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# Agencies issue final rule on quality control standards for automated valuation models

Initial perspectives related to agencies final rule for automated valuation models (AVMs) used by mortgage originators and secondary market issuers

Center *for* Regulatory Strategy US

On July 17, 2024, six federal regulatory agencies—the Federal Reserve Board of Governors (FRB), Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), Consumer Financial Protection Bureau (CFPB), Federal Housing Finance Agency (FHFA), and National Credit Union Administration (NCUA) (collectively, the Agencies)—issued a final rule[1] to implement quality control standards for AVMs[2] used by mortgage originators and secondary market issuers in valuing those homes. The final rule is expected to become effective September 1, 2025.

## 5 insights you should know

**Quality control standards:** Institutions will be required to adopt policies, practices, procedures, and control systems to meet five quality control standards designed to: (1) ensure a high level of confidence in the estimates produced; (2) protect against data manipulation; (3) avoid conflicts of interest; (4) require random sample testing and reviews; and (5) comply with applicable nondiscrimination laws. However, the final rule does not expand upon or provide further guidance on the standards themselves.

**Flexible approach to setting standards:** The final rule does not set specific requirements for how institutions are to structure applicable policies, practices, procedures, and control systems. Instead, the rule provides institutions with the flexibility to set quality controls for AVMs as appropriate based on the size, complexity, and risk profile of the institution, as well as the transactions for which they would use AVMs covered by the rule.

**Connection with credit decisions:** The final rule applies to AVMs used in connection with making credit decisions, which is defined broadly to include—among other things—decisions regarding whether and under what terms to originate, modify, terminate, or make other changes to a mortgage. AVMs used in monitoring the quality or performance of mortgages or mortgage-backed securities, or to validate a prior determination of value, are excluded from the final rule's scope.

**Covered securitization determinations:** The final rule applies to certain securitization activities of secondary market issuers, including government sponsored enterprises (GSEs), defined as "covered securitization determinations." These would include determinations regarding, whether to waive an appraisal requirement for a mortgage origination or as part of a new or revised value determination in connection with a covered securitization determination, among other things.

**Nondiscrimination focus:** The fifth quality control factor to comply with applicable nondiscrimination laws (a standard the Agencies determined "to be appropriate" under the Dodd-Frank Act) highlights the continued concern among regulators that AVMs may produce property estimates that reflect discriminatory bias, such as by perpetuating systemic inaccuracies and historical patterns of discrimination.

## 5 considerations to evaluate

1 **Update policies, practices, procedures, and control systems:** Covered institutions should conduct a gap analysis to understand where their policies, practices, procedures, and control systems may need updating. Institutions may consider setting up cross-function teams, such as data/technology and compliance offices, to implement any necessary changes. Once updated, it's important to clearly communicate those changes across the organization, train relevant staff accordingly, and revisit systems regularly.

2 **Implement a trusted and secure AI framework:** Covered institutions should consider implementing a responsible AI framework that has the following characteristics: (1) transparent and explainable; (2) fair and impartial; (3) robust and reliable; (4) respectful of privacy; (5) safe and secure; and (6) responsible and accountable. This framework can help to alleviate some of the regulators' concerns that are outlined in the final rule.

3 **Review data controls:** To address regulators' concerns regarding AVMs, covered institutions should be able to demonstrate proper data quality and transparency standards. As such, institutions should have clear insight into their data sources, including upstream data from third-party sources, as well as downstream users of the AVM. Additionally, it is important to regularly audit such data sources and validate data collection methods, as well as provide for ongoing monitoring of data integrity (and procedures for reporting and escalating quality issues if found.

4 **Review model governance practices:** To meet leading model risk management practices and regulatory expectations (e.g., FRB SR 11-7 and the *Comptroller's Handbook on Model Risk Management*[3]), it is important for firms to perform effective challenge, whereby informed parties can identify model limitations and assumptions and initiate steps to address such limitations. It is also important to establish monitoring of model performance over time and maintain detailed documentation of AVM applications across the model lifecycle. Regulators expect such documentation to be made available in a timely manner.

5 **Pay careful attention to discrimination risk:** While existing nondiscrimination laws apply to institutions' use of AVMs, the Agencies included a fifth quality control factor relating to nondiscrimination to heighten awareness among lenders of the applicability of nondiscrimination laws to AVMs. As such, it will be especially important for financial institutions to carefully consider discrimination risks and take meaningful steps to reduce the risk of AVMs relying on data or algorithms that may incorporate potential biases in their outputs.

## Endnotes

[1] Federal Reserve Board of Governors (FRB), Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), Consumer Financial Protection Bureau (CFPB), Federal Housing Finance Agency (FHFA), and National Credit Union Administration (NCUA), "Quality Control Standards for Automated Valuation Models," July 17, 2024.

[2] Automated valuation models (AVMs) are defined in Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act 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. *See* 12 USC 3354(d).

[3] FRB, "SR 11-7: Guidance on Model Risk Management," April 4, 2011. See OCC, "Comptroller's Handbook on Model Risk Management," August 2021.

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