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## CFPB and Federal Banking Agencies Propose Quality Control Standards on Automated Valuation Models Used in Underwriting Mortgage Loans

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On June 1, 2023, the Consumer Financial Protection Bureau along with Federal Reserve, OCC, FDIC, NCUA and FHFA (collectively, the "Agencies") issued a [Notice of Proposed Rulemaking](#) seeking comment on rules to implement quality control standards for automated valuation models (AVMs) used by residential mortgage originators and secondary market issuers in determining the collateral worth of a mortgage loan that is secured by a consumer's principal dwelling. The proposed quality control standards are meant "to ensure the credibility and integrity of valuations" by protecting against manipulation of data, avoiding conflicts of interest, requiring random sample testing and reviews, and to promote compliance with applicable nondiscrimination laws. The Agencies' pre-existing guidance related to AVMs would remain applicable (most notably, the 2010 Appendix B to the Interagency Appraisal and Evaluation Guidelines). Recently, the Agencies 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.

The proposed quality control standards for AVMs are mandated by Section 1473(q) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), 12 USC 3354. Of note, the proposed rule does not call for prescriptive quality control standards for AVMs. Rather, the proposal restates Section 1473(a)'s list of 4 general quality control standards, with the addition of a fair lending factor. The Agencies explain it as follows: "[a]s modeling technology continues to evolve, this flexible approach would allow institutions to refine their policies, practices, procedures, and control systems as appropriate." Here are the 4 general quality control standards for AVMs already statutorily required under Section 1473(a) plus the proposed addition of a fifth non-discrimination standard for AVMs:

- Ensure a high level of confidence in the estimates produced;
- Protect against the manipulation of data;
- Avoid conflict of interest;
- Require random sample testing and reviews; and
- Comply with applicable non-discrimination laws.

The proposed rule would require **mortgage originators (as defined)** to adopt policies, procedures and control systems to ensure that AVMs used in residential and commercial mortgage credit decisioning when a borrower's primary residence is the intended collateral, adhere to quality control standards, not only for purposes of mortgage loan origination, but also for modifying the terms of an existing loan, or renewing, increasing or terminating a line of credit. For **secondary market issuers (as defined)**, this proposed rule requires adoption of policies, procedures and control systems to ensure that AVMs used in covered securitization determinations, including decisions of valuation acceptance and appraisal waiver, meet the prescribed quality control standards.

Of note, the proposed rule does not have specific enforcement and penalty provisions for non-compliance. Rather, each Agency has proposed to amend or add to existing respective valuation rules for real estate lending and will be enforced in the same manner. Thus, covered financial institutions under this proposed rule can expect an expansion in scope of regulatory examinations to cover how effectively the financial institution is adhering to the proposed quality control standards in the use of AVMs in mortgage loan underwriting. Close attention to this proposed rule and its upcoming iterations is warranted.

The Notice of Proposed Rulemaking presents a list of 37 questions for commenters and the public at large to consider in the context of AVM use in underwriting mortgage loans secured by a borrower's principal dwelling. In their line of questioning regarding adoption of non-discrimination in lending policies and practices in the use of AVMs, the Agencies seek responsive information on the following:

- *What are advantages and disadvantages of specifying a 5th quality control factor on nondiscrimination? What, if any, alternative approaches should the Agencies consider?*
- *To what extent is compliance with nondiscrimination laws with respect to covered AVMs already encompassed in the 4 statutory factors listed in Section 1473(q)? Would specifying a nondiscrimination quality control factor in the rule be useful in preventing market-distorting discrimination in the use of AVMs?*
- *What are the advantages and disadvantages of a flexible versus prescriptive approach to the nondiscrimination quality control factors?*
- *Are lenders' existing compliance management systems and fair lending monitoring programs able to assess whether a covered AVM, including the underlying artificial intelligence or machine learning, applies different standards or produces disparate valuations on a prohibited basis? If not, what additional guidance or resources would be useful or necessary for compliance?*
- *What, if any, other approaches should the Agencies consider for incorporating nondiscrimination requirements in this proposed rule?*

Comments must be received within 60 days of publication in the Federal Register. If adopted by the Agencies as final, these AVM standards would take effect on the first day of a calendar quarter following the 12 months after publication of the final rule in the Federal Register. The Agencies also seek comment on this proposed implementation time period.

Buchalter's experienced Commercial Real Estate Practice Group's and its Consumer Financial Services and Mortgage Regulatory Industry Group's knowledgeable expert attorneys can assist financial institutions operating in the mortgage lending and secondary market space to navigate the issues raised by this proposed Interagency Rule and on quality control standards for AVMs.



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