Final Report of the Small Business Review Panel on the CFPB's Proposals and Alternatives Under Consideration for the Automated Valuation Model (AVM) Rulemaking

May 13, 2022

Table of contents

1. Introduction

In the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),[1] Congress directed the Consumer Financial Protection Bureau (Bureau or CFPB), along with the Board of Governors of the Federal Reserve System (Board), the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Federal Housing Finance Agency (FHFA) (collectively, the rulemaking agencies), to develop regulations for quality control standards for automated valuation models (AVMs),[2] which are "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] While Federal agencies generally are required to consider whether the rules they propose will have a significant economic impact on a substantial number of small entities, the Regulatory Flexibility Act (RFA),[4] as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) and Dodd-Frank Act, imposes additional requirements on the Bureau with respect to small entities.[5]

Under SBREFA, the Bureau must convene and chair a Small Business Review Panel (Panel) if it is considering a proposed rule that could have a significant economic impact on a substantial number of small entities.[6] The Panel considers the impact of the proposals under consideration by the Bureau and obtains feedback from representatives of the small entities that would likely be subject to the rule. The Panel is comprised of a representative from the Bureau, the Chief Counsel for Advocacy of the Small Business Administration (Advocacy),[7] and a representative from the Office of Information and Regulatory Affairs (OIRA) in the Office of Management and Budget (OMB).

This Panel Report addresses the options the Bureau is considering for the AVM rule. To provide background to small entity representatives (SERs) and to facilitate the Panel process, on February 23, 2022, the Bureau issued its Outline of Proposals and Alternatives under Consideration (Outline).[8] The Panel process should not be construed to represent the views or recommendations of the Board, OCC, FDIC, NCUA, or FHFA.

[1] Public Law 111-203, 124 Stat. 1376 (2010).

[2] Dodd-Frank Act section 1473(q), 124 Stat. 2198 (codified at 12 U.S.C. 3354).

[3] 12 U.S.C. 3354(d).

[4] 5 U.S.C. 601 *et seq.*

[5] Public Law 104-121, 110 Stat. 857 (1996) (5 U.S.C. 609) (amended by Dodd-Frank Act section 1100G).

[6] 5 U.S.C. 609(b).

[7] Advocacy is an independent office within the U.S. Small Business Administration (SBA), so the views expressed by Advocacy do not necessarily reflect the views of the SBA.

[8] Bureau of Consumer Fin. Prot., Small Business Advisory Review Panel For Automated Valuation Model (AVM) Rulemaking Outline Of Proposals And Alternatives Under Consideration (Feb. 23, 2022), https://files.consumerfinance.gov/f/documents/cfpb_avm_outline-of-proposals_2022-02.pdf.

In accordance with the RFA, the Panel conducts its review at a preliminary stage of the Bureau's rulemaking process. The Panel's findings and discussion here are based on information available at the time the Panel Report was prepared and, therefore, may not reflect the updated findings of the Bureau in the process of producing a notice of proposed rulemaking (NPRM) on an interagency basis with the Board, OCC, FDIC, NCUA, and FHFA. As the Bureau proceeds with the rulemaking process, including taking actions responsive to the feedback received from SERs and the findings of this Panel, the Bureau may conduct additional analyses and obtain additional information. This Panel Report reflects feedback provided by the SERs and identifies potential ways for the Bureau to shape the proposals under consideration to minimize the burden of an eventual AVM rule on small entities while achieving the purposes of the rulemaking. Options identified by the Panel for reducing the regulatory impact on small entities of the rule may require further consideration, information collection, and analysis by the Bureau to ensure that the options are practicable, enforceable, and consistent with the Dodd-Frank Act and other laws as applicable. Pursuant to the RFA, the Bureau will consider the Panel's findings when preparing the initial regulatory flexibility analysis in the eventual NPRM. This Panel Report will be included in the public record for the Bureau's AVM rulemaking.

This Panel Report includes the following:

- A description of the proposals that are being considered by the Bureau and that were reviewed by the Panel;
- Background information on small entities that would likely be subject to those proposals and on the particular SERs selected to advise the Panel;
- A discussion of the feedback from and recommendations made by the SERs; and
- A discussion of the findings and recommendations of the Panel.

In particular, the Panel's findings and recommendations address the following:

- A description of and, where feasible, an estimate of the number and type of small entities likely impacted by the proposals under consideration;
- A description of projected compliance requirements of all aspects of the proposals under consideration;
- A description of alternatives to the proposals under consideration that may accomplish the stated objectives of the Bureau's rulemaking and that may minimize the economic impact on small entities of the proposals under consideration; and
- An identification, to the extent practicable, of relevant Federal laws or regulations that may duplicate, overlap, or conflict with the proposals under consideration.

2. Background

2.1 Market background

AVMs are being used with increasing frequency. This trend is being driven in part by advances in database and modeling technology and the availability of larger property datasets. Research indicates that 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.[9]

However, the use of AVMs may introduce risks, including issues with data integrity and accuracy. Moreover, like algorithmic systems generally, there are concerns that AVMs may reflect bias in design and function or through the use of biased data and may introduce potential fair lending risk.[10]

For consumers, obtaining a mortgage is one of the most important financial decisions they will ever make and it is a crucial component of access to homeownership, which can be a key building block of consumer wealth. Overvaluing a home potentially can lead the consumer to take on an increased amount of debt that raises risk to the consumer's financial well-being. On the other hand, undervaluing a home can result in a consumer being denied access to credit for which the consumer is otherwise qualified or offered credit at less favorable terms.[11]

2.2 Statutory authority

In the Dodd-Frank Act,[12] Congress directed the rulemaking agencies to develop regulations for AVM quality control standards.[13] Specifically, the Dodd-Frank Act added section 1125 to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA);[14] that section requires that AVMs meet quality control standards designed to: (1) ensure a high level of confidence in the estimates produced by automated valuation models; (2) protect against the manipulation of data; (3) seek to avoid conflicts of interest; (4) require random sample testing

[9] U.S. Dep't of the Treasury, *A Financial System the Creates Economic Opportunities: Nonbank Financials, Fintech and Innovation*, at 103 (July 2018), https://home.treasury.gov/sites/default/files/2018-08/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financials-Fintech-and-Innovation.pdf.

[10] *See, e.g.*, Andreas Fuster *et al.*, *Predictably Unequal? The Effects of Machine Learning on Credit Markets*, 77 J. of Fin. 5 (Feb. 2022), 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), https://brookings.edu/research/to-stop-algorithmic-bias-we-first-have-to-define-it/; Reva Schwartz *et al.*, *A Proposal for Identifying and Managing Bias in Artificial Intelligence*, Nat'l Inst. of Standards & Tech., U.S. Dep't of Com. (June 2021), https://nvlpubs.nist.gov/nistpubs/SpecialPublications/NIST.SP.1270-draft.pdf.

[11] *See, e.g.*, *Appraisals for Higher-Priced Mortgage Loans*, 78 FR 10367, 10417 (Feb. 13, 2013) (inflated valuations can "lead consumers to borrowing that would not be supported by their true home value" and deflated valuations "can lead consumers to be eligible for a narrower class of loan products that are priced less advantageously").

[12] Public Law 111-203, 124 Stat. 1376 (2010).

[13] Dodd-Frank Act section 1473(q), 124 Stat. 2198 (codified at 12 U.S.C. 3354).

[14] Public Law 101-73, 103 Stat. 183 (1989).

and reviews; and (5) account for any other such factor that the rulemaking agencies determine to be appropriate.[15]

The statute provides that the eventual section 1125 rule will be enforced by the FDIC, Board, NCUA, and OCC (collectively, the prudential agencies) with respect to insured banks, savings associations, and credit unions (collectively, financial institutions), as well as federally regulated subsidiaries that financial institutions own and control.[16] The statute gives the CFPB, as well as the Federal Trade Commission and State attorneys general, enforcement authority with respect to other non-depository participants in the market.[17]

By issuing the Outline, convening the Panel, and completing this Panel Report, the Bureau is fulfilling its obligations under SBREFA to assess the impact of its proposals under consideration on directly affected small entities prior to issuing an NPRM regarding section 1125. The Bureau will consider the SERs' feedback and the Panel Report as the Bureau prepares the eventual NPRM on an interagency basis with the Board, OCC, FDIC, NCUA, and FHFA.

2.3 Closely related Federal laws and regulations

In the Outline, the Bureau identified other Federal laws and regulations related to determining the collateral worth of a mortgage that have potentially duplicative, overlapping, or conflicting requirements with FIRREA section 1125. Title XI of FIRREA and the prudential agencies' implementing regulations require a licensed or certified appraiser for certain transactions.[18] Section 129H of the Truth in Lending Act (TILA)[19] and its implementing regulations require lenders to obtain an appraisal by a certified or licensed appraiser—and in some cases two appraisals—for certain higher-risk transactions (termed "higher-priced mortgage loans" or "HPMLs" in the regulations).[20]

In addition to these Federal laws and regulations requiring a licensed or certified appraiser for various transactions, other Federal laws and regulations broadly address determining the collateral worth of a mortgage, whether using an appraisal, AVM, or other method. For consumer credit transactions secured by a consumer's principal dwelling, TILA section 129E[21] and its implementing regulations require valuation independence by, for example, prohibiting

[15] 12 U.S.C. 3354(a).

[16] 12 U.S.C. 3354(c). *See also* 12 U.S.C. 3350(6) (defining "Federal financial institutions regulatory agencies") and (7) (defining "financial institution").

[17] 12 U.S.C. 3354(c). Unlike the CFPB, the Federal Trade Commission and State attorneys general do not have FIRREA section 1125 rulemaking authority. 12 U.S.C. 3354(b).

[18] *See, e.g.*, 12 U.S.C. 3331; 75 FR 77450, 77465 (Dec. 10, 2010); 12 CFR 34.43(a)(1) through (14) (OCC); 12 CFR 225.63(a)(1) through (15) (Board); 12 CFR 323.3(a)(1) through (14) (FDIC); 12 CFR 722.3(a)(1) through (6) (NCUA).

[19] 15 U.S.C. 1639h (added by Dodd-Frank Act section 1471).

[20] CFPB: 12 CFR 1026.35(a) and (c); OCC: 12 CFR part 34, subpart G and 12 CFR part 164, subpart B; Board: 12 CFR 226.43; NCUA: 12 CFR 722.3(a); FHFA: 12 CFR part 1222, subpart A. The FDIC adopted the CFPB's version of the regulations. *See* 78 FR 10368, 10370 (Feb. 13, 2013).

[21] 15 U.S.C. 1639e (added by Dodd-Frank Act section 1472).

material misrepresentation of property value and conflicts of interest for persons preparing valuations or performing valuation management functions.[22] Title XI of FIRREA, as amended by the Dodd-Frank Act, provides in part that, "[i]n conjunction with the purchase of a consumer's principal dwelling, broker price opinions may not be used as the primary basis to determine the value of a piece of property for the purpose of a loan origination of a residential mortgage loan secured by such piece of property."[23] Section 701(e) of the Equal Credit Opportunity Act (ECOA)[24] and its implementing regulation, Regulation B, generally require creditors to provide applicants for first-lien loans on a dwelling with copies of written valuations developed in connection with an application.[25] Moreover, in the Outline the Bureau discussed how valuations are subject to other provisions of ECOA and other Federal nondiscrimination laws.[26]

3. Overview of proposals and alternatives under consideration

This section summarizes the Bureau's proposals and alternatives under consideration as set forth in the Outline. The Outline is attached to this Panel Report as Appendix D.

3.1 Defining AVMs used to "determine" the collateral worth generally

FIRREA section 1125 defines AVMs as computerized models "used by mortgage originators and secondary market issuers to determine the collateral worth" of certain mortgages.[27] Depending on how that phrase in the statute is implemented, the rule's quality control requirements might cover a variety of AVM uses by mortgage originators and secondary market issuers.

3.2 AVMs used for making underwriting decisions

The Bureau is considering proposing that AVMs are covered when used for making underwriting decisions regarding the value of collateral rather than broadly covering AVMs used to produce *any* valuation estimate. The Bureau preliminarily believes such an approach may better accomplish the objectives of FIRREA section 1125 to the extent that underwriting decisions

[22] CFPB: 12 CFR 1026.42; Board: 12 CFR 226.42; *see* 75 FR 66554 (Oct. 28, 2010) (interim final rule); 75 FR 80675 (Dec. 23, 2010) (correction). TILA section 129E(g)(2) directed the Board to issue an interim final rule. 15 U.S.C. 1639e(g)(2).

[23] Dodd-Frank Act section 1473(r), 124 Stat. 2198-99 (codified at 12 U.S.C. 3355) (adding section 1126 to FIRREA). Under FIRREA section 1126, a "broker price opinion" means "an estimate prepared by a real estate broker, agent, or sales person that details the probable selling price of a particular piece of real estate property and provides a varying level of detail about the property's condition, market, and neighborhood, and information on comparable sales, but does not include an automated valuation model." 12 U.S.C. 3355(b).

[24] 15 U.S.C. 1691(e) (amended by Dodd-Frank Act section 1474).

[25] 12 CFR 1002.14.

[26] Bureau of Consumer Fin. Prot., *Small Business Advisory Review Panel for Automated Valuation Model Rulemaking Outline of Proposals under Consideration* 23-25 (2022), https://files.consumerfinance.gov/f/documents/cfpb_avm_outline-of-proposals_2022-02.pdf.

[27] 12 U.S.C. 3354(d). As discussed below, FIRREA section 1125 focuses on mortgages "secured by a consumer's principal dwelling." *Id.*

entail a more official valuation than the estimates generated for other activities such as marketing or portfolio monitoring.

3.3 Reviews of already completed determinations

Where there is already a completed determination of collateral value (completed determination), the Bureau is considering proposing to expressly not cover AVMs used in subsequent reviews of that completed determination. A completed determination is often an appraisal. In certain transactions not requiring a licensed or certified appraiser, a completed determination might entail, for example, an AVM supplemented with a report of the property's actual physical condition.

3.4 Developing an appraisal by a certified or licensed appraiser

The Bureau is considering proposing that an AVM is not covered when used by a certified or licensed appraiser (appraiser) who is already subject to quality control standards under other Federal and State regulation and supervision. As discussed in sections 3.9 and 3.10 below, FIRREA section 1125 applies to AVMs used by "mortgage originators" and "secondary market issuers," respectively.[28] Appraisers generally would not be mortgage originators or secondary market issuers; thus, appraisers themselves generally would not be covered by the eventual rule. But to the extent that an appraiser is in an employment or third-party service provider relationship with a mortgage originator or secondary market issuer, an eventual rule implementing FIRREA section 1125 might require the mortgage originator itself (or the secondary market issuer itself) to ensure that AVMs used by the appraiser adhere to quality control standards.[29] However, the Bureau preliminarily believes a mortgage originator's (or secondary market issuer's) responsibility for an AVM used by an appraiser may be distinguishable from a mortgage originator's (or secondary market issuer's) responsibility for an AVM used by other types of employees or service providers. Thus, the Bureau is considering proposing that an AVM is not covered when a mortgage originator (or secondary market issuer) relies on an appraisal developed by a certified or licensed appraiser, notwithstanding that the appraiser used the AVM in developing an appraisal.

3.5 Loan modifications and other changes to existing loans

The Bureau currently is considering two alternatives regarding cases where an AVM is used in deciding whether to change the terms of an existing loan. Under the first alternative, the Bureau is considering proposing that the rule cover AVMs used in transactions that result in the consumer receiving a new mortgage origination. Under this option, the rule would cover transactions like refinancings, but not transactions like loan modifications that do not result in a new mortgage origination. Under the second alternative, the Bureau is considering proposing

[28] 12 U.S.C. 3354(d).

[29] *See generally* Bureau of Consumer Fin. Prot., *Compliance Bulletin and Policy Guidance; 2016–02, Service Providers* (Oct. 31, 2016), https://www.consumerfinance.gov/documents/1385/102016_cfpb_OfficialGuidanceServiceProviderBulletin.pdf ("[T]he mere fact that a supervised bank or nonbank enters into a business relationship with a service provider does not absolve the supervised bank or nonbank of responsibility for complying with Federal consumer financial law to avoid consumer harm.").

that the rule cover any AVM used to decide whether to change the terms of an existing mortgage even if the change does not result in a new mortgage origination, so long as a "mortgage originator" or "secondary market issuer," or a service provider acting on behalf of a mortgage originator or a secondary market issuer, uses the AVM "to determine the collateral worth of a mortgage secured by a consumer's principal dwelling."[30]

3.6 Credit line reductions or suspensions

The Bureau understands that creditors use AVMs to monitor home equity lines of credit (HELOCs), which are often held in portfolio, and AVM outputs can factor into a decision to reduce or suspend a borrower's credit line in accordance with the terms of an initial credit agreement (a reduction or suspension decision).[31] Such reduction or suspension decisions are distinct from decisions to change the terms of a credit agreement, which is discussed above in section 3.5.

One potential option the Bureau is considering is to expressly not cover AVMs used to make reduction or suspension decisions for HELOCs. As discussed below in sections 3.9 and 3.10, the Bureau is considering potential definitions of the terms "mortgage originator" and "secondary market issuer" that are focused on mortgage origination and securities issuance activities, rather than activities relating to mortgage servicing. The Bureau likewise is considering proposing that reduction or suspension decisions would not be covered so long as they were made in accordance with *an initial agreement* and did not involve a new mortgage origination. Unlike reductions and suspensions, increases to a home equity credit line typically require a new mortgage origination and would therefore be covered as discussed above in section 3.5.

In contrast with the first option, another potential option the Bureau is considering is to broadly cover reduction or suspension decisions whenever the institution making the reduction or suspension decision is a mortgage originator or secondary market issuer—or their service provider—and the AVM is used to determine the collateral worth of a mortgage secured by a consumer's principal dwelling. The Bureau notes that section 1125 references AVMs used by "mortgage originators and secondary market issuers," but does not expressly reference AVMs used by mortgage servicers. As a result, this option would cover mortgage originators and secondary market issuers when they—or a servicer acting on their behalf—service their mortgages, but would not cover entities that subsequently acquire the mortgage if such institution is not a mortgage originator or secondary market issuer. For example, under this option, in instances where a covered institution sold the mortgage and transferred the servicing to another entity that is not itself a mortgage originator or secondary market issuer, an AVM used by the subsequent institution would not be covered.

[30] 12 U.S.C. 3354(d).

[31] For transactions covered by Regulation Z § 1026.40, creditors' ability to suspend further advances or reduce the credit limit is subject to certain limitations.

