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August 21, 2023

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

RE: Quality Control Standards for Automated Valuation Models; RIN 3133–AE23

Dear Ms. Conyers-Ausbrooks:

The Credit Union National Association (CUNA) represents America’s credit unions and their more than 135 million members. On behalf of our members, we are writing in response to the Notice of Proposed Rulemaking regarding Quality Control Standards for Automated Valuation Models¹ issued by the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Federal Reserve), Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA), Consumer Financial Protection Bureau (CFPB), and Federal Housing Finance Agency (FHFA) (collectively the Agencies).

Background

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) added section 1125 to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).² Section 1125 governs automated valuation models (AVMs) used in mortgage lending, and it 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.”³ Section 1125 requires AVMs to satisfy quality control standards that:

- (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.⁴

¹ 88 Fed. Reg. 40638 (June 21, 2023).

² See 12 U.S.C. § 3354 (codifying section 1125).

³ 12 U.S.C. § 3354(d).

⁴ 12 U.S.C. § 3354(a).

The Agencies are responsible for consulting with the Appraisal Subcommittee and the Appraisal Standards Board and issuing regulations to implement the section 1125 quality control standards.⁵ To satisfy this statutory obligation, the Agencies issued this proposed rule, which was published in the Federal Register on June 21, 2023.⁶

While section 1125 provided a roadmap for the Agencies to follow in the rulemaking, several of the terms used in the statutory language were not defined. As such, the proposed rule defines many of the terms used in section 1125, and these definitions draw the boundaries around what the proposed rule is designed to cover.

The Agencies elected to issue a principles-based proposed rule as opposed to one that contained prescriptive requirements about what institutions needed to do to comply with section 1125⁷. They also chose to use the discretion granted in section 1125 to include a fifth quality control standard: “compl[iance] with applicable nondiscrimination laws.”

Credit Unions Support Principles-Based Approach and Excluded Uses from Coverage

CUNA commends the Agencies for moving forward with a principles-based approach to this proposed rulemaking. Credit unions favor that approach because it ensures they will be able to tailor their quality control standards to their unique circumstances and account for their size, complexity, and risk profile. The principles-based approach provides credit unions with more flexibility to choose how to incorporate AVMs as part of their lending programs and makes it less likely that requirements that are too prescriptive inhibit innovation and adoption. Credit union members likewise benefit because AVMs can be a faster and more cost-effective valuation tool for mortgage origination and could make human discretion and bias less of a factor in the valuation process.

CUNA appreciates the exclusions built into the proposed rulemaking. We agree that there is no reason to apply the proposed quality control standards to AVMs that are used to review completed appraisals and evaluations.⁸ That exclusion aligns with the statutory direction that the quality controls standards cover AVMs used by mortgage originators and secondary market issuers in determining the value of collateral rather than reviewing an established value and provides institutions with the flexibility to use AVMs as a cost-effective tool in its appraisal review process when the appraisal is providing the underlying valuation for the collateral.

⁵ 12 U.S.C. § 3354(b).

⁶ *Supra* note 1.

⁷ *See id.* at 40641 (“The proposed rule would not set specific requirements for how institutions are to structure these policies, practices, procedures, and control systems.”).

⁸ *See id.* at 40643-44 (“The proposed rule would not cover use of an AVM by a certified or licensed appraiser in developing an appraisal.”).

CUNA supports the Agencies' exclusion of AVMs used by appraisers to develop appraisals from the coverage of the proposed rule.⁹ Including that usage could adversely affect credit unions and consumers by potentially limiting who a credit union could use as an appraiser. In areas where there are already shortages of appraisers, limiting the size of the appraiser pool could delay closings and cause hardship for credit union members. Including this usage within the scope of the proposed rule is also unnecessary in that the appraisal rules promulgated by the banking agencies and the NCUA require a review process that can evaluate whether the appraisal is reasonable and well-supported.

