in a fragmented, complicated system. Agencies will have to devote considerable time and resources to understand and assess the likely many different standards. Chaos is the likely result making regulation and enforcement a nightmare.

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15 *See* Kayla Shoemaker, *Trends In Mortgage Origination And Servicing: Nonbanks in the Post-Crisis Period*, 13 FDIC Q.53, Chart 2 (Third Quarter 2019), https://www.fdic.gov/analysis/quarterly-banking-profile/fdic-quarterly/2019-vol13-4/fdic-v13n4-3q2019.pdf.

16 *Id.*

17 *Id.*

18 Dela Cruz et al., *supra* note 13.

19 Home Mortgage Disclosure Act data show that 4,460 U.S. financial institutions made residential mortgage loans in 2022. The 10 lenders with the largest residential mortgage portfolios originated nearly 22 percent of all residential mortgage loan origination. *See* Summary of 2022 Data on Mortgage Lending, Consumer Financial Protection Bureau (June 29, 2023), https://www.consumerfinance.gov/data-research/hmda/summary-of-2022-data-on-mortgage-lending/; *see also* Jeff Ostrowski, *The 10 largest mortgage lenders in the U.S.*, BANKRATE (Apr. 3, 2023), https://www.bankrate.com/mortgages/largest-mortgage-lenders/.

The Agencies need to develop a set of minimum standards that all lenders would be expected to meet. Better Markets urges the Agencies to be explicit about the expectations for each of the components of the quality control standards so that the minimums can be understood, approved, and followed consistently by all market participants.[20] For instance, Agencies should provide specific instructions to market participants on:

- What constitutes an AVM result in which lenders and the American people can have confidence;
- Types of data manipulation that must be avoided and ways to test for it;
- Conflicts of interest that must be avoided and ways to test for them; and
- Examples of random sample testing and what constitutes a passing result for such tests.

Even with additional specifics, compliance with the standards will likely be a complex and expensive endeavor, so lenders who are motivated to maximize profits and minimize costs may be incentivized to do the minimum amount of work required to comply. Furthermore, smaller banks may not have the capabilities or resources to create their own set of quality control metrics.

We offer two possible solutions to assist in this area:

1) Assign the responsibility for developing a set of minimum standards that would be applicable to all market participants to one or more of the Agencies, or work with an entity with expertise in technical standards such as the National Institute of Standards and Technology ("NIST") at the U.S. Department of Commerce. Well-developed standards provide industry participants, consumers, and innovators with a common language and set of expectations to facilitate fair and clear transactions.

2) Assist lenders, especially smaller banks, by developing a set of models that ***do comply*** with the minimum standards. This would ensure that borrowers who obtain loans from these lenders are receiving service that meets the minimum standards. This would help lenders because they would not have to spend their own resources to build or buy the capability to test their own models for compliance. This would also allow both borrowers and lenders to benefit from AVM usage, with quicker appraisal results and lower cost.

[20] Better Markets provided a similar comment on the need for specific industry standards related to the management of Third-Party Relationships. *See* Better Markets Comment Letter, *Request for Comment on Proposed Guidance on Managing Risks Associated with Third Party Relationships* (Oct. 18, 2021), https://bettermarkets.org/wp-content/uploads/2021/10/Better_Markets_Comment_Letter_on_Interagency_Guidance_on_Third_Party_Relationships.pdf.