3.7 Securitization

A potential option the Bureau is considering for the proposal to implement the statutory phrase "to determine the collateral worth" is excluding a secondary market issuer's use of an AVM in the offer and sale of residential mortgage-backed securities (securitization). This discussion is separate from a secondary market issuer's use of an AVM in a mortgage loan origination (as discussed in section 3.8 below) to determine the collateral worth of a mortgage secured by a consumer's principal dwelling. For example, even if securitization were excluded, when a Government Sponsored Enterprise (GSE) has relied on a proprietary computer model to offer an appraisal waiver to a lender originating a mortgage loan, the GSE's use of the model would be subject to the eventual AVM rule.

3.8 Certain AVM use related to appraisal waiver loans

Appraisal waivers are offers to waive the appraisal requirement for originations.[32] In the current market, appraisal waivers are primarily issued by GSEs. When an appraisal waiver is exercised by a mortgage originator, the GSE accepts the estimate submitted as the market value and provides relief from enforcement of representations and warranties on the value of the property.[33]

The Bureau is considering proposing to exclude a mortgage originator's use of certain AVMs for transactions where the secondary market issuer's use of an AVM is covered instead. The Bureau is considering two potential options.

One option is to exclude the mortgage originator's use of the secondary market issuer's AVM for appraisal waiver programs. The Bureau recognizes that when a mortgage originator applies for an appraisal waiver, the mortgage originator typically does not have access to the secondary market issuer's underlying AVM. Under this option, the secondary market issuer, and not the mortgage originator, would be responsible for ensuring compliance with quality control standards.

A second option is to exclude the mortgage originator's use of any AVM used exclusively to determine whether a loan qualifies for an appraisal waiver program or to generate a value estimate exclusively for an appraisal waiver program. If the mortgage originator's use of an AVM in the appraisal waiver process is excluded from the scope of the rule, the secondary market issuer's use of an AVM would still be covered by the rule. Secondary market issuers could possibly include entities such as guarantors, insurers, or underwriters of residential mortgage-backed securities (RMBS) that are not necessarily RMBS issuers.

[32] Fannie Mae, *Fannie Mae Single Family Selling Guide* (Oct. 6, 2021), https://singlefamily.fanniemae.com/media/29306/display.

[33] Fannie Mae, *Appraisal Waivers Fact Sheet* (Dec. 4, 2018), https://singlefamily.fanniemae.com/media/5916/display; Freddie Mac, Guide Section 5601.9, *Seller representations and warranties regarding the mortgaged premises* (June 21, 2021), https://guide.freddiemac.com/app/guide/section/5601.9.

3.9 Defining "mortgage originators"

FIRREA section 1125 covers AVMs used by "mortgage originators," but does not define the term.[34] The Bureau is considering options for a definition of "mortgage originator" that draws heavily from other consumer financial laws, such as TILA and Regulation Z. Specifically, the Bureau is considering proposing a definition of "mortgage originator" that potentially could cover persons who are loan originators, creditors, and/or, under limited circumstances, servicers for purposes of Regulation Z.

3.10 Defining "secondary market issuers"

FIRREA section 1125 does not define the term "secondary market issuer" and the term does not appear elsewhere in the Dodd-Frank Act or FIRREA.[35] The Bureau is considering options for a definition of "secondary market issuer" that are consistent with other relevant portions of the Dodd-Frank Act, and could potentially minimize the impacts on small entities while achieving the objectives of section 1125. One option is to define the term "secondary market issuer" to include only entities that issue RMBS. A second option is to define the term more broadly to mean an issuer, guarantor, insurer, or underwriter of RMBS. The Bureau preliminarily believes that the appropriate definition of "secondary market issuer" may rely in part on whether AVMs used in securitization are covered by the eventual proposed rule.

3.11 Defining "mortgage"

In addition to covering AVMs used by "mortgage originators," section 1125(d) of FIRREA further limits coverage to AVMs used "to determine the collateral worth of a mortgage secured by a consumer's principal dwelling."[36] The word "mortgage" is not defined in the statute. To clarify the type of transactions that this statutory language encompasses, the Bureau is considering proposing two alternative definitions of "mortgage." The first alternative the Bureau is considering proposing would be to define "mortgage" as an extension of credit secured by a dwelling. The second alternative the Bureau is considering proposing would be to define the term "mortgage" as a 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 dwelling.

3.12 Defining "consumer's principal dwelling"

FIRREA section 1125(d) defines an AVM by reference to "a mortgage secured by a consumer's principal dwelling."[37] Neither FIRREA section 1125 nor title XI of FIRREA[38] defines

[34] 12 U.S.C. 3354(d).

[35] Public Law 101-73, 103 Stat. 183 (1989).

[36] 12 U.S.C. 3354(d).

[37] 12 U.S.C. 3354(d).

[38] 12 U.S.C. 3331 through 3356.

"consumer's principal dwelling." The Bureau is considering whether using a definition that is derived from existing related regulatory requirements could minimize the potential impacts on small entities while achieving the objectives of FIRREA section 1125. Specifically, the Bureau is considering proposing to base a definition of "consumer's principal dwelling" generally on how the phrase is used in the Bureau's provisions on valuation independence codified in Regulation Z § 1026.42.

3.13 Options for AVM quality control standards generally

FIRREA section 1125(a) requires that AVMs 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; (4) require random sample testing and reviews; and (5) account for any other such factor that the rulemaking agencies determine to be appropriate. Section 1125(b) requires the rulemaking agencies to promulgate regulations to implement these quality control standards.

In regard to the first four factors, the Bureau is considering proposing two alternative methods for compliance. In the first alternative for compliance with the quality control factors (principles-based option), the Bureau is considering proposing to require regulated institutions to adopt and maintain their own policies, practices, procedures, and control systems to ensure that AVMs used for covered transactions adhere to quality control standards designed to meet those factors, but not proposing specific requirements for those policies, practices, procedures, and control systems. For the second alternative regarding the quality control factors (prescriptive option), the Bureau is considering proposing a prescriptive rule with more detailed and specific requirements in regard to the first four factors.

3.14 Specifying a nondiscrimination quality control factor

FIRREA section 1125 provides the rulemaking agencies the discretion to account for any other such factor that the rulemaking agencies determine to be appropriate.[39] The first four statutory factors do not expressly address quality control standards designed to protect against unlawful discrimination. The Bureau is considering proposing to specify a fifth quality control factor designed to ensure that AVMs used for covered transactions comply with applicable nondiscrimination laws.

In regard to the fifth factor, the Bureau is considering proposing two alternative methods for compliance. In the first alternative for compliance with the fifth factor, the Bureau is considering proposing to require regulated institutions to adopt and maintain their own policies, practices, procedures, and control systems to ensure that AVMs used for covered transactions adhere to quality control standards designed to comply with applicable nondiscrimination laws, but not proposing specific requirements for those policies, practices, procedures, and control systems. For the second alternative regarding the fifth factor, the Bureau is considering proposing a prescriptive rule with more detailed and specific requirements.

[39] 12 U.S.C. 3354(b).

As an alternative to adopting a fifth factor, the Bureau is considering whether compliance with applicable nondiscrimination laws with respect to AVMs is already encompassed within three of the first four statutory quality control factors requiring a high level of confidence in the estimates produced by AVMs, protection against the manipulation of data, and random sample testing and reviews, such that delineation of a nondiscrimination factor is not necessary.

3.15 Implementation period

The Bureau is considering a 12-month implementation period after issuance of an eventual interagency final rule. A 12-month period would be consistent with title XIV of the Dodd-Frank Act.[40]

3.16 Potential impacts on small entities

The CFPB believes that the primary costs of the options under consideration are one-time costs. Broadly, one-time costs include (1) the cost of drafting policies and procedures governing AVM use for entities that use AVMs but do not have existing policies and procedures and (2) the cost of verifying that the policies and procedures are compliant with an eventual final rule.

In the Outline, the CFPB noted that it lacked data and information to quantify costs generally. Correspondingly, it lacked data to estimate how those costs may vary across institutions, especially small entities. Accordingly, the CFPB projected estimated costs from indirect sources. In particular, the estimates combined aggregated compensation costs from the Bureau of Labor Statistics with task-specific hour requirements obtained from the one-time cost survey of financial institutions used to support the Small Business Lending Data Collection rulemaking.

The CFPB estimated that the costs of verifying compliance would be roughly $10,000 per entity. The estimated costs of drafting policies and procedures was approximately $7,000, and the estimated costs of updating training practices was approximately $6,000. However, because the estimates are highly sensitive to assumptions, the CFPB solicited information from the SERs that helps to evaluate more accurately these eventual costs.

4. Applicable small entity definitions

A "small entity" may be a small business, small nonprofit organization, or small government jurisdiction. The NAICS classifies business types and the SBA establishes size standards for a "small business." To assess the impacts of the proposals under consideration, the Panel met with

[40] Section 1473(q) of the Dodd-Frank Act added section 1125 to FIRREA, which directs the rulemaking agencies to develop regulations for AVM quality control standards. Dodd-Frank Act section 1473(q), 124 Stat. 2198 (codified at 12 U.S.C. 3354). Section 1473(q) is in title XIV of the Dodd-Frank Act and section 1400(c) of the Dodd-Frank Act states that the "regulations required to be prescribed under this title [XIV] or the amendments made by this title shall . . . take effect not later than 12 months after the date of issuance of the regulations in final form." Dodd-Frank Act section 1400(c), 124 Stat. 2136 (codified at 15 U.S.C. 1601 note); *see also* 78 FR 78519, 78524 (Dec. 26, 2013) ("The Dodd-Frank Act . . . requires that regulations required under Title XIV take effect not later than 12 months after the date of issuance of the regulations in final form.") (citation and internal quotation marks omitted).

small entities that may be impacted by those proposals. Any small entity that falls within the eventual rule's definition of "mortgage originators" or "secondary market issuers" and uses an AVM to determine the collateral worth of covered mortgages could potentially be affected. In this instance, the Bureau sought feedback from community banks, credit unions, non-depository mortgage lenders, and mortgage brokers.

5. Small entities that may be subject to the proposals under consideration

The CFPB has identified certain types of small entities that may be subject to the AVM rule options under consideration. Non-depository institutions are regulated by the CFPB, which is subject to the SBREFA requirement. Depository institutions are regulated by other agencies collaborating on the AVM rulemaking.

The CFPB has identified several categories of non-depository institutions whose use of AVMs may be covered under the revenue criteria established by the SBA:[41] real estate credit companies;[42] secondary market financing companies;[43] other non-depository credit intermediation companies;[44] mortgage and nonmortgage loan brokers;[45] and companies with activities related to credit intermediation such as mortgage loan servicers.[46] Depository institutions regulated by other agencies may be covered if their assets are less than $600 million according to the asset criterion established by the SBA.

The Outline noted that not all small entities use AVMs, which was corroborated by the SERs.

[41] *See* U.S. Small Bus. Admin., *Table of Small Business Standards Matched to North American Industry Classification System Codes* (effective Aug. 19, 2019), https://www.sba.gov/sites/default/files/2019-08/SBA%20Table%20of%20Size%20Standards_Effective%20Aug%2019%2C%202019_Rev.pdf. The SBA updated the size criteria effective May 2, 2022, *i.e.*, after representatives from small businesses were selected as SERs for this SBREFA process. *See* https://www.sba.gov/sites/default/files/2022-05/Table%20of%20Size%20Standards_Effective%20May%202%202022_Final.pdf.

[42] The 2017 six-digit NAICS code for institutions in the "Real estate credit" industry is 522292.

[43] The 2017 six-digit NAICS code for institutions in the "Secondary market financing" industry is 522294.

[44] The 2017 six-digit NAICS code for institutions in the "Other non-depository credit intermediation" industry is 522298.

[45] The 2017 six-digit NAICS code for institutions in the "Mortgage and nonmortgage loan brokers" industry is 522310.

[46] The 2017 six-digit NAICS code for institutions in the "Other activities related to credit intermediation" industry is 522390.

6. Summary of small entity outreach

6.1 Summary of the Panel's outreach meetings with small entity representatives

Representatives from 16 small businesses were selected as SERs for this SBREFA process and participated through written or oral feedback. The Bureau convened the Panel on March 14, 2022 and held a total of two Panel Outreach Meetings during March 15-16, 2022, conducted online via video conference.

In preparation for the Panel Outreach Meetings and to facilitate an informed and detailed discussion of the proposals under consideration, discussion questions for the SERs were included throughout the Bureau's Outline; these questions also appeared in a shorter Discussion Guide for Small Entity Representatives (see Appendix E).

In advance of the Panel Outreach Meetings, the Bureau, Advocacy, and OIRA held a total of six online video conferences with the SERs between February 24, 2022 and March 9, 2022 (pre-Panel video conferences) to describe the Small Business Review Process, obtain important background information about each SER's current business practices, and begin discussions on selected portions of the proposals under consideration.

The Panel Outreach Meetings began with introductory remarks by representatives from the Bureau, Advocacy, and OIRA. The meetings were then organized around discussions led by the Bureau's Office of Regulations, Office of Mortgage Markets, and Office of Research about each aspect of the proposals under consideration and the potential impact on small businesses. The presentation slides framing this discussion are attached at Appendix F. The Bureau also provided the SERs with an opportunity to submit written feedback by April 8, 2022. Ten of the 16 SERs provided written feedback, copies of which are attached at Appendix B.

6.2 Other outreach efforts, including to small entities

In addition to the SBREFA process, the Bureau has been active through statements, events, and outreach in exploring the topics of home valuations and the use of AVMs. In April 2020, due to the COVID-19 pandemic, the CFPB participated in an interagency statement on appraisals and evaluations for real estate related financial transactions affected by the coronavirus. The statement outlined existing flexibilities in industry appraisal standards and in the appraisal regulations to assist lenders. In June 2021, the Bureau hosted a virtual event with civil rights organizations, housing policy experts, and other Federal agencies to explore how racial bias in housing appraisals and automated valuation models may occur. At its November 2021 Consumer Advisory Board meeting, the Bureau addressed appraisal bias in homeownership, recognizing homeownership's role as a key building block of wealth and the danger of undervaluation based on race. The Bureau has prioritized resources to evaluate tools and approaches to address property valuation bias. The Bureau is also a member of the Interagency Task Force on Property Appraisal and Valuation Equity (PAVE).

As part of the Bureau's market monitoring process, CFPB is engaged in ongoing discussions with financial institutions and AVM providers regarding the construction, use, and limitations of AVMs, with a specific focus on the mechanisms used to test models for accuracy and bias towards disadvantaged communities. The Bureau plans to continue to conduct outreach to stakeholders, including to consumer groups, community advocates, and industry participants of a range of sizes.

7. List of small entity representatives

The following 16 SERs were selected to participate in the Panel's Small Business Review process.

Table 1: List of small entity representatives

Name & Title	Business Name, City, and State	Business Type
Lisa Arnold President and CEO	Home Bank SB Martinsville, IN	Community bank
Brian Bialik Executive Vice President and Chief Lending Officer	Hometown Bank Kent, OH	Community bank
Leton Harding President and CEO	Powell Valley National Bank Jonesville, VA	Community bank
Richard Jones President and CEO	Randall State Bank Randall, MN	Community bank
Kevin Cole President and CEO	Mid Oregon Credit Union Bend, OR	Credit union
Craig Gummow Chief Lending Officer	Beehive Federal Credit Union Rexburg, ID	Credit union
Brad Haddock President and CEO	Alabama Central Credit Union Birmingham, AL	Credit union
Lauren MacVay President and CEO	True North FCU Juneau, AK	Credit union
Joe Thomas President and CEO	NextMark FCU Fairfax, VA	Credit union
Joanne Todd President and CEO	Northeast Family FCU Manchester, CT	Credit union
Lee Trumble Director of Real Estate Lending	Clackamas FCU Oregon City, OR	Credit union
Valerie Saunders Vice President	RE Financial Services Inc. Jacksonville, FL	Mortgage broker
Kurt Weidner Broker/Owner	Weidner Financial Marin County, CA	Mortgage broker

Name & Title	Business Name, City, and State	Business Type
Joseph F. Bayer Jr., CEO	First Integrity Mortgage Services, Inc. St. Louis, MO	Non-depository lender
Sergey Pokolodin Product Development Manager	A&D Mortgage Hollywood, FL	Non-depository lender
Jack Thompson President and CEO	Legacy Mortgage LLC Albuquerque, NM	Non-depository lender

8. Summary of feedback from small entity representatives

Through the SBREFA process, the Panel solicits feedback from small businesses early in a rulemaking proceeding and prior to the Bureau's development of an NPRM. To obtain specific information about the costs of complying with a potential rule, the Bureau provided SERs with a list of questions, which appear in both the Outline (Appendix D) and the Discussion Guide for Small Entity Representatives (Appendix E). These questions prompted SERs to consider the impacts of the proposals under consideration and to provide information that would assist the Bureau in refining those proposals. These questions also formed the basis of both the discussions during the Panel Outreach Meetings and the subsequent written feedback.

During the Panel Outreach Meetings and the pre-Panel video conferences, as well as in the written feedback submitted by SERs following the Panel Outreach Meetings, the SERs provided feedback on all aspects of the proposals under consideration. The SERs provided information to the Panel about their business operations and how the Bureau's proposals under consideration could impact their businesses. The Panel appreciates both the meaningful feedback that SERs provided and the time they spent assisting the Panel. This section summarizes feedback received from the SERs on the various parts of the Outline. Written feedback provided by SERs is included in Appendix B.

8.1 General feedback from SERs

SERs explained that at least two drivers of the significant and ongoing industry shift from valuations by licensed appraisers towards AVM valuations are the considerable costs and delays that traditional appraisals pose to mortgage consumers. Several SERs stated that they prefer valuations by licensed appraisers because they have a better understanding of the local market, including more recently updated information and private sale information. One of these SERs further stated that licensed appraisers' valuation methods are easier to understand than AVM methods. However, another SER stated that the appraisal system is broken because current licensing regulations make it difficult for potential new entrants to obtain licenses, which, in turn, results in a shrinking and less diverse appraiser workforce. That SER also highlighted that some mortgage consumers hoping to purchase a home are competing with cash buyers, who do not rely on mortgages or the mortgage appraisal process. SERs stated that appraisal costs and delays are even greater in rural areas; however, SERs also expressed concern regarding the viability of using AVMs as an alternative to appraisals in rural areas where it is hard to find other properties that are relatively nearby and can otherwise serve as a basis for comparison.