CUNA also agrees with the Agencies' decision to exclude mortgage originators from having to implement quality control standards for AVMs that secondary market issuers use to determine whether a loan may be eligible for an appraisal waiver.¹⁰ Requiring credit unions to implement quality controls over the AVMs used by the secondary market issuer in that situation would be redundant given that the proposed rule covers the secondary market issuer's use of the AVM in that context. Moreover, the secondary market issuers are in the best position to implement quality controls standards over their usage of AVMs to determine whether a loan is eligible for an appraisal waiver.

Align the Definition of a Dwelling with Existing AVM Guidance and Appraisal Rules

CUNA urges the Agencies to constrain the definition of a dwelling in the proposed rule to real estate. The appraisal regulations of the federal banking agencies and NCUA and the 2010 Interagency Appraisal and Evaluation Guidelines (IAEG) apply to real estate-related transactions.¹¹ The proposed definition of a dwelling could apply to certain collateral that is not real estate, including boats.¹² Credit unions in some markets make these non-real estate-related loans to meet the credit and housing needs of their members, and they use different tools that might be an AVM under the proposed definition of a dwelling. To the extent those non-real estate-related transactions fit within the definition of a dwelling as contemplated in the proposed rule, those alternative tools (e.g., NADA, Kelly Blue Book) would appear to be covered by the rule whereas

⁹ *See id.* at 40644 (“The proposed rule would not cover AVMs used in reviews of completed collateral value determinations, given that the underlying appraisal or evaluation determines the value of the collateral, rather than the review of the appraisal or evaluation.”).

¹⁰ *See id.* at 40643 (“As a result, the mortgage originator would not be responsible for ensuring that the GSEs' AVMs comply with the proposed rule's quality control standards.”).

¹¹ *See* 12 C.F.R. § 722.1(b) (“Title XI provides protection for federal financial and public policy interests in real estate-related transactions by requiring real estate appraisals used in connection with federally related transactions to be performed in writing, in accordance with uniform standards, by appraisers whose competency has been demonstrated and whose professional conduct will be subject to effective supervision. This part implements the requirements of title XI and applies to all federally related transactions entered into by the National Credit Union Administration or by federally insured credit unions (‘regulated institutions’.”); 12 C.F.R. § 34.41(b) (similar language for OCC-regulated institutions); 12 C.F.R. § 225.61(b)(1) (similar language for Federal Reserve-regulated institutions); 12 C.F.R. § 323.1(b)(1) (similar language for FDIC-regulated institutions); IAEG at 25, *available at* <https://www.fdic.gov/news/financial-institution-letters/2010/fil10082a.pdf> (noting that loans not secured by real estate are not subject to appraisal or evaluation requirements).

¹² *See supra* note 1, at 40645 (“The OCC, Board, FDIC, NCUA, and FHFA would define dwelling to mean a residential structure that contains one to four units, whether or not that structure is attached to real property.”).

they were not previously covered by the prudential regulators' appraisal regulations. This increased regulatory burden could lead credit unions to exit from this type of lending, if they have difficulty applying AVM quality control standards to these valuation tools. Credit union members may be left with fewer lending options for these types of loans. Tethering the definition of dwelling in the proposed rule to real estate would better align with the existing framework of the appraisal regulations of the federal banking agencies and NCUA that govern real estate-related transactions and provide for consistent treatment for appraisals, evaluations, and AVMs.

Definition of a Credit Decision Should Exclude Loan Modifications and HELOC Suspensions or Reductions

CUNA recommends that the Agencies not include loan modifications and line of credit reductions within the scope of a credit decision. Credit unions are concerned about the breadth of the proposed rule's definition of credit decision, which includes modifications and decisions to change the limit on a line of credit.¹³ Some credit unions order an AVM when considering a loan modification request from their members. In the context of loss mitigation, consumers benefit when their modification requests are processed in a timely manner. If credit unions need to apply the AVM quality control standards to AVMs used in the context of evaluating the collateral risk when determining whether to modify a loan to a member in financial distress, they are concerned that they may be forced to either forgo valuations or move forward with a more expensive appraisal that takes more time and delays the completion of a modification. Both outcomes could negatively affect either credit union members seeking loan modifications or credit unions attempting to work prudently with members in financial distress.