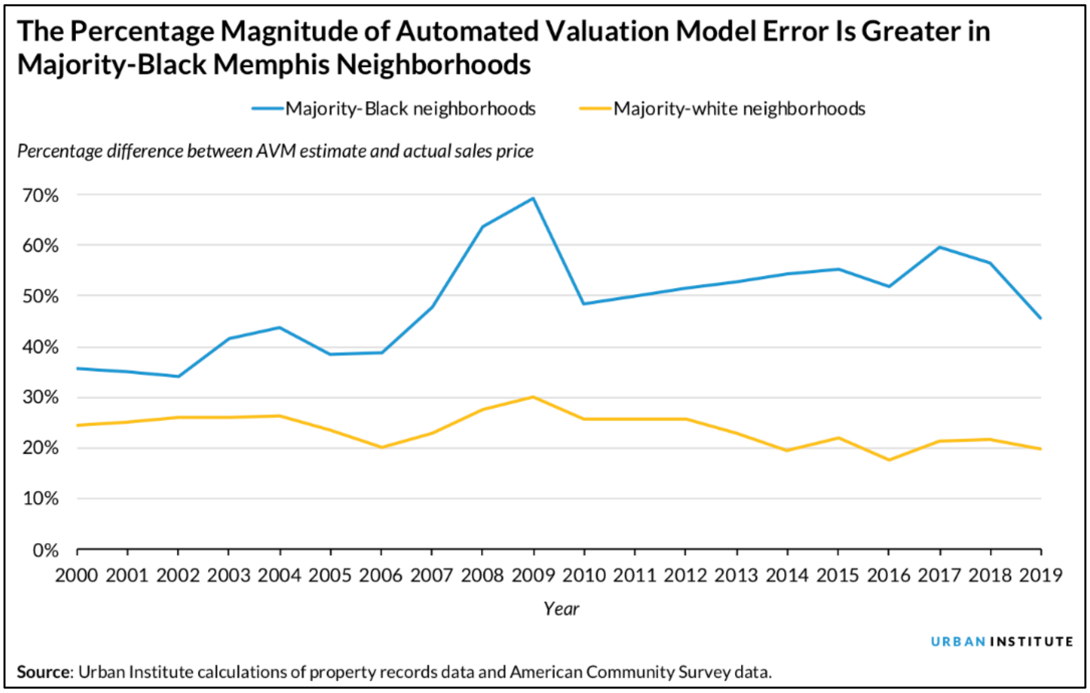
IV. AGENCIES AND THE AMERICAN PEOPLE SHOULD NOT ASSUME OR CONCLUDE THAT THE REQUIREMENT FOR COMPLIANCE WITH NONDISCRIMINATION LAWS WILL ELIMINATE BIAS FROM AVMS OR THE MORTGAGE LENDING PROCESS. IN FACT, AVMS COULD ACTUALLY MAKE DISCRIMINATION MORE DIFFICULT TO DETECT.

Individual appraisers determine the value of collateral for a residential mortgage loan based on a visit to the physical property and an assessment of an array of data. Supporters of AVMs contend that human appraisers may be influenced during their work by factors that result in biased results, and that use of AVMs alleviates this problem. However, while AVMs themselves are not subject to human error or bias during an individual home-visit decision, they do rely entirely on a data set that almost certainly contains bias. Several recent studies highlight both the concerns that arise when using AVMs for credit decisions during the lending process as well as the significant challenges associated with removing bias and strengthening AVM systems.

One study examined residential real estate transactions in majority-Black and majority-white neighborhoods in Atlanta, Memphis, and Washington, DC from 2000 to 2018.[21] Several notable findings emerged. AVM estimates are consistently different than sales price for properties in both majority-white and majority-Black neighborhoods, leading to questions about AVM's comparative value relative to human appraisers. Moreover, for majority-Black neighborhoods, the ***percentage difference*** between the appraised value and sales price was consistently larger than in majority-white neighborhoods. As shown in the chart below from the study,[22] AVM results differed by about 20 to 30 percent from the actual sales price in majority-white neighborhoods (displayed by the lower, yellow line). In majority-Black neighborhoods (displayed by the higher blue line), the average AVM results were never less than 30 percent different than the actual sales price. In majority-Black neighborhoods, the difference between AVM results and sales prices averaged about 50 percent and peaked near 70 percent. While any error is undesirable, AVM undervaluation can be particularly damaging for borrowers and perpetuate systemic discriminatory practices.

21 Neal et al., *supra* note 5.

22 *Id.*



The study then explores the cause of the greater valuation errors in majority-Black neighborhoods and finds several contributing factors. Majority-black neighborhoods typically have older homes, which often results in lower valuations. Majority-black neighborhoods also have more gentrification and more distressed sales, resulting in greater potential for undervaluation. AVMs' reliance on large data sets of comparable sales are, by their nature, slow to reflect the potential benefit from gentrification and weighed down by the negative effects of distressed sales.