SERs noted there is currently a lack of transparency regarding details of how AVMs are calculating values. One SER expressed a general confidence in present-day AVMs and a belief that, currently, AVMs largely calculate values based on data from sales contracts and appraisals; however, this SER cautioned that risks posed by AVM valuations may increase as AVMs evolve and potentially incorporate additional types of data, such as photos or floorplan data—particularly if such additional data are provided by homeowners and their agents rather than by someone without a financial interest in the transaction.

Several SERs expressed the importance of greater transparency particularly regarding how the GSEs' own AVMs derive values; these SERs suggested that, if made available, such information could serve as a basis for market-wide AVM standardization. Additionally, some SERs stressed the need for greater certainty regarding the conditions under which—and the extent to which—the GSEs, the U.S. Department of Housing and Urban Development (HUD), the U.S. Department of Veterans Affairs (VA), and other agencies and investors will allow originators and aggregators to rely on AVMs in the future. One of these SERs highlighted the risk that, following a future housing price downturn, agencies and investors may require originators to buy back loans—particularly loans that were originally underwritten using AVMs given their relative novelty versus appraisals. Several SERs also thought that non-originator market participants, such as the GSEs, likely would play a major role in setting AVM standards for the industry.

Several SERs expressed their support for ensuring AVM accuracy. One of these SERs stressed the need to protect both small entities and consumers with AVM regulation and disclosure. Several SERs stated that, currently, their institutions' level of confidence in AVMs supports only limited AVM use. Some of these SERs stated that this approach puts their institution at a disadvantage compared to competitors that are less concerned with the risks of AVM use. Another SER noted that, if the eventual rule increases AVM reliability, their institution might use AVMs for more purposes.

SERs generally expressed concern about the cost of complying with the AVM rule and recommended that the Bureau explore options for lowering compliance costs. To that end, while SERs acknowledged that Congress has required the rulemaking agencies to issue a rule, SERs generally expressed a preference for the less prescriptive, principles-based option presented in the Outline, along with nonbinding guidance to aid in compliance with that rule. A SER expressly highlighted that the prudential agencies' FIRREA regulations for residential mortgages set a dollar-based threshold for requiring an appraisal; this SER urged that the eventual AVM rule similarly not cover loans under $400,000, when such loans are held in the originator's portfolio. Other SERs asked the Bureau to consider exempting small entities from the rule or establishing a safe harbor for compliance with the rule.

8.2 SER feedback related to defining AVMs used to "determine" the collateral worth generally

In addition to the different types of valuation purposes discussed in the Outline[47] (and further discussed below), SERs raised some additional distinctions for the Bureau to consider when implementing the statutory phrase "computerized model used by mortgage originators and secondary market issuers to determine the collateral worth."[48] A SER advocated for implementing the statutory phrase to exclude use of AVMs when such use is supported by a physical inspection of the property. Some SERs stated that they sometimes use tax assessments to determine the collateral worth and these SERs questioned whether tax assessments would be viewed as a computerized model generally and, if so, whether tax assessments would be covered by the eventual rule. Another SER requested that the Bureau clarify whether and how the eventual rule would distinguish between AVM usage before and after origination of a mortgage.

8.3 SER feedback related to making underwriting decisions

Many SERs stated that their institutions use AVMs to make underwriting decisions. When originating a mortgage, one SER stated that their institution usually uses AVMs in addition to appraisals because the institution's securitization partners typically require two valuations. Another SER stated that their institution uses AVMs to validate appraisals that are six- to twelve-months old. Another SER explained that their institution uses AVMs for underwriting HELOCs. Finally, another SER stated that their institution uses AVMs to underwrite smaller transactions, but will not use AVMs to underwrite larger transactions unless they are supported by a physical inspection of the property.

One SER explained that their institution generally does not use AVMs to make underwriting decisions because they prefer a valuation by a licensed appraiser that includes a physical inspection of the property.

Many SERs stated that their institutions use AVMs for non-underwriting purposes, such as marketing, accounting, or servicing, including spotting potentially distressed properties and staying abreast of potential home insurance replacement values. One of these SERs emphasized the importance, particularly to mortgage servicing, of being able to use low-cost AVMs rather than expensive appraisals.

Regarding using AVMs for foreclosures, one SER cautioned that AVMs would tend to overestimate a property's value unless it was accompanied by a physical inspection to assess the property's condition. However, another SER noted that, in some foreclosure situations, an adverse relationship between the parties may limit the ability to enter and to inspect the property.

---

[47] Bureau of Consumer Fin. Prot., *Small Business Advisory Review Panel for Automated Valuation Model Rulemaking Outline of Proposals under Consideration* 5-13 (2022), https://files.consumerfinance.gov/f/documents/cfpb_avm_outline-of-proposals_2022-02.pdf.

[48] 12 U.S.C. 3354(d).

One SER stated that AVM models can vary greatly in scope and confidence and that a given AVM may be appropriate in some contexts—such as for HELOCs, second liens, or servicing generally—but not other contexts. This SER advocated for the eventual rule to make detailed distinctions between AVM uses.

Several SERs indicated that their institutions' level of confidence in AVMs supports a variety of AVM uses—including underwriting—with respect to small-dollar mortgages but not large-dollar mortgages. Moreover, one of those institutions limits its AVM use to only *second-lien* small-dollar mortgages with lower loan-to-value ratios.

One SER stated that their institution currently reviews AVM valuations but that such reviews are considerably less robust than their reviews of appraisals or broker price opinions because the AVMs do not provide as much data for the institution to review. Another SER explained that, given the small size of both their institution and their market area, the institution relies on their own knowledge of neighborhoods to review AVM valuations.

Some SERs advocated that, in order to lower potential compliance cost burdens, the eventual rule should cover only AVMs used to make underwriting decisions and should not cover AVMs used for other purposes. One of these SERs believed that this approach was appropriate because, in their view, AVMs used for non-underwriting purposes have less of an impact on consumers than AVMs used to make underwriting decisions. Moreover, this SER further explained that AVMs used for non-underwriting decisions are sometimes provided in a summary form with limited data for an institution to review. As a result, this SER believed that institutions would need to expend more resources to review AVMs used for non-underwriting decisions, which ultimately would increase costs to consumers. However, another SER noted that if the eventual rule covered more types of AVM uses, such coverage might increase AVM reliability and result in greater use of AVMs by their institution.

8.4 SER feedback related to reviews of already completed determinations

One SER stated that, for some markets, AVMs are more reliable than tax assessments for reviewing completed appraisals—and that using AVMs is far less costly than using a second licensed appraiser to review an appraisal. Another SER expressed a belief that licensed appraisers are frequently more accurate than AVMs; this SER stated that, nonetheless, there is value in using AVMs to check appraisals and their institution does so when a GSE underwriting system assigns a higher-risk score to an appraisal. Another SER stated that their institution does not use AVMs for reviewing completed appraisals because, for their institution, AVMs are not a cost-effective means of appraisal review.

Several SERs expressly supported the option of the eventual rule not covering AVMs used in subsequent reviews of already completed determinations. One of these SERs stated that this option would provide small entities with greater flexibility if the eventual rule becomes too burdensome. Another SER stated that a rule requiring quality control of AVMs when they are, in turn, being used to quality control already completed determinations would be an excessive amount of quality control and would not provide additional benefit—but would increase the cost of credit for consumers. One SER requested clarification regarding whether the eventual rule would cover AVMs used in subsequent reviews if more than a certain amount of time passed between the completed determination and the subsequent review.

8.5 SER feedback related to developing an appraisal by a certified or licensed appraiser

Several SERs indicated that, in their experience, appraisers do not use AVMs often. One of these SERs explained that an appraiser hypothetically could use an AVM as part of doing research or validation for an appraisal but that would be an unnecessary added expense for the appraiser.

Several SERs supported the option of the eventual rule not covering AVMs used by appraisers to develop appraisals. These SERs asserted that mortgage originators should not be responsible for ensuring that appraisers adhere to quality control standards because those appraisers are already subject to other Federal and State regulation and supervision. SERs further explained that, given other Federal laws requiring valuation independence, as discussed in section 2.3 above, mortgage originators have limited ability to oversee appraisers' use of AVMs. Some of these SERs stated that if the eventual rule held mortgage originators responsible for appraisers' use of AVMs, that would further incentivize mortgage originators to value homes themselves using AVMs rather than using appraisers.

8.6 SER feedback related to loan modifications and other changes to existing loans

With respect to the two alternative approaches under consideration for the application of the AVM rule to loan modifications and other changes to existing loans, SERs generally expressed a preference for the Bureau's first alternative over the second. One SER stated that they prefer a rule that does not cover loan modifications and other changes to existing loans, even if it ultimately covered refinancing transactions, because such a rule would have lower implementation costs. That SER further explained that consolidating the AVM quality control processes in their institution's origination functions (including refinancing) would be less burdensome than building processes for multiple use cases. Several SERs expressed concern that the second alternative could negatively impact consumers who are pursuing loss mitigation options. Specifically, those SERs stated that AVMs are quicker and cheaper than appraisals, but that the second alternative could discourage use of AVMs in favor of appraisals during the loss mitigation process, which, in turn, would harm consumers by increasing both property valuation costs and application processing times.

Though SERs generally expressed a preference for the Bureau's first alternative over the second, two SERs also provided feedback regarding the first alternative. One SER asked the Bureau to clarify whether the first alternative would apply to transactions that are withdrawn or denied in addition to transactions that are consummated. The second SER stated that the main purpose of FIRREA section 1125 is to protect industry from undue risk and asked the Bureau to consider adding a dollar-based threshold in its first alterative that would exclude low-risk, small dollar transactions.

8.7 SER feedback related to credit line reductions or suspensions

While several SERs stated that their institutions use AVMs when originating or renewing home equity lines of credit, fewer commented about using AVMs while servicing them. In general, SERs discussed balancing the consumer protections of covering credit line reductions or suspensions against the burdens of such regulation.

One SER noted that AVMs used to determine credit line reductions or suspensions ought to be covered from a consumer protection standpoint. In speaking about the burden of such coverage, another SER noted that credit line reductions or suspensions occur only a couple times a year at their institution. Because of this limited use, the SER further believed that the burden of additional regulations could cause servicers like them to abandon the use of AVMs for such purposes. Additionally, SERs expressed dissatisfaction with a proposal that would cover servicing activities if the servicer was the same institution that originated the loan but not if another creditor sold the loan to the servicer.

8.8 SER feedback related to securitization

Some SERs stated that their institutions offer and sell participations in mortgages. These SERs explained that—particularly if a significant amount of time has passed since origination—they might use an AVM to revalue the homes securing mortgages for the participations. Another SER said that their institution is considering the possibility of issuing, guaranteeing, or underwriting RMBS in the future but is not currently doing so. A SER stated that their institution does not offer and sell RMBS but that their institution uses AVMs during origination to provide securitizers with a second valuation opinion (*i.e.*, in addition to an appraisal); this SER explained that if their institution did not obtain a second valuation, then the securitizer itself would do so in order to have RMBS rated by the rating agencies.

A SER expressly supported the option of the eventual rule not covering AVMs used in the offer and sale of RMBS. The SER stated that if the rule covered such AVM use, then it would create a cost burden and hinder access to the secondary market, particularly for small mortgage originators; this SER further cautioned that their institution would probably originate fewer mortgages without access to secondary market liquidity. Another SER stated that most small entities do not securitize loans and that they would be discouraged from doing so if the eventual rule covered AVMs used in securitization. This SER further stated that if the eventual rule were to cover AVMs used in securitization, the impacts on small entities throughout the mortgage value chain would be mitigated to the extent that the rule expressly described how existing data and validation provided by AVM vendors could be used to satisfy the rule requirements—and further mitigated by the rule not including a nondiscrimination quality control factor.

8.9 SER feedback related to appraisal waiver loans

SERs were asked questions about their use of appraisal waivers. Most of the SERs use appraisal waivers issued through Fannie Mae or Freddie Mac. Additionally, several SERs indicated they use appraisal waivers issued through institutions that are not Fannie Mae or Freddie Mac, including secondary market issuers' appraisal waiver programs. At least one SER uses the

GSEs' underwriting systems to underwrite and approve loans, even if the loan ends up in the originator's portfolio. No SERs indicated they use AVMs elsewhere in the appraisal waiver process.

SERs were supportive of the eventual rule not covering certain AVMs for transactions where the secondary market issuer's use of an AVM is covered instead. One SER expressed the opinion that it does not make much sense to require mortgage originators to perform quality control on an AVM from Fannie Mae or Freddie Mac. Another SER expressed concern about the downstream impacts of increased compliance burden if the mortgage originator had an obligation to perform quality control on secondary market issuer AVMs. If so, the SER stated that the increased compliance burden could mean their institution would not be able to offer appraisal waiver loans or use GSE underwriting systems, making them uncompetitive in the marketplace, disadvantaging smaller community financial institutions, and resulting in higher appraisal costs for consumers.

8.10 SER feedback related to defining "mortgage originators"

Several SERs expressed support for an approach similar to the one under consideration, which proposes to define "mortgage originator" using existing consumer financial laws. These SERs further indicated that such an approach would simplify implementation of a future final regulation. However, one of these SERs thought that it may be more appropriate to define the term "mortgage originator" using the definition of "loan originator" in Regulation X rather than the definitions of "loan originator," "creditor," and "mortgage servicer" in Regulation Z because a "loan originator" under Regulation X covers both lenders and mortgage brokers. Another SER suggested that, as a compromise between the various approaches discussed by the panel, the Bureau could consider defining the term "mortgage originator" using the definitions of "loan originator" in both Regulations X and Z. Four SERs also offered alternative definitions for the term "mortgage originator" in their written comments. One of these SERs suggested that the Bureau could define the term "mortgage originator" to cover any person or entity that must obtain a license or registration through the NMLS. Another of these SERs recommended that the definition of the term "mortgage originator" exclude servicers because servicers do not engage in mortgage origination activities frequently enough to justify the additional burden posed by the rule and because, at the time of ordering an AVM, a servicer may not know whether an AVM will be used to support a loan modification, a refinancing, or a change of obligor to an existing debt. Yet another of these SERs indicated that the Bureau should adopt a definition of the term "mortgage originator" that corresponds to the plain language meaning of the term rather than including other types of entities, such as creditors and servicers. In contrast, the last of these SERs suggested that the definition of the term "mortgage originator" should apply to lenders and investors rather than mortgage brokers because, even though mortgage brokers are "loan originators," they, unlike lenders and investors, rarely use AVMs and have no control over the valuation methods or vendors used in mortgage transactions.

Several SERs also commented on the scope of the definition of the term "mortgage originator." Two SERs advocated for a definition of the term "mortgage originator" that carves out small entities by applying a transaction-based or asset-based threshold. Another SER asked the Bureau to ensure that any definition of the term "mortgage originator" it ultimately adopts will apply equally to both traditional market participants and fintech firms.

8.11 SER feedback related to defining "secondary market issuers"

Some SERs stated that their institutions currently offer and sell participations in mortgages and another SER said that their institution is considering the possibility of issuing, guaranteeing, or underwriting RMBS in the future. As discussed in section 8.8, a SER urged that the eventual rule should not cover AVMs used in the offer and sale of RMBS. One SER stated that most small entities would not be impacted by the definition of "secondary market issuer" and supported a broad definition, similar to the definition of secondary mortgage market participant used elsewhere in FIRREA regulations. Other SERs did not express specific views regarding whether the term "secondary market issuer" should include only entities that issue RMBS or, more broadly, should include issuers, guarantors, insurers, or underwriters of RMBS. However, some SERs generally urged uniformity with definitions in existing rules.

8.12 SER feedback related to defining "mortgage"

Two SERs preferred the first mortgage definition. One SER suggested that the first mortgage definition was easier to understand and less confusing than the second. The other SERs did not express a preference for one mortgage definition over the other, but some did request that this definition, as well as others in the rule, be made uniform with definitions in existing financial regulations. Those SERs explained that this uniformity would make compliance with the new rule simpler. Other SERs requested that the Bureau make clear whether the two definitions of mortgage would include home equity lines of credit, loans on vacant land, and loans for new construction. One SER expressed concern about loans on dwellings when no real estate is involved, as the different valuation methods used for those might not work with the eventual rule.

One SER preferred the first mortgage definition because it excluded installment sales contracts, stating that the term installment sales contract is broad enough that it may include consumer purchases for improvements to a home (for example, financing an HVAC system). That SER requested that the definition exclude open-ended credit, which would be beneficial to small entities that use AVMs to originate HELOCs. That SER further stated that HELOCs are a much smaller part of the secondary market and pose less systemic risk.

8.13 SER feedback related to defining "consumer's principal dwelling"

Consistent with their input on other definitions, several SERs supported deriving the definition of "consumer's principal dwelling" from how the term is used in existing consumer financial laws, such as Regulation Z. One SER suggested that alignment with existing regulatory provisions would simplify compliance.

Coverage of "consumers." Several SERs addressed applying the term "consumer" beyond a natural person to include, for example, limited liability companies and trusts. One SER noted that, for the institution's purposes, the distinction of using an AVM for an LLC rather than a natural person would not matter. One SER stated that the AVM requirements are not intended to cover business transactions or non-natural persons and observed that business-purpose real estate loans may be underwritten in different departments, using different standards, than consumer loans. A couple of SERs noted that including business-purpose loans collateralized by a consumer's residence within the rule's coverage might increase both the consumer's valuation costs and valuation processing times. The effect, as described by a couple of SERs, could be to limit small business customers' ability to use their homes to support their business endeavors at reasonable cost, or to thwart deals where financial support could not be timely assured. One SER commented that, if the definition of "consumer's principal dwelling" covered a person who is not on the loan but who has an ownership interest in the dwelling, such coverage likely would not increase compliance costs, but it likewise would not provide any additional benefits to consumers. One SER stated that they can understand why the Bureau would expand coverage of AVM quality control standards to trusts, while another SER suggested that, if the Bureau were to extend AVM coverage to trusts for tax planning or estate purposes, it should align such coverage with official interpretations in Regulation Z. One SER suggested that the Bureau should make its definition of consumer credit consistent with current secondary market practices.

Coverage of "dwelling." One SER supported the TILA approach to the interpretation of "dwelling," while another requested clarification on whether the AVM rule would apply to loans secured by undeveloped land. Some SERs commented that the Bureau should limit application of any quality control standards established by the AVM rule to mortgages secured by real property, while another SER stated it was not clear whether doing so would be less burdensome. One SER suggested that the definition of the term "dwelling" should cover manufactured homes, but not other forms of chattel, such as boats and recreational vehicles that are currently valued using established, industry-based guides. Another SER noted that AVMs are not often used to value manufactured homes or condominiums, which could create sampling challenges and make implementation of quality control standards for AVMs involving such transactions difficult for small entities.