Similarly, applying the proposed quality control standards to AVMs that may be used in decisions to reduce or suspend a credit line could negatively impact credit unions. Principles of prudent risk management may require reducing a credit limit on a home equity line of credit (HELOC) in different scenarios, including when the value of property securing the line of credit drops far below the appraised value.¹⁴ While the proposed rule suggests that AVMs used to monitor a portfolio would not be covered by the rulemaking, the proposed rule expressly covers AVMs "used in deciding whether or to what extent to reduce or suspend a HELOC." If credit unions need to apply the AVM quality control standards to AVMs that are used to manage the collateral risk within their HELOC portfolios, credit unions are worried that it may become more difficult or more expensive to manage this risk if they are unable to keep using AVMs because of the difficulty in implementing the proposed quality control standards over AVMs used for this purpose.

¹³ *Id.* at 40642 (explaining that AVMs used to decide whether to modify a mortgage loan or to suspend or reduce a home equity line of credit would be covered by the proposed rule).

¹⁴ See OCC et al., Credit Risk Management Guidance for Home Equity Lending (May 2005) at 6, available at <https://ncua.gov/files/letters-credit-unions/LCU2005-07Encl.pdf> ("Where appropriate, financial institutions should refuse to extend additional credit or reduce the credit limit of a HELOC, bearing in mind that under Regulation Z such steps can be taken only in limited circumstances. These include, for example, when the value of the collateral declines significantly below the appraised value for purposes of the HELOC, default of a material obligation under the loan agreement, or deterioration in the borrower's financial circumstances.").

Consumer benefit and safety and soundness considerations may weigh in favor of excluding loan modifications and HELOC suspensions and reductions from the definition of a credit decision under the proposed rule.

Difficulties With Operationalizing the Non-discrimination Factor

CUNA asks the Agencies to reconsider whether a fifth non-discrimination quality control standard is necessary considering the existing supervisory guidance that applies to the usage of AVMs by credit unions and banks. Credit unions support the Equal Credit Opportunity Act, the Fair Housing Act, “and regulatory initiatives that promote the availability of credit to all creditworthy applicants.”¹⁵ CUNA and its member credit unions expect, however, that the Agencies will “weigh the regulatory burden on credit unions with the benefit to consumers when implementing regulations”¹⁶ Viewed through this lens, it is not apparent that the benefit to consumers of having a non-discrimination quality control factor outweighs the regulatory burden the additional quality control standard will place on credit unions.

Credit unions, especially small credit unions, are concerned that the regulatory burden of requiring a non-discrimination quality control standard through the proposed rule will preclude them from being able to use AVMs in the origination of a mortgage loan. To the extent that the quality control standards and the control systems expected to be implemented by a mortgage originator require fair lending testing of AVM values, credit unions worry that they may not have large enough data sets to be able to do meaningful, statistically significant testing with their AVM results. Without that capability, a question arises as to what benefits that limited kind of testing would actually provide to credit unions or consumers.

Credit unions lack control over the inputs and the data that feed into AVMs. Moreover, credit unions, especially smaller ones, simply do not have the bargaining power or the resources to examine the third-party proprietary algorithms that power AVMs. When credit unions ask AVM vendors about fair lending risk, the vendors may represent that their AVMs do not include discriminatory inputs or contractually agree to comply with all applicable law. But credit unions do not have the ability to compel AVM vendors to disclose proprietary information about how the AVMs work.

The proposed non-discrimination quality control factor injects a level of uncertainty that could lead some credit unions to decide that the most prudent course of action going forward is to stop using AVMs in the mortgage origination context. That decision, unfortunately, may prevent credit union members from being able to take advantage of the benefits of an AVM (e.g., quicker closings, fewer opportunities for human discretion, etc.). And the potential consumer loss is

¹⁵ CUNA, *The Compendium of CUNA Policies and Regulatory Issues* (Feb. 2022) at 15, *available at* https://www.cuna.org/content/dam/cuna/advocacy/actions/documents/CUNA_Compendium%20of%20Policies_DG.pdf.

¹⁶ *Id.*

unnecessary in light of the existing supervisory expectations surrounding the use of AVMs by credit unions.