Another study explored 1.8 million appraisals from 2019 and 2020 to examine how the race of the borrower, not just the neighborhood, influence appraisal results.[23] As the chart below from the study shows,[24] in both majority-white and majority-Black neighborhoods, white borrowers were more likely to receive overvalued appraisals. Because the sales price for a home is often the same as the appraisal value, a greater incidence of overvaluation for white borrowers has contributed to increased wealth-building, often from generation to generation.

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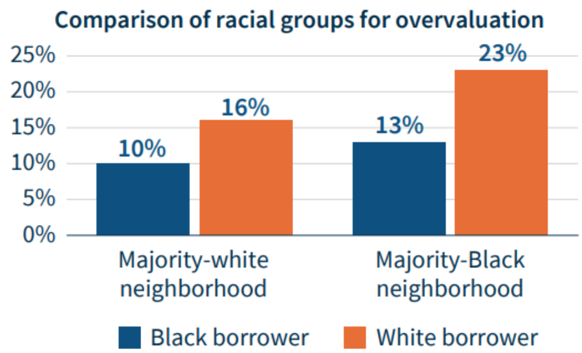
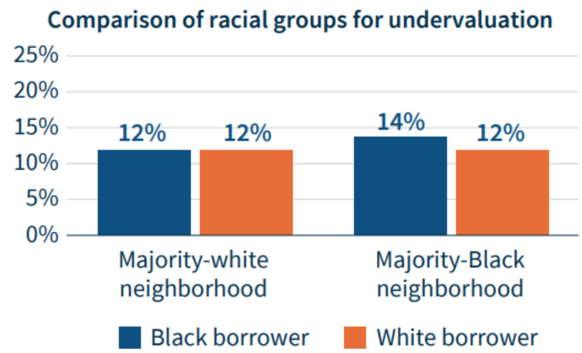
23 *See* Jake Williamson & Mark Palim, *Appraising the Appraisal*, FANNIE MAE (Feb. 2022), https://www.fanniemae.com/media/42541/display.

24 *Id.*





While models themselves may be less likely than human appraisers to produce biased results, the fact that models rely entirely on ***data sets that almost certainly contain the effects of latent discrimination and redlining*** is cause for concern and caution. Furthermore, the extreme complexity and dynamic nature of many models make it difficult to identify bias or resolve the specific cause of results affecting disparate groups.[25]

Insights from research on the explainability and fairness of using technology in credit underwriting contend that "existing legal, policy, and regulatory frameworks lag woefully behind in understanding these technologies or how best to oversee their application."[26] In other words, while it is noble to aim for a lending process that is free from discrimination, the use of AVMs certainly complicates the analytical process and potentially masks the existence of discrimination. At the same time, there is persistent tension between the need for collateral valuations that serve safety and soundness goals, for loan-to-value measures for example, and the need for valuations that do not overemphasize certain neighborhood characteristics which perpetuate historical bias and unfairly disadvantage borrowers. Given current capabilities, the Agencies and lenders alike face a significant challenge in the assessment of AVMs' nondiscrimination, and therefore must allocate appropriate resources to this task.

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25 *See* Laura Blattner & Jann Spiess, *Machine Learning Explainability & Fairness: Insights from Consumer Lending*, FINREGLAB (Apr. 2022), https://finreglab.org/wp-content/uploads/2022/04/FinRegLab_Stanford_ML-Explainability-and-Fairness_Insights-from-Consumer-Lending-April-2022.pdf.

26 *The Use of Machine Learning for Credit Underwriting*, FINREGLAB (Sept. 2021), https://finreglab.org/wp-content/uploads/2021/09/The-Use-of-ML-for-Credit-Underwriting-Market-and-Data-Science-Context_09-16-2021.pdf.

CONCLUSION

We hope these comments are helpful as the Agencies finalize the Proposal.

Sincerely,

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