Limiting coverage to "principal" dwelling. One SER commented on the importance of considering how coverage might apply to active military personnel who are purchasing a home for their future permanent residence while assigned temporarily to a different duty station. Two SERs expressed support for clarifying that borrowers can have only one primary residence and that vacation and second homes are not principal dwellings. Several SERs, however, suggested that coverage should apply to second homes. These SERs noted, for example, that (i) in practice the process of valuing a home is the same for first and second residences, (ii) consumers may occupy second homes for extended periods of time, (iii) expanding AVM datasets to include second homes will improve overall AVM accuracy, especially in rural areas, and (iv) including second and vacation homes in the AVM rule's quality control standards would ensure that those mortgages would be supported by appropriate collateral. One SER advocated that the AVM rule follow the approach in Regulation Z with respect to coverage of new construction. Two SERs questioned whether AVMs would or should be used for new construction, and one of them stated that properties with homes under construction would rarely qualify as a principal dwelling anyway. One SER requested clarification on who would be responsible for determining whether a dwelling was a principal residence, while another SER suggested that lenders be permitted to rely on the borrower's application to determine coverage.

8.14 SER feedback related to options for AVM quality control standards generally

Regulatory flexibility and support for the "policies and procedures" option

SERs generally expressed support for the first option the Bureau presented, which would require covered entities to develop policies and procedures that would achieve the quality control standards, but would not set specific requirements for those policies and procedures. For example, one SER explained that their institution focuses on the risk assessed, especially the dollar amount of the loan, and the first option would allow them to maintain that focus. The SER further stated that a more prescribed approach would increase their costs and affect their ability to offer services that utilize AVMs. The SER then suggested that the Bureau allow AVM use to evolve rather than shut down useful innovation with specific controls, and that imposing specific controls at this point could have significant unintended consequences. The SER further stated that the less prescriptive approach would give an opportunity to learn about the impact of the regulation on this market and still provide the flexibility to respond appropriately and create programs that are in the best interests of the consumer. Because their institution already has strict risk management, this SER does not think a more prescriptive rule is necessary.

Another SER stated that a more prescriptive rule might conflict with or preempt existing guidance from State regulators and the NCUA. The SER explained that many NCUA rules, such as those on liquidity and interest rate risk management, are calibrated to account for varying levels of complexity in credit unions. That SER stated that a size-contingent and risk-based approach would greatly help smaller entities comply. Another SER agreed that a "one-size-fits-all" approach would be inappropriate. A third SER stated that a prescriptive rule would result in a complex and expansive regulation because it would need to address risk factors across many aspects of the market, including product type, geographic area, loan purpose and loan size. This SER also noted that any prescriptive rule language that bleeds into software structure would lead to significant cost hikes. In addition, another SER suggested that the Bureau conduct further research to determine the best way to implement the statute.

One SER suggested that the regulation should be broadened and opened up to be as flexible as possible, and cautioned against "regulation by enforcement." The SER then requested that the Bureau provide specific guidance about the requirements of the regulation that they can show to their AVM provider. Although that SER asked for specific guidance, they also requested the flexibility to tailor AVM use to individual clients or members.

Another SER agreed with the previous SER's concerns and suggested that the Bureau could adopt broad standards with a safe harbor specifying what would be acceptable, and generally those safe harbor standards would become the norm. Other SERs agreed with the suggestion to establish a safe harbor.

One SER noted that a small institution might only use 400 or 500 AVMs a year and that such usage would not provide a sufficient sample to validate the model. Because of this limitation, the SER supported a rule that (i) took a risk-based approach at the institution level, (ii) provided a safe harbor, and (iii) included guidance describing how lenders and their AVM providers can use existing data to meet the rule's quality control standards.

Another SER explained that quality control for AVMs can be thought of in the same way as current quality control reviews for appraisals, but that expecting financial institutions to review algorithms is unrealistic. That SER went on to suggest that there could be a simple format, tailored to the risk profile of the financial institution, that would require about five to seven steps to ensure compliance. Another SER concurred with this statement, explaining that smaller institutions appreciate having some discretion in assessing their risks and tailoring processes to fit them, but that sometimes new or ambiguous situations make guidance helpful in ensuring compliance, with that guidance reflecting regulator expectations. That SER then suggested that the Bureau could provide high level priorities, but allow latitude for institutions based on risk profile and size. A different SER stated that this idea could be carried out effectively by creating a safe harbor for those who meet the priorities. Another SER, however, suggested that if the safe harbor is too difficult to achieve because it involves statistical regression or complex AVM analysis, it would not work for small entities.

One SER suggested that, as the Bureau implements the quality control standards required by section 1125 of FIRREA, it should adopt an approach that balances the financial risks posed by a mortgage loan, based on factors such as the amount and purpose of the loan, against the borrower's needs and property valuation costs. That SER further explained that low-risk home equity loans for relatively small amounts should not have to meet the same requirements as half-million dollar loans and that, otherwise, the small-dollar mortgages would become unaffordable. The SER also cautioned that small entities are essential for serving rural areas, and overly restrictive rules could interfere with their ability to do so. In regard to covered first mortgages, which often can be for a half-million dollars or more, a different SER suggested that the Bureau should impose minimum standards and standardization of any AVM model used to value properties. Another SER requested sensible rules that explore solutions while mindful of implementation costs, including the cost of finding a suitable AVM model that meets the four quality control standards.

One SER stated that since the purpose of AVMs is to establish fair, unbiased values, the Bureau should consider leveraging the GSEs' modeling systems, suggesting that the GSEs could provide the information to private market participants to help ensure fair and reasonable standards. That SER went on to explain that if, in the estimation of the SERs and the CFPB, Freddie and Fannie standards are the best in the industry and are fair and nondiscriminatory, the Bureau should start with those, assuming they are in the public domain.

Two SERs suggested that the CFPB should consider allowing them to tailor AVM use to help underserved populations, by providing flexibility in the rule. One of these SERs also suggested that the quality control standards should be scalable and flexible to account for lenders of all sizes.

Requests for nonbinding guidance

Although the SERs generally expressed a preference for the less prescriptive regulatory option for the quality control standards, they also expressed a preference for nonbinding guidance to aid in compliance with that regulation. One SER stated that such guidance should include modest specificity, while allowing small institutions to maintain control so that the rule does not disrupt their operations. That SER also suggested that such guidance could be similar to the Uniform Standards for Professional Appraisal Practice (USPAP) and folded into the current appraisal standards framework. Another SER requested that the Bureau create general guidance on AVM use, providing as an example the fact that loans using valuations with a 50 percent confidence score are being originated and securitized. The SER suggested that guidance, as long as it is not excessive, could enhance industry's understanding of risk. The SER went on to suggest that guidance could help lead to better policies and procedures regarding when and how to use AVMs. The SER also suggested that such guidance initially could adopt a conservative approach, but then expand options as AVM technology improves. However, the SER warned that if such guidance is excessively strict, small institutions will not be able to use AVMs as adroitly, which would affect consumers negatively.

One SER, who also expressed support for external oversight of the AVM providers, stated that nonbinding guidance would give institutions the flexibility to tailor their use of AVMs for their size and complexity. In addition, this SER suggested that nonbinding guidance would permit institutions to adjust their compliance, allowing them to lessen requirements when risks were low. The SER then suggested that the Bureau should provide flexible guidance that could change over time as conditions and situations change. Another SER stated that nonbinding guidance is the only approach that might mitigate the negative impacts of the rule on small issuers. That SER explained that it is important that the rule allow small entities to continue to take reasoned risks, so that they can continue to serve their communities.

However, another SER, whose institution does not currently use AVMs, stated that less prescriptive, potentially vague guidance could add to their upfront costs by requiring expert personnel to interpret how the guidance would be applied.

Current quality control procedures

The Bureau asked SERs to discuss their current quality control procedures and their use of vendor-provided confidence scores, and the SERs described a wide variety of practices. With respect to validating the quality of AVMs provided by vendors, one SER explained that, though their institution is small, they validate the quality of their AVMs by comparing them to appraised values and assessed values. According to this SER, if AVM values appear to be about as accurate as appraised values, that provides some confidence in the AVM values. The SER further noted that this approach also allows them to assess AVM confidence ratings as well as the applicability of certain AVMs to their market. Another SER stated that their institution has an appraisal policy that outlines the types of valuations required for each loan type based on factors such as property type and loan amount, and that this policy includes a requirement that an AVM achieve a specified confidence level in order to be considered valid for underwriting. That SER added that their institution applies their standard vendor due diligence and review procedures to their AVM service providers. That SER also stated that their institution sometimes purchases AVMs that include physical property inspections from their appraisal management company.

Another SER agreed that confidence scores are very helpful, but explained that in rural areas confidence scores can be very low; however, this SER noted that their institution can still use an AVM if an internal review suggests that the valuation it provides is appropriate given the type and quality of the home and other such factors. For this reason, the SER suggested that it may be inappropriate to apply excessive requirements to AVMs in a rural context, whether through a safe harbor or some other means. Another SER also cautioned against being overly restrictive in a rural context, because their institution might be able to use an AVM with a low confidence score by supplementing it with an inspection, with their local knowledge, or by comparing it to other valuation methodologies, allowing them to avoid appraisal costs for borrowers.

Another SER described their institution's most recent securitization, stating that for pooled loans with AVM confidence scores below 80, the variance from sale price was generally not above 10 percent. That SER went on to state that confidence scores are not the sole indicator of reliability, and that there has to be human involvement in determining whether to use an AVM. That SER also stated that the Bureau should not adopt a rule that bans the use of AVMs that have confidence scores below 80.

One SER stated that investor requirements determine the models and confidence scores that their institution uses for first mortgage transactions. Another SER also indicated that their institution follows investor requirements for AVMs. However, the first SER explained that in their home equity portfolio their institution tries to be more flexible, though the institution is still figuring out how best to handle those loans. That SER also noted that, for areas that have tax assessments, their institution tracks the relationship between tax assessments and appraised values in order to get a sense of the accuracy of tax assessments. The SER then further explained that, if an AVM has a low confidence score, but is in line with a tax assessment or an appraisal, they will view the AVM with more confidence than they otherwise might have. That SER also stated that when using an AVM to establish value, their institution requires digital photographs of the property to ensure that its condition is reasonable. Another SER stated that they also use tax assessments, which are done yearly in their area, to check values on both AVMs and appraisals.

One SER explained that their institution does oversight on AVMs by aggregating and comparing appraisals with AVM data, though they only apply very simple analysis. Their institution uses two AVM companies that are very conservative in their valuations, which matches up well with how they use the product. They use AVMs with low-risk products, and believe that it is a fast, cost-effective tool to produce a low-risk loan for their members. One AVM provider gives them three values, low-medium-high, depending on the condition of the unexamined interior of the house, and they use the low value. That SER suggested that the Bureau should avoid a more prescriptive rule that would interfere with their process on these low-risk loans and would raise costs to consumers by making an appraisal necessary.

One SER stated that their institution uses GSE scores to determine whether to use AVMs, and that about 70 percent of the AVM valuations they buy have a confidence score of 75 percent or above, which they consider a good outcome; but in the future it could be better if there are more AVM companies and more technological advancements. That SER went on to suggest that in the future they could provide loan data to two different AVM providers and analyze the outcomes for both, as a kind of due diligence. That SER also suggested that standardization in the AVM market could allow their institution to use AVMs with desk reviews and save their borrowers money. They went on to suggest that they could use AVMs more often and more safely and could avoid the cost of appraisals, if there were better regulation of AVMs to ensure that AVM providers met a baseline standard for their algorithms and datasets. The SER also explained that their institution does not have written policies and procedures for AVMs at this point but would establish them in order to comply with the rule.

One SER emphasized that their institution was primarily focused on the AVM provider's coverage and how much data they included in their model. After choosing the vendor, they now perform back testing on a quarterly basis, comparing AVM valuations for properties they have a full appraisal on with that appraised value. The institution then manages the vendor relationship by inquiring about any variances discovered through its back testing, in order to understand how the vendor's algorithm works.

That SER went on to explain that their institution is using AVMs to check appraisal values, and not as a standalone. The SER also said that about a quarter of their institution's business is in a rural setting, and given the unreliability of AVMs in areas with few comparable sales, it is difficult to know what policies and procedures would be necessary to ensure sufficient quality control in those areas.

One SER stated that they believe there are already a lot of quality controls on AVMs in the marketplace, imposed by some of the big players. That SER further suggested that the GSEs have a strong interest in highly reliable, nondiscriminatory AVMs without conflicts of interest. For these reasons, the SER stated that the marketplace could actually take care of some of the quality control issues, and that an overly burdensome rule could have unintended consequences. The SER further explained that in the past such unintended consequences have taken their institution out of the market on a few products.

Another SER suggested that it was difficult to discuss how the quality control standards would affect their institution without a more fulsome description of the controls under consideration, a concern that other SERs agreed with. This SER went on to suggest that they understand the other SERs as describing how they learned to use AVMs in a way that makes them feel comfortable, and there is a level of risk above which they will not go. That SER then emphasized that whatever guidance, preferably nonbinding, comes out of the rulemaking, there will be a cost. Another SER stated that its institution has limited resources to address regulatory issues, and that incorporating quality control measures for AVMs into its due diligence framework will test those limits.

Monitoring vendor compliance

Numerous SERs were extremely concerned about the possibility that they might be responsible for the quality controls of AVM vendors they work with. Several SERs stated that a small institution would have little ability to control or influence how an AVM provider handled quality control. One SER pointed out that a small institution would have difficulty influencing how an AVM provider or model works. Another SER stated that AVMs contain proprietary information, and that small entities' ability to quality control an AVM is limited.

Another SER stated that, as a small lender, their institution would have to rely on third-party vendors and an accepted GSE-approved AVM. From a vendor management point of view, that SER stated that its institution would not have the skill set or manpower to monitor whether or not an AVM vendor met the quality control standards.

One SER stated that, although there is a general obligation for vendor management, AVM vendors are vastly different from the other vendors that small institutions currently manage. There are material parts of the product, the algorithms and statistical analyses, that small entities do not have the resources or expertise to properly evaluate. In addition, that SER stated that most of the vendors would not make their algorithms available to AVM users even if those users had somebody to evaluate them.

Another SER explained that its AVM provider has a well-documented process that tests the model against millions of transactions, which is far more reliable than any quality control the SER's institution could perform. The SER then emphasized that the Bureau should allow lenders to use work completed by the AVM provider to comply with the rule. The SER likened this process to the use of System and Organization Controls (SOC) reports for IT service providers, explaining that their institution's staff reviews the SOC reports and other due diligence information to gain reasonable certainty that the controls are adequate.

Another SER suggested that there could be an accrediting body for AVM providers, and once an AVM is accredited, lenders would have a higher level of confidence that it would meet compliance standards. That SER then suggested that this approach would work better than having each financial institution come up with its own standards, leading to a patchwork of AVM standards. The SER also suggested that standardization would help speed up the lending process.

Another SER agreed with the need for external standardization, suggesting that it would be particularly useful for small institutions, which lack the expert personnel to assess accuracy independently. That SER suggested that, though there might not be enough standardization currently for appraisals, there is far more than for AVMs, which may not even have a governing body. The SER then stated that it is incredibly challenging to not only select a vendor but also to manage that vendor going forward without having some foundation to start with.

In regard to vetting AVM providers, another SER explained that they represent a very small institution and they work with an organization that does different origination services, including providing AVM valuations, for about 100 credit unions. They vetted that organization, though they did not vet the AVM specifically. They do assess the individual valuations and make judgments based on those assessments.

One SER explained that their institution has a very robust vendor assessment process with pointed questions requiring substantive answers, but they have no way of assessing the internal algorithm. For this reason, they use the AVM in smaller, less risky transactions, and they maintain policies and procedures for using AVMs that mainly address the handling of AVMs with low confidence scores. That SER concluded by stating that AVM standards are important, but they probably need to come through a body with authority over AVMs—similar to how USPAP is promulgated by the Appraisal Standards Board of the Appraisal Foundation. As explained above, several SERs agreed with the idea that a governing body should regulate AVMs, not the financial institutions using them. One of these SERs also suggested that the Bureau should provide guidance to financial institutions on how to choose an appropriate AVM provider.

One SER stated that the examples the Bureau provided in the SBREFA Outline of potential requirements under the four statutory quality control standards are problematic because two of the four standards may be beyond the capability of small entities and better handled by the AVM provider itself.

Another SER discussed the difficulty of knowing whether a vendor is reliable, even after appropriate vetting on the front end and appropriate ongoing oversight. That SER expressed, as many others had, discomfort at being held responsible for the vendor's compliance.

8.15 SER feedback related to specifying a nondiscrimination quality control factor

SERs uniformly voiced concern regarding how they can assess fair lending issues in AVMs or know that they are in violation of the law. SERs stated that it is impractical for them to assess AVM fair lending performance because they are not equipped to validate the algorithms that AVM providers utilize. SERs commented that, as small institutions, they do not have the staff, the data, or the scale to assess AVM model results meaningfully. One SER stated that they do not have the volume to conduct statistically relevant fair lending analysis. SERs stated that lenders do not have access to the data or methodology used by the AVM because the data is proprietary. One SER added that lack of data prevents them from detecting systemic issues with their algorithms. Moreover, several SERs stated that the use of AVM algorithms reduces the potential for human bias, as AVMs typically are masked and do not consider race or other protected classes.

SERs expressed that it is important to ensure fairness in AVM development and application, including ensuring that AVMs do not rely on data that results in inadvertent discrimination. However, SERs stated that the burden should be on AVM providers to comply with nondiscrimination requirements, and the providers should be regulated. One SER stated that the onus should be on the CFPB or other regulators to ensure that AVM providers are complying with fair lending requirements, and another SER stated that the CFPB should focus on AVM data inputs prior to making fairness decisions regarding AVM outputs. Several SERs expressed that because they cannot validate AVM algorithms, they must rely on a third party to validate the data. Due to this dynamic, several SERs urged the CFPB to be clear that lenders may rely on data and external reviews provided by the AVM provider to comply with this rule. A SER noted that this point is especially critical for small entities. In addition, a SER stated that if the GSEs are going to purchase mortgages that rely on an AVM, then the GSEs should be involved in the AVM approval process. Another SER stated that lenders should conduct due diligence to identify good AVM providers. One SER stated that lenders are frequently asked to be the regulator for business partners in another field, adding that regulating other businesses is costly for a small entity and does not benefit consumers.

SERs requested that the CFPB provide guidance on how they can assess compliance with a nondiscrimination quality control standard. One SER asked for guidance on how to implement a fair lending quality control standard for AVMs. Another SER commented that they were struggling with how to identify and to assess AVM fair lending compliance. The SER further stated that, if the Bureau does not address how to assess fair lending issues in AVMs directly with the model creators, the vendors essentially receive a blank check from the lender to certify the model as nondiscriminatory.