The IAEG sets forth certain expectations for institutions under the jurisdiction of the OCC, Federal Reserve, FDIC, and NCUA, including federally-insured credit unions, with respect to AVM usage. Credit unions are expected to do the following:

- Perform due diligence before selecting an AVM for use so that they understand how AVM vendors test their models and what kinds of data are used in the model;
- Have controls in place to limit the use of an AVM when results may not be reliable (e.g., low confidence scores);
- Have policies and procedures regarding the validation of AVM results.¹⁷

The IAEG is consistent with other supervisory guidance regarding the expectations regarding third-party risk management and model risk management.¹⁸ In short, the IAEG and NCUA's third-party risk management expectations tell credit unions that they need to understand the AVMs they use, including an AVM's limitations; have controls in place to mitigate the risks that may arise from the use of a third-party AVM (e.g., compliance with laws, including non-discrimination laws); and monitor the relationship and the results to ensure that the AVM is working the way it is designed to work and being used the way it is designed to be used.

When comparing a non-discrimination quality control standard with the IAEG and other existing guidance, the former offers uncertainty while the latter provides familiarity. The IAEG and the existing regulatory guidance also appear to work: The FDIC noted that a review of about 22,000 examinations conducted between June 2011 and June 2021 revealed that examiners determined there were "44 instances of a flag indicating an institution's AVM use or management practices needed to improve."¹⁹ In other words, the benefits of having a non-discrimination quality control factor as part of the rulemaking may not outweigh the regulatory burden placed on credit unions. A better alternative might be for the CFPB and FHFA to adopt the IAEG and apply it to their regulated institutions not already covered by the IAEG.

¹⁷ IAEG at 32-35, *available at* <https://www.fdic.gov/news/financial-institution-letters/2010/fil10082a.pdf>.

¹⁸ *See generally* Interagency Guidance on Third-Party Relationships: Risk Management, 88 Fed. Reg. 37,920 (June 9, 2023) (describing the OCC, Federal Reserve, and FDIC's supervisory guidance surrounding their expectations for how their regulated institutions manage third-party risk through the lifecycle of a third-party relationship that generally cover strategic planning, due diligence, and monitoring and oversight); OCC & Federal Reserve, Supervisory Guidance on Model Risk Management (Apr. 2011), *available at* <https://www.occ.gov/news-issuances/bulletins/2011-bulletin-2011-12a.pdf> (explaining effective approaches for managing model risk, including guidance on validating third-party models and model governance best practices); NCUA, Letter to Credit Unions 07-CU-13, Evaluating Third Party Relationships (Dec. 2007), *available at* <https://ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/evaluating-third-party-relationships> (analyzing third-party risk management in three phases: risk assessment and planning; due diligence; and measuring risk, monitoring it, and controlling it).

¹⁹ *Supra* note 1, at 40659 n. 115.

Other Alternatives

CUNA is aware that some other commenters are recommending that the Agencies consider implementing an alternative framework that involves a standard-setting organization (SSO) and an independent third-party testing organization. If the Agencies were to contemplate the use of an SSO as a feasible option to address AVM quality control standards, CUNA requests that the Agencies engage in a full notice and comment rulemaking process to ensure a fulsome discussion. While an SSO combined with an independent third-party testing organization could relieve credit unions of some of the regulatory burdens associated with the proposed rule—which some credit unions might welcome—a full rulemaking process would provide the Agencies with a better understanding of the potential costs and benefits from such an approach. It could also address how the combination of an SSO and independent third-party testing organization would fit together with the statutory requirements in section 1125 of FIRREA. For example, would AVMs that satisfy the standards set by the SSO as determined by the independent third-party testing organization receive some kind of certification that could serve as a safe harbor for compliance with the AVM quality control standards requirements? A robust rulemaking process would help to ensure that comments and concerns are addressed before a final rule is implemented.

Conclusion

Thank you for this opportunity to provide input on the Notice of Proposed Rulemaking regarding Quality Control Standards for Automated Valuation Models. If you have questions or if we can be of any assistance, please do not hesitate to contact me at (202) 603-1985 or dpark@cuna.coop.

Sincerely,



David Park
Senior Director of Advocacy & Counsel