Similar to comments on the quality control standards generally, SERs expressed concern that the lack of specificity with respect to the nondiscrimination quality control standard made it difficult to quantify the standard's precise impacts and costs. However, most of the SERs stated that implementing a nondiscrimination quality control standard would drive up costs for the lender and consumer. For example, one SER stated that a fair lending standard likely would be the most challenging and the most costly piece of the AVM regulation. Another SER stated that it would be extremely costly for institutions to evaluate models for potential fair lending concerns prior to their use. The SER stated that it likely would increase the fees charged to consumers in order to pay for the additional staff required to perform fair lending analyses for its AVMs. One SER stated that a regulation requiring them to validate AVM model results for compliance with fair lending laws would be either unworkable or would result in higher costs for consumers. Another SER stated that they think they can overcome all the costs associated with AVMs and quality control standards under consideration because everyone benefits from not waiting for an appraisal. SERs suggested that the rules be written so that a small lender may be confident in the use of AVMs without incurring large costs or compliance risks. Several SERs stated that, if the CFPB includes a nondiscrimination quality control standard, then the CFPB should allow a significant phase-in period for lenders to work with AVM providers to incorporate it into the AVM providers' quality control processes.

Furthermore, several SERs stated that a nondiscrimination quality control standard would discourage SERs from using AVMs, likely increasing consumers' cost of credit. One SER noted that most low- to moderate-income business is done by smaller institutions, and the increased costs may cause smaller lenders to exit that market. Another SER stated that the rule could push smaller community financial institutions out of what is a competitive marketplace.

In addition, SERs expressed that there is sufficient fair lending regulatory infrastructure already in place and that adding a fair lending requirement to the quality control standards for AVMs would be duplicative and, therefore, unnecessary. SERs further stated that the other four quality control standards required by statute already account for fair lending compliance. Furthermore, several SERs stated that regulators conduct fair lending examinations and potential fair lending concerns should emerge under the existing regulatory framework. One SER stated that the CFPB should monitor fair lending through existing regulations. One SER stated that they already invest tremendous resources to ensure that they comply with ECOA and the Home Mortgage Disclosure Act of 1975 (HMDA).[49] Two SERs questioned whether the CFPB has data to indicate that there is a need for a fair lending quality control standard in this rule. One SER commented that neighborhoods with depressed valuations should be provided support through local housing programs. The SER expressed concern that addressing undervaluation through AVM rules may undermine one or more of the first statutory quality control factors. Another SER commented that they could safely use AVMs, if there were more and better regulation of AVMs to ensure that AVM providers met a baseline standard for their algorithms and datasets that incorporated the required quality control factors.

Several SERs requested a safe harbor or exemption for small entities from the nondiscrimination quality control factor. Some SERs encouraged a volume or asset-based limitation, while one SER asked for an exemption from fair lending evaluation requirements for portfolio loans. In addition, one SER requested a safe harbor for small entities that rely on third-party or vendor-supplied compliance information. Another SER requested that the CFPB establish a model policy or procedure as a safe harbor.

8.16 SER feedback related to the implementation period

SERs stated that, without more details regarding what the eventual rule will actually require, it is difficult to estimate how much time would be needed for implementation of the rule. Several SERs expressly highlighted the potential nondiscrimination quality control factor as an aspect of the potential rule that would be particularly time consuming to implement.

One SER stated that their institution's implementation would take at least 12 months. This SER noted that their institution's AVM vendor currently does not provide them with AVM policies and procedures.

Many SERs advocated that small entities would need more than the statutory 12-month period to comply with the eventual rule. SERs highlighted that modifying computerized loan systems, including AVMs, requires more implementation time. However, one of these SERs stated that if the eventual rule did not require software revisions, then implementation regarding the first four statutory quality control factors would only take six months. Another SER contrasted a flexible, principles-based rule with a prescriptive rule where institutions must change their computer systems; the SER stated that the former could probably be implemented in 12 months, but the latter would require at least 24 months to work with vendors, test the systems, and train staff. This SER further stated that implementation will take significantly longer than 24 months if the eventual rule includes a nondiscrimination quality control factor because that factor would drastically increase complexity to integrate with data for determining discriminatory impact. Another SER explained that the amount of time needed for implementation of the eventual rule will depend on how much fair lending compliance is required and whether lenders are permitted

[49] 12 U.S.C. 2801 *et seq.*

to comply by relying on information from third parties. This SER further stated that AVM providers are likely to need to make changes to respond to the eventual rule and that 24 months would be preferable to 12 months to allow for any adjustments to and testing of algorithms. Another SER cautioned that quality control is integral to many other aspects of their institution's business; therefore, implementation efforts will not be limited to the institution's quality control function. This SER stated that the rule will be a major change to the industry and that their institution will need two years for implementation in order to establish policies and procedures for AVM quality control generally and a nondiscrimination factor specifically and to work with vendors, to test the systems, and to train staff. Another SER described a prolonged three-year transition to new loan software caused, in part, by vendor difficulties recruiting computer programmers. Some SERs noted small entities' dependence on implementation decisions from wholesale lenders and investors; because small entities have limited ability to influence the timing of those partners' decisions, small entities need more implementation time.

A SER stressed that implementing an AVM regulation will require even more time than implementing a typical regulation because AVM vendors generally maintain secrecy about AVM algorithms. Moreover, the SER stated that, even if vendors shared those details with mortgage originators, small entities generally lack the specialized skills required for evaluating computer algorithms.

A SER explained that, to the extent that their instution could not come into compliance with the eventual final rule within the alloted implementation period, using non-AVM valuation methods (*e.g.*, appraisals) may be a feasible alternative for some valuation purposes, such as underwriting; however, the inability to use low-cost AVMs would hamper certain functions, such as mortgage servicing (see section 8.3 above).

8.17 SER feedback related to potential impacts on small entities

8.17.1 SER feedback related to the Bureau's impact methodology

As discussed above, the CFPB hypothesized in the Outline that most of the costs associated with the rule would be one-time costs. Entities with existing AVM policies and procedures would have lower one-time costs, and those without policies and procedures would have higher one-time costs. In large part, the SERs did not contest the CFPB's categorization of costs. However, the SERs did express concern that an AVM rule would increase costs.

8.17.2 SER feedback related to one-time costs

During the Panel meetings, the CFPB asked the SERs how policies, practices, and procedures would change. The SERs noted the difficulty of anticipating specific changes without corresponding specificity in the rule. Overall, the SERs did not provide much quantitative feedback on how one-time costs would increase. Some of the SERs expressed concern about their ability to implement quality control standards on vendor-provided models. Nevertheless, the SERs expressed confidence that requiring policies and procedures would increase costs, but stated that quantifying the magnitude of those costs was hampered by the lack of specific quality control requirements.

Most, but not all, SERs stated that they currently use AVMs in the loan origination process. Many have procedures—formal or informal—on how and when AVMs should be used. For instance, one SER noted that they use AVMs for small dollar transactions. Another SER often uses AVMs for HELOCs, another limits them to second mortgages with a dollar threshold, and yet another uses AVMs under specific loan amount and loan-to-value criteria. Another does not use AVMs for lending. The SERs did not specify whether the rule would affect the circumstances under which AVMs are used.

The circumstances in which SERs use AVMs sometimes reflect the requirements of investors. However, SERs described their tendency to limit their use of AVMs to conservative cases where risk is limited not by the quality of the model but by the size of the loan. The SERs described two sources of information with which they validate the AVM value: the confidence score and their experience living and working in a specific community.

Some SERs provided precise criteria for when they use AVMs, which include standards determined by characteristics of the loans and ranges of confidence scores. Others were less precise.

One SER reported devoting less than 40 hours to develop their initial policies governing appraisals. AVM use was subsequently added by amendment. The SER stated that reviewing and updating the policies takes less than 10 hours annually.

8.17.3 SER feedback related to ongoing costs

No SER reported building AVM models in-house. Some SERs evaluate AVM model output against sales values at procurement and on an ongoing basis. The SERs described providing AVM vendors with a sample dataset to test model accuracy.

SERs described paying for AVMs on a per-use basis, and that the AVMs are procured by appraisal management companies. Some SERs noted that they have robust procurement procedures for AVMs. Vendors that accommodate such SERs must be able to validate their models for SER-specific circumstances. Overall, the SERs did not provide quantitative information on how costs would change as a result of requiring incorporation of quality control standards into policies and procedures.

8.17.4 SER feedback related to additional potential impacts of the eventual rule

One SER expressed concern that any increase in costs associated with the use of AVMs would lead to market concentration toward larger entities whose scale enables to them to quality control AVMs. This concern includes both larger financial institutions as well as larger AVM vendors. As such, multiple SERs expressed support for specific non-binding guidance to accompany fewer specific requirements of the rule.

One SER speculated that the eventual rule may lead to market segmentation. For instance, compliant AVMs would be used for determining the collateral worth of mortgages, and non-compliant AVMs would be used for non-covered purposes such as marketing. The SER did not elaborate on whether and how much costs would be higher as a result of market segmentation, only that compliant AVMs would likely be more expensive.

8.17.5 SER feedback related to the cost and availability of credit to small entities

When asked, the SERs did not give feedback on how their credit would be affected or how their lending to small businesses would be affected by the rule.

9. Panel findings and recommendations

9.1 Findings regarding the number and types of small entities affected

For purposes of the RFA, the CFPB has identified certain types of small entities that may be subject to the AVM rule options under consideration and that may be regulated by the CFPB. Specifically, the CFPB has identified several categories of non-depository institutions whose use of AVMs may be covered under the revenue criteria established by the SBA:[50]

- Real estate credit[51] companies with average annual receipts of $41.5 million or less;
- Secondary market financing companies[52] with average annual receipts of $41.5 million or less;
- Other non-depository credit intermediation[53] companies that originate mortgages with average annual receipts of $41.5 million or less;
- Mortgage and nonmortgage loan brokers with average annual receipts of $8 million or less;[54] and
- Other activities related to credit intermediation[55] such as mortgage loan servicers with average annual receipts of $22 million or less.

Across these five industries, 87 percent to 96 percent of entities' annual receipts would qualify them as small (Table 2).

---

[50] *See supra* note 41.

[51] The 2017 six-digit NAICS code for institutions in the "Real estate credit" industry is 522292.

[52] The 2017 six-digit NAICS code for institutions in the "Secondary market financing" industry is 522294.

[53] The 2017 six-digit NAICS code for institutions in the "Other non-depository credit intermediation" industry is 522298.

[54] The 2017 six-digit NAICS code for institutions in the "Mortgage and nonmortgage loan brokers" industry is 522310. Effective May 2, 2022, the SBA updated the revenue criteria for these institutions to $13 million or less. *See supra* note 41.

[55] The 2017 six-digit NAICS code for institutions in the "Other activities related to credit intermediation" industry is 522390.

Table 2: Number and share of non-depository entities by revenue thresholds

	Number of Entities	Fraction of Entities
A. Potentially Small Entities		
Real estate credit (522292)		
< $40M (Revenue)	**2,872**	**87%**
< $50M (Revenue)	**2,904**	**88%**
Secondary market financing (522294)		
< $15M (Revenue)	**101**	**88%**
< $100M (Revenue)	**106**	**92%**
All Other Non-depository Credit Intermediation (522298)		
< $40M (Revenue)	**5,292**	**98%**
< $50M (Revenue)	**5,300**	**99%**
Mortgage and Nonmortgage Loan Brokers (522310)		
< $7.5M (Revenue)	**6,609**	**97%**
< $10M (Revenue)	**6,643**	**98%**
< $15M (Revenue)	**6,670**	**98%**
Other Activities Related to Credit Intermediation (522390)		
< $20M (Revenue)	**3,595**	**95%**
< $25M (Revenue)	**3,610**	**96%**
B. Large Entities		
Real estate credit (522292)		
> $50M (Revenue)	**385**	**12%**
Secondary market financing (522294)		
> $100M (Revenue)	**9**	**8%**
All Other Non-depository Credit Intermediation (522298)		
> $50M (Revenue)	**122**	**5%**
Mortgage and Nonmortgage Loan Brokers (522310)		
> $15M (Revenue)	**139**	**2%**
Other Activities Related to Credit Intermediation (522390)		
> $25M (Revenue)	**162**	**4%**

Source: U.S. Census Bureau, 2017 Economic Census, *The Number of Firms and Establishments, Employment, Annual Payroll, and Receipts by Industry and Enterprise Receipts Size: 2017* (May 28, 2021), https://www2.census.gov/programs-surveys/susb/tables/2017/us_6digitnaics_rcptsize_2017.xlsx. The tabulations and shares were computed according to available enterprise size cells.

As noted above, not all small entities use AVMs.

9.2 Findings and recommendations regarding related Federal laws and regulations

As discussed in section 2.3 above, the Bureau in its Outline identified other Federal statutes and regulations related to determining the collateral worth of a mortgage that have potentially duplicative, overlapping, or conflicting requirements with FIRREA section 1125. SERs also provided suggestions of other potentially related Federal statutes and regulations. The statutes and regulations identified by the Bureau and by SERs include the FIRREA, TILA, and ECOA laws and implementing regulations. A SER expressly highlighted that the prudential agencies' FIRREA regulations for residential mortgages set a dollar-based threshold for requiring an appraisal. Another SER stated that many of the prudential agencies' safety and soundness regulations, including liquidity and interest rate risk management regulations, have potential intersections with FIRREA section 1125. Some SERs also identified other statutes they believe have some potential intersections with FIRREA section 1125, including the Fair Credit Reporting Act (FCRA),[56] the Gramm-Leach-Bliley Act (GLBA),[57] and HMDA.

The Panel recommends that the Bureau continue to evaluate the extent to which these and other Federal laws and regulations have potentially duplicative, overlapping, or conflicting requirements with FIRREA section 1125, and that the Bureau continue to coordinate with the other Federal agencies responsible for relevant laws and rules.

9.3 Compliance burden and potential alternative approaches

Based on the oral and written feedback from SERs on the Bureau's proposals under consideration, as summarized in section 8 above, the Panel makes the following recommendations.

9.3.1 General recommendations

The Panel recommends that the Bureau continue to explore ways to minimize the burden to small entities of the AVM rule in light of SERs' concerns about compliance costs generally and their feedback regarding the potential additional costs and delays that could result if the industry substituted current AVM usage with appraisals. The Panel also recommends that the Bureau seek comment in the NPRM on how providing additional clarity on what the AVM rule would require might help establish a more level playing field in the mortgage market, particularly for small entities that may currently be at a disadvantage relative to competitors less concerned with compliance risk. The Panel further recommends that the Bureau seek comment in the NPRM regarding the benefits and costs of a rule based on the less prescriptive, principles-based option presented in the Outline, along with nonbinding guidance to aid in compliance with that rule.

[56] 15 U.S.C. 1681 *et seq.*

[57] Public Law 106-102, 113 Stat. 1338 (1999).

9.3.2 Recommendations regarding defining AVMs used to "determine" the collateral worth generally

The Panel recommends that the Bureau seek comment in the NPRM on whether, and to what extent, the final AVM rule should cover use of tax assessments by mortgage originators and secondary market issuers "to determine the collateral worth."[58] The Panel also recommends that the Bureau consider clarifying in the NPRM whether, and to what extent, the proposed rule distinguishes between AVMs used before and after the origination of a mortgage.

9.3.3 Recommendations regarding AVMs used for making underwriting decisions

The Panel recommends that the Bureau continue to explore the extent to which limiting the rule's coverage to uses of AVMs for underwriting decisions (*e.g.*, when originating loans, modifying loans, issuing RMBS)—rather than also covering non-underwriting uses (*e.g.*, marketing, accounting, portfolio monitoring)—would sufficiently further the statutory purposes of FIRREA section 1125, along with the benefits and costs of such an approach.

9.3.4 Recommendations regarding reviews of already completed determinations

The Panel recommends that the Bureau continue to explore the extent to which a rule not covering uses of AVMs for subsequent reviews of completed determinations would sufficiently further the statutory purposes of FIRREA section 1125, along with the benefits and costs of such an approach. The Panel also recommends that the Bureau consider clarifying in the NPRM whether, and to what extent, the proposed rule makes distinctions based on the amount of time between the completed determination and the subsequent review.

9.3.5 Recommendations regarding developing an appraisal by a certified or licensed appraiser

The Panel recommends that the Bureau continue to assess the extent to which a rule not covering uses of AVMs to develop an appraisal would sufficiently further the statutory purposes of FIRREA section 1125. As part of this assessment, the Panel recommends that the Bureau seek comment in the NPRM regarding the benefits and costs of such an approach as well as the frequency with which appraisers use AVMs to develop appraisal valuations.

9.3.6 Recommendations regarding loan modifications and other changes to existing loans

In light of SERs' concerns regarding applying the rule to uses of AVMs to decide whether to modify or to change the terms of an existing mortgage, the Panel recommends that the Bureau seek comment in the NPRM on the potential costs and benefits of such approach.

[58] 12 U.S.C. 3354(d).

9.3.7 Recommendations regarding credit line reductions or suspensions

The Panel recommends that the Bureau continue to explore the extent to which a rule not covering uses of AVMs for credit line reductions and suspensions would sufficiently further the statutory purposes of FIRREA section 1125, along with the benefits and costs of such approach. The Panel also recommends that the Bureau consider whether covering such uses only for originators and secondary market issuers disadvantages entities vis-à-vis competitors that aquire mortgages but are not originators or secondary market issuers.

9.3.8 Recommendations regarding securitization

The Panel recommends that the Bureau continue to explore the extent to which a rule not covering uses of AVMs in securitizations would sufficiently further the statutory purposes of FIRREA section 1125, along with the benefits and costs of such an approach. The Panel also recommends that the Bureau seek comment in the NPRM on how covering uses of AVMs for securitizations might hinder small entities' access to secondary market liquidity and, if so, how such impacts might be mitigated by other rule options under consideration.

9.3.9 Recommendations regarding appraisal waiver loans

The Panel recommends that the Bureau continue to explore the extent to which a rule excluding a mortgage originator's use of certain AVMs for transactions where the secondary market issuer's use of an AVM is covered would sufficiently further the statutory purposes of FIRREA section 1125, along with the benefits and costs of such approach. The Panel also recommends that the Bureau seek comment in the NPRM on the extent to which institutions other than GSEs issue appraisal waivers, the extent to which mortgage originators use GSE underwriting systems to quality control loans held on portfolio, and the consequences of also covering uses of AVMs by mortgage originators to generate value estimates for appraisal waiver programs.

9.3.10 Recommendations regarding defining "mortgage originators"

The Panel recommends that the Bureau seek to adopt a definition of "mortgage originator" that draws heavily from existing defintions in existing consumer financial regulations, such as Regulation G, Regulation H, Regulation X, and Regulation Z. The Panel further recommends that the Bureau consider whether to exempt entities from the definition of "mortgage originator" based on transaction-based or asset-based thresholds. Additionally, the Panel recommends that the Bureau consider whether to exclude mortgage brokers from the definition of "mortgage originator." Finally, the Panel recommends that the Bureau seek comment in the NPRM on whether its proposed definition of "mortgage originator" would disadvantage any regulated entities vis-à-vis their competitors.

9.3.11 Recommendations regarding defining "secondary market issuers"

The Panel recommends that the Bureau continue to explore the extent to which a broader or narrower definition of "secondary market issuers" would further the statutory purposes of FIRREA section 1125, along with the benefits and costs of such approach. The Panel also recommends that the Bureau seek comment in the NPRM on how a broader definition might hinder small entities' access to secondary market liquidity and, if so, how such impacts might be mitigated by other rule options under consideration.

9.3.12 Recommendations regarding defining "mortgage"

The Panel recommends that the Bureau attempt to coordinate a definition of "mortgage" with pre-existing regulations, to the extent feasible.

9.3.13 Recommendations regarding defining "consumer's principal dwelling"

The Panel recommends that the Bureau propose to establish a definition of "consumer's principal dwelling" that is consistent with how existing consumer financial laws and regulations apply the term. For example, the Panel recommends that the Bureau consider whether the AVM rule should incorporate the concept of "consumer's principal dwelling" from the appraisal independence requirements in Regulation Z. The Panel further recommends, however, that the Bureau consider whether adjustments in the definition would be appropriate based on how the term is applied in other FIRREA contexts and Bureau regulations, including Regulation X.

Coverage of "consumers." The Panel recommends that, in the NPRM, the Bureau seek comment on whether quality control standards should apply to uses of AVMs for mortgage transactions involving business-purpose loans and loans to limited liability companies and trusts. The Panel further recommends that, if the Bureau proposes a rule covering uses of AVMs for loans to limited liability companies and trusts, the Bureau consider whether it should align the extent of coverage with Regulation Z.

Coverage of "dwelling." The Panel recommends that the Bureau continue to explore the extent to which limiting coverage of the AVM quality control standards to transactions in which the consumer's dwelling is secured by a lien on real property would sufficiently further the statutory purposes of FIRREA section 1125, along with the benefits and costs of such an approach. The Panel also recommends that the Bureau clarify in the NPRM whether mortgages secured by undeveloped land, manufactured homes, and other structures used as dwellings are proposed to be covered by the quality control standards.

Limiting coverage to "principal" dwelling. The Panel recommends that the Bureau assess whether any adjustment or clarification of the NPRM would be appropriate to accommodate the special circumstances of active-duty military personnel. The Panel also recommends that the Bureau continue to explore the extent to which defining "principal" broadly to cover second homes and vacation homes would further the statutory purposes of FIRREA section 1125, along with the benefits and costs of such an approach. The Panel further recommends that the Bureau seek comment in the NPRM on whether coverage of the rule should vary from the definition of principal dwelling used in other statutes and Bureau regulations, including how the definition is applied to new construction.

9.3.14 Recommendations regarding AVM quality control standards generally

The Panel recommends that the Bureau consider providing additional clarity in the NPRM on what the rule would require of small entities in order to comply with the quality control standards, and seek comment on improving that clarity. In addition, the Panel recommends that the Bureau consider seeking comment in the NPRM on potential methods to facilitate compliance targeted on small financial institutions, such as providing clear and simple instructions, allowing some form of safe harbor, or some other method or methods. Such methods considered could include clear instruction on how a small entity can monitor compliance regarding use of third-party AVM vendors.

9.3.15 Recommendations regarding specifying a nondiscrimination quality control factor

The Panel recommends that the Bureau consider providing additional clarity in the NPRM on what the rule would require of institutions in order to comply with a nondiscrimination quality control factor and seek comment on improving that clarity. In addition, the Panel recommends that the Bureau consider seeking comment in the NPRM on potential methods to facilitate compliance targeted on small financial institutions, such as providing clear and simple instructions, allowing some form of safe harbor, or some other method or methods. Such methods considered could include clear instruction on how a small entity can monitor compliance regarding use of third-party AVM vendors.

9.3.16 Recommendations regarding the implementation period

The Panel recommends that the Bureau seek comment in the NPRM on ways to facilitate implementation for small entities. The Panel also recommends that the Bureau continue to explore the appropriateness of an implementation period longer than the 12 months provided in section 1400(c) of the Dodd-Frank Act.

9.3.17 Recommendations regarding potential impacts on small entities

The Panel recommends that the Bureau incorporate feedback from SERs in its consideration of costs and benefits in the NPRM. The Panel also recommends that the Bureau seek broader comment in the NPRM on its categorization of costs. The Panel further recommends that the Bureau continue to explore the extent to which compliance burdens associated with AVMs will discourage their use and subsequently increase costs to small business credit.

APPENDIX A: EXCERPTS OF THE DODD-FRANK ACT

Section 1471 of the Dodd-Frank Act

SEC. 1471. PROPERTY APPRAISAL REQUIREMENTS.

Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended by inserting after 129G (as added by section 1464(b)) the following new section:

"§ 129H. Property appraisal requirements 15 USC 1639h.

"(a) IN GENERAL.—A creditor may not extend credit in the form of a higher-risk mortgage to any consumer without first obtaining a written appraisal of the property to be mortgaged prepared in accordance with the requirements of this section.

"(b) APPRAISAL REQUIREMENTS.—

"(1) PHYSICAL PROPERTY VISIT.—Subject to the rules prescribed under paragraph (4), an appraisal of property to be secured by a higher-risk mortgage does not meet the requirement of this section unless it is performed by a certified or licensed appraiser who conducts a physical property visit of the interior of the mortgaged property.

"(2) SECOND APPRAISAL UNDER CERTAIN CIRCUMSTANCES.—

"(A) IN GENERAL.—If the purpose of a higher-risk mortgage is to finance the purchase or acquisition of the mortgaged property from a person within 180 days of the purchase or acquisition of such property by that person at a price that was lower than the current sale price of the property, the creditor shall obtain a second appraisal from a different certified or licensed appraiser. The second appraisal shall include an analysis of the difference in sale prices, changes in market conditions, and any improvements made to the property between the date of the previous sale and the current sale.

"(B) NO COST TO APPLICANT.—The cost of any second appraisal required under subparagraph (A) may not be charged to the applicant.

"(3) CERTIFIED OR LICENSED APPRAISER DEFINED.—For purposes of this section, the term 'certified or licensed appraiser' means a person who—

"(A) is, at a minimum, certified or licensed by the State in which the property to be appraised is located; and

"(B) performs each appraisal in conformity with the Uniform Standards of Professional Appraisal Practice and title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, and the regulations prescribed under such title, as in effect on the date of the appraisal.

"(4) REGULATIONS.—

"(A) IN GENERAL.—The Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau shall jointly prescribe regulations to implement this section.

"(B) EXEMPTION.—The agencies listed in subparagraph (A) may jointly exempt, by rule, a class of loans from the requirements of this subsection or subsection (a) if the agencies determine that the exemption is in the public interest and promotes the safety and soundness of creditors.

Deadline.

"(c) FREE COPY OF APPRAISAL.—A creditor shall provide 1 copy of each appraisal conducted in accordance with this section in connection with a higher-risk mortgage to the applicant without charge, and at least 3 days prior to the transaction closing date.

"(d) CONSUMER NOTIFICATION.—At the time of the initial mortgage application, the applicant shall be provided with a statement by the creditor that any appraisal prepared for the mortgage is for the sole use of the creditor, and that the applicant may choose to have a separate appraisal conducted at the expense of the applicant.

"(e) VIOLATIONS.—In addition to any other liability to any person under this title, a creditor found to have willfully failed to obtain an appraisal as required in this section shall be liable to the applicant or borrower for the sum of $2,000.

"(f) HIGHER-RISK MORTGAGE DEFINED.—For purposes of this section, the term 'higher-risk mortgage' means a residential mortgage loan, other than a reverse mortgage loan that is a qualified mortgage, as defined in section 129C, secured by a principal dwelling—

"(1) that is not a qualified mortgage, as defined in section 129C; and

"(2) with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction, as defined in section 129C, as of the date the interest rate is set—

"(A) by 1.5 or more percentage points, in the case of a first lien residential mortgage loan having an original principal obligation amount that does not exceed the amount of the maximum limitation on the original principal obligation of mortgage in effect for a residence of the applicable size, as of the date of such interest rate set, pursuant to the sixth sentence of section 305(a)(2) the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(2));

"(B) by 2.5 or more percentage points, in the case of a first lien residential mortgage loan having an original principal obligation amount that exceeds the amount of the maximum limitation on the original principal obligation of mortgage in effect for a residence of the applicable size, as of the date of such interest rate set, pursuant to the sixth sentence of section 305(a)(2) the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(2)); and

"(C) by 3.5 or more percentage points for a subordinate lien residential mortgage loan.".

Section 1472 of the Dodd-Frank Act

SEC. 1472. APPRAISAL INDEPENDENCE REQUIREMENTS.

(a) IN GENERAL.—Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended by inserting after section 129D (as added by section 1461(a)) the following new section:

"§ 129E. Appraisal independence requirements 15 USC 1639e.

"(a) IN GENERAL.—It shall be unlawful, in extending credit or in providing any services for a consumer credit transaction secured by the principal dwelling of the consumer, to engage in any act or practice that violates appraisal independence as described in or pursuant to regulations prescribed under this section.

"(b) APPRAISAL INDEPENDENCE.—For purposes of subsection (a), acts or practices that violate appraisal independence shall include—

"(1) any appraisal of a property offered as security for repayment of the consumer credit transaction that is conducted in connection with such transaction in which a person with an interest in the underlying transaction compensates, coerces, extorts, colludes, instructs, induces, bribes, or intimidates a person, appraisal management company, firm, or other entity conducting or involved in an appraisal, or attempts, to compensate, coerce, extort, collude, instruct, induce, bribe, or intimidate such a person, for the purpose of causing the appraised value assigned, under the appraisal, to the property to be based on any factor other than the independent judgment of the appraiser;

"(2) mischaracterizing, or suborning any mischaracterization of, the appraised value of the property securing the extension of the credit;

"(3) seeking to influence an appraiser or otherwise to encourage a targeted value in order to facilitate the making or pricing of the transaction; and

"(4) withholding or threatening to withhold timely payment for an appraisal report or for appraisal services rendered when the appraisal report or services are provided for in accordance with the contract between the parties.

"(c) EXCEPTIONS.—The requirements of subsection (b) shall not be construed as prohibiting a mortgage lender, mortgage broker, mortgage banker, real estate broker, appraisal management company, employee of an appraisal management company, consumer, or any other person with an interest in a real estate transaction from asking an appraiser to undertake 1 or more of the following:

"(1) Consider additional, appropriate property information, including the consideration of additional comparable properties to make or support an appraisal.

"(2) Provide further detail, substantiation, or explanation for the appraiser's value conclusion.

"(3) Correct errors in the appraisal report.

"(d) PROHIBITIONS ON CONFLICTS OF INTEREST.—No certified or licensed appraiser conducting, and no appraisal management company procuring or facilitating, an appraisal in connection with a consumer credit transaction secured by the principal dwelling of a consumer may have a direct or indirect interest, financial or otherwise, in the property or transaction involving the appraisal.

"(e) MANDATORY REPORTING.—Any mortgage lender, mortgage broker, mortgage banker, real estate broker, appraisal management company, employee of an appraisal management company, or any other person involved in a real estate transaction involving an appraisal in connection with a consumer credit transaction secured by the principal dwelling of a consumer who has a reasonable basis to believe an appraiser is failing to comply with the Uniform Standards of Professional Appraisal Practice, is violating applicable laws, or is otherwise engaging in unethical or unprofessional conduct, shall refer the matter to the applicable State appraiser certifying and licensing agency.

"(f) NO EXTENSION OF CREDIT.—In connection with a consumer credit transaction secured by a consumer's principal dwelling, a creditor who knows, at or before loan consummation, of a violation of the appraisal independence standards established in subsections (b) or (d) shall not extend credit based on such appraisal unless the creditor documents that the creditor has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of such dwelling.

"(g) RULES AND INTERPRETIVE GUIDELINES.—

"(1) IN GENERAL.—Except as provided under paragraph (2), the Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau may jointly issue rules, interpretive guidelines, and general statements of policy with respect to acts or practices that violate appraisal independence in the provision of mortgage lending services for a consumer credit transaction secured by the principal dwelling of the consumer and mortgage brokerage services for such a transaction, within the meaning of subsections (a), (b), (c), (d), (e), (f), (h), and (i).

Deadline.

"(2) INTERIM FINAL REGULATIONS.—The Board shall, for purposes of this section, prescribe interim final regulations no later than 90 days after the date of enactment of this section defining with specificity acts or practices that violate appraisal independence in the provision of mortgage lending services for a consumer credit transaction secured by the principal dwelling of the consumer or mortgage brokerage services for such a transaction and defining any terms in this section or such regulations. Rules prescribed by the Board under this paragraph shall be deemed to be rules prescribed by the agencies jointly under paragraph (1).

"(h) APPRAISAL REPORT PORTABILITY.—Consistent with the requirements of this section, the Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau may jointly issue regulations that address the issue of appraisal report portability, including regulations that ensure the portability of the appraisal report between lenders for a consumer credit transaction secured by a 1-4 unit single family residence that is the principal dwelling of the consumer, or mortgage brokerage services for such a transaction.

"(i) CUSTOMARY AND REASONABLE FEE.—

"(1) IN GENERAL.—Lenders and their agents shall compensate fee appraisers at a rate that is customary and reasonable for appraisal services performed in the market area of the property being appraised. Evidence for such fees may be established by objective third-party information, such as government agency fee schedules, academic studies, and independent private sector surveys. Fee studies shall exclude assignments ordered by known appraisal management companies.

"(2) FEE APPRAISER DEFINITION.—For purposes of this section, the term 'fee appraiser' means a person who is not an employee of the mortgage loan originator or appraisal management company engaging the appraiser and is—

"(A) a State licensed or certified appraiser who receives a fee for performing an appraisal and certifies that the appraisal has been prepared in accordance with the Uniform Standards of Professional Appraisal Practice; or

"(B) a company not subject to the requirements of section 1124 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3331 et seq.) that utilizes the services of State licensed or certified appraisers and receives a fee for performing appraisals in accordance with the Uniform Standards of Professional Appraisal Practice.

"(3) EXCEPTION FOR COMPLEX ASSIGNMENTS.—In the case of an appraisal involving a complex assignment, the customary and reasonable fee may reflect the increased time, difficulty, and scope of the work required for such an appraisal and include an amount over and above the customary and reasonable fee for non-complex assignments.

"(j) SUNSET.—Effective on the date the interim final regulations are promulgated pursuant to subsection (g), the Home Valuation Code of Conduct announced by the Federal Housing Finance Agency on December 23, 2008, shall have no force or effect.

"(k) PENALTIES.—

"(1) FIRST VIOLATION.—In addition to the enforcement provisions referred to in section 130, each person who violates this section shall forfeit and pay a civil penalty of not more than $10,000 for each day any such violation continues.

Applicability.

"(2) SUBSEQUENT VIOLATIONS.—In the case of any person on whom a civil penalty has been imposed under paragraph (1), paragraph (1) shall be applied by substituting '$20,000' for '$10,000' with respect to all subsequent violations.

"(3) ASSESSMENT.—The agency referred to in subsection (a) or (c) of section 108 with respect to any person described in paragraph (1) shall assess any penalty under this subsection to which such person is subject.".

(b) CLERICAL AMENDMENT.—The table of sections for chapter 2 of the Truth in Lending Act is amended by inserting after the item relating to section 129D (as added by section 1461(c)) the following new items:

"129E. Appraisal independence requirements.
"129F. Requirements for prompt crediting of home loan payments.
"129G. Requests for payoff amounts of home loan.
"129H. Property appraisal requirements.".

(c) DEFERENCE.—Section 105 of the Truth in Lending Act (15 U.S.C. 1604) is amended by adding at the end the following:

Applicability.

"(h) DEFERENCE.—Notwithstanding any power granted to any Federal agency under this title, the deference that a court affords to the Bureau with respect to a determination made by the Bureau relating to the meaning or interpretation of any provision of this title, other than section 129E or 129H, shall be applied as if the Bureau were the only agency authorized to apply, enforce, interpret, or administer the provisions of this title.".

(d) CONFORMING AMENDMENTS IN TITLE X NOT APPLICABLE TO SECTIONS 129E AND 129H.—Notwithstanding section 1099A, the term "Board" in sections 129E and 129H, as added by this subtitle, shall not be substituted by the term "Bureau".

Section 1473(q) of the Dodd-Frank Act

(q) AUTOMATED VALUATION MODELS.—Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3331 et seq.), as amended by this section, is amended by adding at the end the following new section (and amending the table of contents accordingly):

12 USC 3354. **"SEC. 1125. AUTOMATED VALUATION MODELS USED TO ESTIMATE COLLATERAL VALUE FOR MORTGAGE LENDING PURPOSES.**

"(a) IN GENERAL.—Automated valuation models shall adhere to quality control standards designed to—

"(1) ensure a high level of confidence in the estimates produced by automated valuation models;

"(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 listed in subsection (b) determine to be appropriate.

"(b) ADOPTION OF REGULATIONS.—The Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau of Consumer Financial Protection, in consultation with the staff of the Appraisal Subcommittee and the Appraisal Standards Board of the Appraisal Foundation, shall promulgate regulations to implement the quality control standards required under this section.

"(c) ENFORCEMENT.—Compliance with regulations issued under this subsection shall be enforced by—

"(1) 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; and

"(2) with respect to other participants in the market for appraisals of 1-to-4 unit single family residential real estate, the Federal Trade Commission, the Bureau of Consumer Financial Protection, and a State attorney general.

"(d) AUTOMATED VALUATION MODEL DEFINED.—For purposes of this section, the term 'automated valuation model' means 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.".

Section 1473(r) of the Dodd-Frank Act

(r) BROKER PRICE OPINIONS.—Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3331 et seq.), as amended by this section, is amended by adding at the end the following new section (and amending the table of contents accordingly):

12 USC 3355. **"SEC. 1126. BROKER PRICE OPINIONS.**

"(a) GENERAL PROHIBITION.—In conjunction with the purchase of a consumer's principal dwelling, broker price opinions may not be used as the primary basis to determine the value of a piece of property for the purpose of a loan origination of a residential mortgage loan secured by such piece of property.

"(b) BROKER PRICE OPINION DEFINED.—For purposes of this section, the term 'broker price opinion' means an estimate prepared by a real estate broker, agent, or sales person that details the probable selling price of a particular piece of real estate property and provides a varying level of detail about the property's condition, market, and neighborhood, and information on comparable sales, but does not include an automated valuation model, as defined in section 1125(c).".

Section 1474 of the Dodd-Frank Act

SEC. 1474. EQUAL CREDIT OPPORTUNITY ACT AMENDMENT.

Subsection (e) of section 701 of the Equal Credit Opportunity Act (15 U.S.C. 1691) is amended to read as follows:

"(e) COPIES FURNISHED TO APPLICANTS.—

"(1) IN GENERAL.—Each creditor shall furnish to an applicant a copy of any and all written appraisals and valuations developed in connection with the applicant's application for a loan that is secured or would have been secured by a first lien on a dwelling promptly upon completion, but in no case later than 3 days prior to the closing of the loan, whether the creditor grants or denies the applicant's request for credit or the application is incomplete or withdrawn. Deadline.

"(2) WAIVER.—The applicant may waive the 3 day requirement provided for in paragraph (1), except where otherwise required in law.

"(3) REIMBURSEMENT.—The applicant may be required to pay a reasonable fee to reimburse the creditor for the cost of the appraisal, except where otherwise required in law.

"(4) FREE COPY.—Notwithstanding paragraph (3), the creditor shall provide a copy of each written appraisal or valuation at no additional cost to the applicant.

"(5) NOTIFICATION TO APPLICANTS.—At the time of application, the creditor shall notify an applicant in writing of the right to receive a copy of each written appraisal and valuation under this subsection.

"(6) VALUATION DEFINED.—For purposes of this subsection, the term 'valuation' shall include any estimate of the value of a dwelling developed in connection with a creditor's decision to provide credit, including those values developed pursuant to a policy of a government sponsored enterprise or by an automated valuation model, a broker price opinion, or other methodology or mechanism.".

APPENDIX B: WRITTEN FEEDBACK SUBMITTED BY SMALL ENTITY REPRESENTATIVES

Written feedback submitted by the following SERs is attached:

- Joseph F. Bayer Jr., First Integrity Mortgage Services, Inc.
- Brian Bialik, Hometown Bank
- Kevin Cole, Mid Oregon Credit Union
- Craig Gummow, Beehive Federal Credit Union
- Leton Harding, Powell Valley National Bank
- Richard Jones, Randall State Bank
- Lauren MacVay, True North FCU
- Jack Thompson, Legacy Mortgage LLC
- Joanne Todd, Northeast Family FCU
- Kurt Weidner, Weidner Financial

Statement Submitted to the Consumer Financial Protection Bureau
SBREFA Session for Automated Valuation Model (AVM)
Rulemaking
March 15-16, 2022

Statement Submitted by Joseph F. Bayer Jr., Chief Executive Officer, First Integrity Mortgage Services, Inc

AVM RULEMAKING
Outline of Proposals
Some concerns/notes:
AVMs don't always have the most updated information. Sometimes comps are older and therefore values can be off. This can affect consumers down the line. Example: Borrowers purchased at a time when values were coming down; however, all comps used in AVM were from 6-9 months ago. Value might not show sufficient based on this information; however, current market value could be higher or lower. Therefore, borrowers are in a worse position.
Quality Control -- Since there are so many different companies/versions of AVM's – anyone can keep using different models until they come up with what they want/need. How do we protect borrowers from companies that will do this to them? Believe we need to have consistency in what is being used to protect not just the consumers but SBREFA as well. It would be great to have a recommended standard of what we as lenders need to look for.
AUS – how do we get the findings to allow for this option? As a lender to comply with GSE's; we have to run loans through AUS and we cannot override if they state they want an appraisal. Loan will not be saleable to GSE's/Investors. Has any outreach been made to the GSE's and the larger Investors to gauge acceptability of this rule?
FHA/VA/USDA have minimum property standards so cannot use AVMs … will make less desirable for low to moderate people. This will hurt the most in LMI rural and urban communities if there is no plan for the aforementioned unintended consequences. Perhaps, each government agency can agree upon the same standard including conventional.

- What / when will GSE's and Investors to allow for this?
- Allowable types of AVM's – not all models will work in all states – need to have company that allows for Cascading so it will pull the most relevant value
- Need a disclosure for borrowers to allow for this; like the PIW
- Currently do not use method for determining value; use it to support value when Fannie/Freddie UCDP come back with score higher than 2.5
- Advantages for using this will be shorter time frames for closing and less cost to consumers. Disadvantages will be if the GSE's don't allow for it; if AVM doesn't support value; if it's in an area where there is no info – Rural. Also, AVM's don't have access as quickly as appraisers do for what has recently sold/listed to help support values.

- Appraisers that I know do not use AVMs at all. It would be an added expense for them and really doesn't do anything for them to establish value
- No comments for Modifications; Credit line reductions/suspensions as we don't do these
- Dwelling definition – makes sense
- QC -- Guidance vs requirements – I think research needs to be done and specific companies and/or programs utilized that provide this info so that information is same across the board for all. You have covered most of the concerns; but there could be more.
- Nondiscrimination -- think this could be a bigger issue until we know more. Certain areas could be affected based on who knows what as the way AVMS are completed are proprietary and we cannot control what goes into these. (see previous comments about LMI urban and rural areas)
- Cost for SE to implement Fair Lending Policies and procedures could be significant as this is something that would have to be done from scratch and additional resources would be needed to figure this all out.
- Fair Lending issues: page 26 of 42 – All are a concern as until we know what AVM models would be acceptable; we don't know what each model provides. Good idea to run several through a system that uses cascade model to see which ones pick up and do comparison of those for same addresses
- Implementation Period -- 12 month is not long enough for SE. Especially with needing additional QC and Fair Lending policies to be put in place. We had years to prepare for TRID and the new URLA and they were still extreme challenges. This would be a major change to the industry and would take adoption, training, and software preparations.
- AVMS are all done from a software
- Each AVM could cost between $25 - $100
- Would need to put in place policies and procedures as currently AVMs are only used to support an appraisal. Would create cost to lenders as well to come up with it especially if not specific guidelines from GSE/CFPB and how to we get all on same page before we roll this out. Includes Investors – who usually put additional overlays in effect. Getting correspondent investors onboard with this is the key.

Discussion Guide

1. Not sure

2. Concerned about using AVMs overall to determine collateral worth. Must have strong regulations in place regarding this so as not to put SE and borrowers in a worse position.
3. Don't use them, so no
4. We only use to support value of an existing appraisal.
5. Direct impact on consumers would be values could be overinflated or undervalued on an AVM depending on market time used in the comps provided. Based on time of year AVM is done.
6. No need to address AVMs if UW uses an appraisal to make that determination.
7. NA
8. NA
9. High costs
10. Not at all
11. NA
12. No difference for us as we do not do modifications, etc. We only do the initial transaction.
13. NA – we don't do HELOCs -- however, back in the day, I do believe this was used and it hurt consumers as their lines were suspended because lien holders ran an AVM and value was not supported; however, based on improvements done to subject property, the value was there when an appraisal was completed.
14. NA
15. NA
16. NA
17. NA
18. Not sure
19. -21. Think it would be confusing overall to use same word for different reasons. If want to expand, think we should separate these.
22. Not sure
23. First definition is easier to understand and less confusing
24. Not sure, we don't do these.
25. When talking about "Consumer" for someone not on loan; but has ownership interest – I don't believe this would provide additional costs or benefits for anyone
26. I do believe AVM's are not as accurate as an in person appraisal. However, based on technology and information that is being provided to Fannie/Freddie and FHA, I do believe this could change in 5 years.
27. Makes sense.
28. Not sure
29. Agree with clarification
30. Besides new construction, can't think of any. However, since it is New – I would think an AVM should not be used in these instances.

- 31. – 32. I believe that additional research needs to be done and specific companies and/or programs utilized that provide this info so that information is same across the board for all. You have covered most of the concerns; but there could be more.
- 33. Agree with these factors; but not sure how we can implement these
- 34. Unsure
- 36-39 -- think this could be a bigger issue until we know more. Certain areas could be affected based on who knows what as the way AVMS are completed are proprietary and we cannot control what goes into these.
- Cost for SE to implement Fair Lending Policies and procedures could be significant as this is something that would have to be done from scratch and additional resources would be needed to figure this all out.
- 40. Timeframe would be 2 years for final rule. We need time to be sure the AVM model used is acceptable; establish QC policies and procedures; Establish Fair Lending Policy; create disclosures and need the GSEs/Investors on board.
- 41. AVMs are used to support value of an appraisal if we are concerned with appraisal or if UCDP provides us 2.5 or higher score from Fannie/Freddie and for certain states that require an AVM if we get a PIW.
- 42. We use 3rd party
- 43. Costs are per AVM used and can be $25 - $100
- 44. No policies since we don't use them for lending
- 45. NA

JOE BAYER JR.
Chief Executive Officer

Statement Submitted to the Consumer Financial Protection Bureau
SBREFA Session for Automated Valuation Model (AVM)
Rulemaking
March 15-16, 2022

Statement Submitted by Brian Bialik, Executive Vice President and Chief Lending Officer, Hometown Bank

Hometown Bank®

Brian K. Bialik
Executive Vice President
Chief Lending Officer
Lender ID#782070

April 6, 2022

Erik Rubinyi
Financial Analyst / Office of Mortgage Markets
Consumer Financial Protection Bureau

Re: Comment Letter SBREFA Meetings - Automated Valuation Model (AVM) Rulemaking.

Dear Mr. Rubinyi-

As a Small Enterprise Representative (SER), having participated in recent Panel Meetings regarding rulemaking for the use of AVM's, I was satisfied with how the process was conducted. Input was encouraged often from participants. Moreover, the pre-panel meetings were helpful in developing expectations about the content and role SER's were to play. Clearly, the banking landscape is changing, affected by the improved use of technology that is driven by competitive forces that may never abate.

There were numerous occasions during this process where questions did not lend themselves to easy answers – costs of implementation in response to new rules, for example. This was not uncommon throughout. I hope that the absence of responses would not suggest acceptance for a course of action but, rather, symptomatic of the difficulty in opining on the unknown.

Community banks are painfully aware of how additional rules/regulations can bear on a workable solution. Implementation can, and often is, affected by rule(s)/regulation(s) that could be viewed as over-arching. Invariably, banks choose a course of action predicated on its size and complexity. As we all know, our resources to address issues have defined limits. How SER's incorporate the use of AVM's into our due diligence framework in the context of new rules (regulations), is one example of how those limits will be tested.

Within the Fair Credit Reporting Act (FCRA), Equal Credit Opportunity Act [Reg B] (ECOA), Truth in Lending Act [Dodd Frank – Reg Z] (DF/RZ), are contained rules that govern, among other things, the standards of practice on when and how appraisals are provided to applicants; stated prohibitions (i.e., coercion, collusion, inducement, etc.,) designed to protect the independence of an appraiser's work, and reporting requirements by lenders regarding noncompliant or non-credible appraisals to state regulatory agencies (Reg Z ,Section 1427 of the Dodd-Frank Act). As one can see, there is ample layering of rules across different regs that attempt to address, (and redress) inconsistencies, flaws, or blatant mistakes that bear on an opinion of value.

As a SER representative, we advocate for sensible rules that seek to temper solutions against the backdrop of implementation costs. Costs that include but are not limited to; ongoing training; additional overhead; monitoring and outside auditing; and finding and using a suitable AVM model that hits on all four elements of importance. *(A fifth element, quality control standard for non-discrimination, may be rendered moot when one ponders the intent and design of FCRA, ECOA, and DF/RZ.)*

Furthermore, SER's rely heavily on the expertise of outside vendors (i.e., appraisers) to complete real estate transactions. An argument can be made that these vendors charged with the task of providing AVM's should be fully engaged in any long-term solution, as well as share in the burden of responsibility. This is not only logical, but practical. Guidance of the non-binding variety could be developed for or with the assistance of the Uniform Standards for Professional Appraisal Practice (USPAP) into the current standards framework. Non-binding guidance, as was suggested throughout our panel discussions, is a direction that has some appeal, when combined with carefully considered, well-constructed standards.

I believe it is incumbent on the CFPB to strike a balance between its primary task of addressing and protecting the concerns and needs of consumers, with a bank's ability to deliver in a manner that is beneficial to everyone. A "one size fits all" approach would be harmful to community banks and could have the unintended consequence of accelerating more consolidation of the industry.

I urge the CFPB to consider this as you deliberate.

Sincerely,

Brian K Bialik
EVP/CLO
Hometown Bank

BKB

Statement Submitted to the Consumer Financial Protection Bureau
SBREFA Session for Automated Valuation Model (AVM)
Rulemaking
March 15-16, 2022

Statement Submitted by Kevin Cole, President and CEO, Mid Oregon Credit Union

March 22, 2022

Consumer Financial Protection Bureau
By email to: 2022-SBREFA-AVM@cfpb.gov

RE: Comments on Proposed AVM Quality Control Standards Rule

Thank you for the opportunity to provide feedback on the drafting on the rule on AVM quality control (QC) standards. I will address the specific questions upon which the bureau requested feedback below, after background and general comments.

I currently serve at the President of Mid Oregon Federal Credit Union, a low-income and CDFI designated credit union located in Central Oregon. Most of our service area is considered rural and the population ranges from 70% to 94% white. We currently serve a 78-census tract CDFI investment area that covers most of the credit union's charter area. Approximately 73% of our member households and 62% of our lending occurs in our CDFI investment area.

The last set of rules, that were imposed on the industry like the AVM QC standards, were the appraisal independence requirements. Those rules resulted in dramatic changes in how the industry orders and uses appraisals for real estate transactions. Partially because of those rules, the cost of appraisals in our market increased from $300-$400 to $800-$1200. The quality of the appraisal was unchanged. The rules simply added to the cost of the transaction for consumers. I encourage the CFPB to consider the impact of the proposed rule on the cost and availability of credit. Increasing the cost and procedures lenders must implement to use AVMs will undoubtedly reduce their use and increase both the cost to consumers and the time it takes to obtain the credit they need.

The quality control function in lending is normally done at or after loan closing. For example, appraisal quality control programs typically use a random sampling of closed loans and verify the appraisal values to another source to confirm the value obtained from the appraisal is reasonable. This is a very important fact for the Bureau to understand. Quality control procedures at a lender are unlikely to impact the underwriting decision in the short-term. The Bureau's desire to implement an entirely new and duplicative fair lending standard in the AVM QC rule is misguided. The only impact of adding fair lending standards to this rule will be to discourage lenders from using AVM's. This will increase the cost of credit for consumers. There is also a practical consideration the Bureau is choosing to ignore. Lenders do not have access to the data used by the AVM to be able to assess its fair lending performance. This data is proprietary. It is simply impractical for a lender to assess the fair lending compliance of either an appraiser or an AVM. The responsibility for this lies with the AVM provider. At the very least, the CFPB should be clear that lenders can rely on data and external reviews provided by the AVM provider to comply with this rule. This is especially critical for small entities.

While it is a legal requirement for the Bureau to create these rules, an approach that is narrow in interpretation and scope would be most beneficial for consumers. Most of the ills that drove Congress to create this requirement were not created by small lenders like Mid Oregon and I urge the Bureau to use common sense to exempt small entities as much as possible and to limit the scope of this rule to minimize the impact to the cost of credit for consumers.

The comment questions are addressed individually below:

Q1. The Bureau acknowledges that the proposed rule is duplicative with ECOA laws. I strongly urge the Bureau to remove the discretionary venture into fair lending from the rule. We are subject to fair lending examinations by NCUA and invest tremendous resources to assure compliance with ECOA and HMDA. One additional area of consideration is potential conflict with rules that require appraisal independence. For example, the option of including AVMs used by appraisers in the QC rules applicable to lenders would create a conflict with the appraiser independence expectations, as we would be required to QC the tool used by the appraiser.

Q2. The phrase "AVMs used to determine the collateral worth" should be narrowly defined to include only loan underwriting decisions where the AVM is the final determinant. At Mid Oregon we use a stepped process based on loan amount. Step 1 is the tax-assessed value (only used for low-risk transactions), step 2 is an AVM and step 3 is a full appraisal. The scope of the rule should be limited only to extensions of credit. This will limit the scope of procedures lenders have to create. The AVM market has evolved over the past few years. There is now an option to have an AVM with a physical inspection of the property (by a third party) that includes photos. The bureau should define AVMs covered by this rule to exclude algorithmically derived values when supported by a physical inspection. It is essential that the CFPB exclude portfolio reviews, appraisal QC processes, loss mitigation uses, and other non-underwriting uses from the list of covered transactions to limit the scope of compliance work required.

Q3. Mid Oregon FCU uses the quality control mechanism embedded in the product. It is called the confidence score, which represents the standard deviation of the value estimate expressed in an intuitive manner (higher=better). Our AVM provider has a well-documented process to test its results. Based on the standard deviation of the AVM value, a confidence level is given (High, Medium, or Low). We do not use AVM's that have a low confidence score. Our provider tests the model against millions of transactions, which is far more reliable than any quality control we could perform. To reiterate my point from earlier, it is important that the Bureau allow lenders to use work completed by the AVM provider to comply with the rule. I equate this to how we use SOC reports on IT service providers. Our staff is not going on site and testing the controls of our IT service providers, but we review the SOC reports and other due diligence information to gain reasonable certainty that the controls are adequate.

Q4. 40-60% of our real estate loans use an AVM as the determinant of value. For larger transactions we support the AVM with a physical inspection of the property. We update AVMs on our real estate loan portfolio annually (only a property value and confidence score) and use the data in our loan loss reserving process. We have not foreclosed on a property since 2015 so the use in loss mitigation has been rare.

Q5. I encourage the Bureau to limit the scope of the rule to underwriting decisions. The use of AVMs for other purposes has minimal impact on consumers.

Q6. The use of AVMs as a quality control process for appraisals should be excluded from the rule. Including such use would effectively be adding a quality control process to the quality control process. An appraisal is an opinion of value based on data. An AVM is the same thing. Excessive QC of opinions is not going to accomplish anything except driving up the cost of credit for consumers.

Q7. Mid Oregon FCU does not use AVMs as a QC process for appraisers. For large transactions we will have an appraisal reviewed by a third party (typically a senior appraiser) to validate the appraisal. This is rare and used mostly on commercial loans or jumbo transactions.

Q8. AVMs are an expensive quality control mechanism and not something Mid Oregon FCU is likely to use. There are methods that can achieve a suitable level of QC at a much lower cost. It is also duplicative to the extent that the AVM is relying on the same data set (closed sales transactions reported through the MLS) that the appraiser is.

Q9. The current compliance cost of using AVMs as a QC method for appraisals is too high for Mid Oregon FCU to consider using AVMs for that purpose. No new costs need to be factored into the decision.

Q10. I have no experience to answer this question. As noted earlier, assigning QC responsibilities to lenders when appraisers use AVMs in the appraisal process is a terrible idea and would create a lot of problems.

Q11. Lender responsibility for QC of an appraiser's use of AVMs should have no impact on the use of AVMs by lenders. If anything, it might encourage more AVM use by lenders, so they do not have to QC the appraiser's use of an AVM.

Q12. Covering AVMs in refinancing transactions is preferable to the broader definition that include modifications and changes in terms. The preference simply lies with the compliance cost and effort. Consolidating the AVM QC processes in the origination functions (including refinancing) will be less burdensome than building processes for multiple use cases. Also, the volume of the other use cases may so low that random sampling may not provide meaningful data.

Q13. All use of AVMs to suspend or revoke a HELOC should be excluded. The value of the property is one factor that may be considered in a suspension decision. Most likely it is an insignificant factor and the payment history, ability to repay and credit quality will weigh more heavily in the decision. Suspension is a loss mitigation activity and should be excluded as a covered transaction in this rule.

Q14. Most small entities do not securitize pools of loans. Adding this requirement would likely discourage small entities from securitizing.

Q15. Mid Oregon FCU does not offer and sell mortgage-backed securities.

Q16. I am not qualified to speak on the secondary market dynamics. Economics tells us that if you raise the cost of something consumers buy less of it. A new compliance process that duplicates existing risk management processes is likely to raise the cost.

Q17. Small entities throughout the mortgage value chain would benefit from explicit direction from CFPB that utilizing data from AVM providers to meet rule compliance in certain areas. Also, eliminating the discretionary foray into fair lending would help small entities in the securitization process.

Q18. This scenario is unlikely to happen at Mid Oregon FCU. We do not typically obtain an AVM until after the request has been submitted for pre-approval. If the secondary market approver grants an appraisal waiver based on their own AVM, we do not obtain an AVM. A general waiver of the QC requirements for loans where an appraisal waiver is granted by a secondary market purchaser would be preferable for small entities. Requiring QC at both the lender and secondary market level is redundant.

Q19. The Reg Z definition of loan originator to define mortgage originator is not problematic. The Bureau could also define it based on the requirement to register with NMLRS. This is also an area of the rule where the Bureau could exempt entities based on the number of loans originated annually or to create exemptions for small or very small lenders.

Q20. I do not see a material difference in the definitions referenced in question 19 or 20.

Q21. Excluding servicers would be preferable to small entities. The use cases where servicers would be performing activities that constitute originations is very limited. It seems burdensome for servicers who do not originate to have to build a QC compliance process for a limited use of AVMs. It is also likely the AVM would be one of several factors in a servicer led underwriting decision to modify, refinance, or change an obligor.

Q22. Most small entities would not be impacted by the definition. As a general statement I would argue that since many of these secondary market entities were part of the impetus for this rule, it would make sense to utilize the broader definition and make the rule applicable to secondary mortgage market participants as defined in FIRREA.

Q23. Given the two options to define a mortgage presented, the first definition excluding installment sales contracts would be preferable. The term installment sales contract is broad enough that it may include consumer purchases for improvements to a home (for example financing an HVAC system). The best alternative would be to include in the definition an exclusion for open-ended credit. This would exempt HELOC transactions from the rule. This would be beneficial to small entities that issue HELOC's but use a third-party for mortgage loans. HELOC's are also a much smaller part of the secondary market environment and pose less systematic risk.

Q24. I do not have any experience or knowledge upon which to answer this question.

Q25. A narrower definition of consumer for this rule would be preferable. Expanding the definition to include entities and business purpose loans will complicate the compliance process. Credit unions have always defined a loan based on the use of proceeds to determine if it is a business or consumer loan. This rule was not intended to cover business transactions or those involving non-natural persons. Many of the same scope challenges noted earlier would apply here. For example, business purpose loans may be underwritten in different departments and using different standards than a consumer real estate loan.

Q26. AVM usage is less prevalent in business lending than in consumer lending at Mid Oregon FCU. The primary reason for this is loan size. We allow AVM usage for loans up to $400,000. Most business requests exceed this threshold. I see fewer AVM eligible business loans in the next few years.

Q27. The narrower definition of dwelling would be less burdensome for lenders, although I don't see the distinction being material at this time. For the most part, reliable AVMs are only available on stick-built, residential properties on real property. Since there are very few AVMs on condos and manufactured homes, it does not make sense to include them in the rule.

Q28. A narrower scope would be less burdensome. Also, QC on a small number of AVMs available on properties not secured by real property might create sampling challenges.

Q29. A narrow definition of principal residence would be preferable, specifying that lenders can rely on the borrower's statement on the 1003 and that borrowers may only have one primary residence.

Q30. The home under construction cannot qualify as the borrower's principal residence until it is complete, unless there is already an existing structure on the real property the borrower occupies. Therefore, construction on unimproved property should not be covered under this rule. This distinction is not likely to matter much, as AVMs would not provide a value for most construction loans, at least with current offerings. In the case of a lender who uses a single set of documents for construction to permanent financing, these loans should be exempt from the rule since at the time of the loan the property did not qualify as a principal residence.

Q31. Small entities would benefit greatly by adopting guidance rather than specific requirements. This is also another opportunity to specify the use of existing, provider supplied data to comply.

Q32. A prescriptive rule drafted by an agency that is accustomed to $10B institutions would be disastrous. It may also conflict or pre-empt existing guidance from State regulators and NCUA. Many NCUA rules are calibrated to account for varying levels of complexity (for example rules on Liquidity and Interest Rate risk management) in credit unions. The phrase commonly used is "based upon the unique risks and complexity of the FCU." This approach would greatly help smaller entities comply.

Q33. Specific and non-exhaustive examples of acceptable compliance programs are helpful, however, some of the examples under consideration are problematic. For example, the standard cited in the first quality control factor, "the risk that AVMs may suffer from fundamental errors and may produce inaccurate outputs" may be beyond the capabilities of small entities. This is another area where standard deviation or confidence score might be an expedient path to compliance for small entities. For example, the rule could require that institutions establish standards for the acceptable level of confidence (or standard deviation) by policy. The second quality factor is largely covered by existing vendor managements and GLBA requirements applicable to all software credit unions use. The conflict of interest provision is not problematic and consistent with good internal controls. The random sampling requirement is another area where smaller entities would benefit from explicit guidance that allows the use of existing vendor-supplied data to meet this requirement.

Q34. The Bureau should absolutely allow institutions to use a risk-based approach to AVM QC. With most NCUA regulations this requires a risk assessment and appropriate controls based on the risk. This seems like a great opportunity for CFPB to help smaller entities comply.

Q35. There is no reason for CFPB to duplicate existing fair lending requirements in this rule. Statute does not require it and it is not needed, especially in smaller lenders. Lenders do not have access to the data or methodologies used in AVMs to be able to conduct testing for fair lending compliance. This type of testing would be extraordinarily costly and even the presence of this provision in the rule would strongly discourage use of AVMs, thus increasing the cost of and time required for consumers to get loans. If the Bureau is hell-bent on including this provision, please allow a significant phase in period so lenders can work with the AVM providers to incorporate this into AVM providers' quality control processes. Furthermore, it is critical to allow lenders to use the fair lending analyses provided by/for AVM providers. A market solution to this issue is preferable. AVM providers should be encouraged to provide this analysis and credit unions should be able to request or require it of AVM providers to manage the fair lending risk. Requiring each lender to test the AVM algorithm for fair lending compliance is an excessive burden that will harm consumers by raising the cost of credit.

Q36. Mid Oregon FCU has an appraisal policy that outlines what type of valuation is required for each loan type based on property type, loan amount, etc. This policy includes a requirement that an AVM achieve a specified confidence level to be considered valid for underwriting. The AVM service provider is subject to normal vendor due diligence and review procedures. Fair lending risk is not currently called out in that review process. We do include a compliance risk component in the vendor risk assessment.

Q37. Mid Oregon FCU does not perform a fair lending review of the service provider. We do not have access to the proprietary data used to perform such a test.

Q38. We would have to develop an independent data source to test fair lending compliance of the AVM. This is not something we have the capacity to do. We would simply stop using AVMs until a market solution developed that was acceptable to CFPB. The Bureau should strongly avoid action that decreases the use of AVMs and increases the cost of credit for consumers.

Q39. Since AVMs use the same data set as appraisals, mostly closed sale transactions of comparable homes adjusted for differences in property, there is no additional risk of lending bias from using an AVM versus an appraisal. If anything, the algorithm reduces the potential for human bias. The location of and nearby amenities are critical inputs in a property valuation. If fair lending criteria is included in the rule, the cost of compliance will increase and the likelihood of AVM usage will decrease, thus increasing the cost of credit to consumers. It is not possible for small lenders to perform many of the functions listed by bullet in question 39. If the fair lending criteria are not eliminated from the rule, it is essential that CFPB establish a safe harbor for small entities that rely on third party or vendor supplied compliance information.

Q40. Compliance time is dependent on how much fair lending compliance is required and whether the Bureau allows lenders to rely on third party or vendor supplied information for compliance. If the net result of this rule is for lenders to stop using AVMs, compliance will be easy for the lenders. AVM providers are likely to need to make changes to respond to this rule. CFPB should allow a longer implementation window to account for this. Twenty-four months would be preferable to twelve to allow for any adjustments to and testing of algorithms.

Q41. As a small entity we use AVMs to determine the value of property when we underwrite a loan. As noted earlier we use a tiered process based on risk and loan amount. We also use AVMs for portfolio reviews that feed into the Allowance for Loan and Lease Loss reserve. This is done via an automated process that provides only a property value and confidence score, without the supporting data or physical inspection that is required for underwriting.

Q42. Mid Oregon FCU procures AVMs through a third party, using our appraisal management company.

Q43. There were no initial costs to implement our AVM service. We pay a per AVM fee to the provider and an additional fee for physical inspection.

Q44. Mid Oregon FCU has an appraisal policy and procedures staff must follow when using an AVM. These policies outline when an AVM is permissible, a required confidence level in the value provided and whether a physical inspection is required.

Q44A. The purpose of policies and procedures are the management of risk.

Q44B. Staff has no discretion to override a property valuation, whether received via AVM or appraisal.

Q44C. Staff spent less than 40 hours developing the initial policies. The AVM provisions were added via amendment to our existing appraisal policy.

Q44D. Annual reviews and policy updates require less than 10 hours, unless there are major changes to regulations as envisioned by the proposed rule. Reviews are performed by internal management and approved by executive management, or the Board as required by regulation.

Q44E. Use of an AVM is never "necessary." There is always an option to obtain an appraisal if needed, or to use an alternative valuation method like tax-assessed value for low-risk, smaller loans.

Q45. AVM reviews are included in our quality control process. Our validation is managed via use of the confidence score, which provides a standard deviation of value, rather than testing after the loan is already issued. Testing AVM data against actual appraisals post-closing would be far too expensive to implement on the scale needed to assure statistical validity. Since property value is one of many factors considered in underwriting loans, the risk to Mid Oregon FCU from the AVM being inaccurate within the standard deviation is low.

Q45A. No staff is currently assigned specifically to validating AVMs. A review is conducted as part of loan QC activity.

Q45B. We rely on the testing and forecast standard deviation documentation supplied by the AVM provider. The scale of testing and complexity of validation far exceed any validation Mid Oregon FCU could conduct internally.

Q45C. If the AVM confidence score does not meet our required threshold, the AVM cannot be used for loan approval. The borrower would be provided the option to obtain a full appraisal for loan approval.

MidOregon
Credit Union
good friends. great service.

Thank you again for the opportunity to provide input.

Sincerely,

Kevin Cole

Kevin Cole, CFA
President
Mid Oregon Federal Credit Union

Statement Submitted to the Consumer Financial Protection Bureau
SBREFA Session for Automated Valuation Model (AVM)
Rulemaking
March 15-16, 2022

Statement Submitted by Craig Gummow, Chief Lending Officer, Beehive Federal
Credit Union

April 8, 2022

RE: AVM SBREFA Panel

To the CFPB,

Thank you for allowing me the opportunity to serve on the Small Business Advisory Review Panel for Automated Valuation Model (AVM) Rulemaking. I want to recognize the professionalism and kindness shown by those working for and representing the CFPB.

I appreciated the opportunity to share verbal feedback during the panel meeting. At this time, I would like to provide written summary comments as a Small Entity Representative.

Q4. How often and what purpose?

Beehive Federal Credit Union used an AVM tool to value and write 263 loans with balances averaging $97,490 in 2021.

Q5. Use?

Please limit covered AVMs as those used for making underwriting decisions only. This will allow financial institutions the flexibility to use the tool for compliance, accounting, and other needs, without the potential cost burdens of a covered AVM. Covering all uses will mean AVMs may not be used in other areas that potentially could help a financial institution's decision making outside of underwriting. For example, Beehive has used AVMs to check the quality of our ALLL calculation.

Q8. Advantages and Disadvantages

Advantages: Speed and cost. We use AVMs on low risk, low dollar loan requests. We use appraisals for medium to high-risk loans and larger loan requests. This allows a quick, low or no cost loan to be offered to our credit union members.

Q9. Compliance costs that would stop or decrease AVM use.

If third-party vendors increased their cost by 20% or more, Beehive would pass the cost of the entire AVM to the consumer. Currently, we provide the valuation at no-charge. If third-party vendors increased their cost by 75% or more to comply, we would opt for a full appraisal. This would cost the consumer more and increase loan turnaround time.

Q10. AVMs by licensed appraisers

We prefer using AVMs by licensed appraisers. They understand the local market better through their daily experience and support the idea of removing them from being covered. Local appraisers will track down private sale information and document it for us. Their valuation method is easier to understand.

Q19-Q23. Definitions

Please define "mortgage originator", "secondary market issuers", "mortgage", "consumers", "dwelling", and other terms spoken during the meeting, with the same descriptions used in other rules. It would be extremely difficult to wrestle with differing definitions of common industry terms based on which rule the financial institution was trying to be compliant. I recommend matching the term definitions with an existing rule.

Q31. Quality Control Standards

Please adopt the first alternative method of complying with AVM QC standards. This would allow institutions to adopt and maintain their own policies, practices, procedures, and control systems, without specific requirements.

The reason for this recommendation is related to product type, loan size, geography of the credit union, and other factors that affect the quality threshold. For example, finding five comparable sales, with comparable lot size, living area, sold in the last six months within a two-mile radius in a Boise suburb might be an easy requirement for a financial institution based in Meridian, ID. However, that same financial institution may find those requirements impossible to comply with in Emmet Idaho, twenty-five miles north. Small entity community banks and credit unions need access to financial tools like AVMs as they fill the void of the large banks that are leaving small towns and the underserved areas of the country.

Additionally, those of modest means need quick and affordable access to the equity in their homes. A financial institution that can provide a low cost, low interest loan using an AVM for a small loan amount of $25,000. The placement of strict requirements meant to tame risk on half million-dollar secondary market loans has the potential to drive the cost of an AVM considerably higher and increase the length of time it takes to receive one. A consumer of modest means looking to replace a roof or HVAC system should not be enticed to sign up for a high cost, high interest loan from a finance company simply because it is faster and the "costs are not much higher". Today consumers of modest means can find quick, affordable access to funds with the aid of an AVM valuation.

The ability to set AVM requirements based on addressing the risk factors of the loan will ensure QC standards are met without sacrificing the underserved and modest mean population.

Q32. Prescriptive Rule

The complexity of a prescriptive rule to address rural properties, product types, different levels of underwriting dollar amounts, economic, business activities, and other risk factors facing institutions in different housing markets would result in a vast regulation. Any prescriptive rule language that bleeds into software structure will lead to significant cost hikes.

Q33. First Four Statutory Factors

Yes. The first four statutory factors will aid our small entity in implementing those factors.

Q35. Nondiscrimination

I recommend the CFPB monitor nondiscrimination through existing regulations that are better equipped to ensure fair lending is part of a financial institution's everyday practice. AVMs should be blind to race, color, national origin, religion, sex, familial status, or disability. The concern that undervalued neighborhoods need increased support should be addressed with local housing authority programs and specific local measures to address the depressed valuations.

My concern is an attempt to address an undervalued neighborhood through AVM rules and regs will undermine one or more of the first four statutory quality control factors. The industry has operated on the belief that the most recent, closest, similar sized, like condition sales comparable must be used and if the appraiser or appraising entity ignores the comparable, the data has been manipulated. The industry strayed from that belief and the consequences of the mortgage meltdown followed soon after.

Q40. Implementation time

Applying testing on random samples of existing models and answering questions related to the first four statutory factors would only take six months to reach best practice.

Any requirement that forces vendors to rewrite software coding will take over one year.

Q43. Current cost

$125 per AVM through a third party

Q45B. Test

Beehive compares full appraisals with AVMs in the same neighborhood.

Q45C. Unreliable

We order a full appraisal

Compliance Cost

Lastly, complex compliance regulations hurt small entity banks and credit unions. The employee power and cost to maintain such systems can be overwhelming and only drives consolidation in the industry. I do not believe the consumer is benefitted when mega banks dominate the market. The reduction of choice for consumers due to mergers related to compliance costs is a real concern. Please keep the written regulation simple and focused on ensuring AVMs do not introduce widespread risk to the housing market. Attempts to do more than this will hurt rural, modest mean, underserved consumers, and possibly small entities one step closer to merging out of existence.

Thank you,

Craig Gummow

Statement Submitted to the Consumer Financial Protection Bureau
SBREFA Session for Automated Valuation Model (AVM)
Rulemaking
March 15-16, 2022

Statement Submitted by Leton Harding, President and CEO, Powell Valley National Bank

From: Leton Harding
To: 2022-SBREFA-AVM
Subject: AVM SBFREA Comments
Date: Wednesday, April 6, 2022 4:32:11 PM
Importance: High

CFPB 2022 SBREFA-AVM Working Group

Dear Sir or Madame,

I wish to thank the CFPB for the opportunity to participate in the AVM SBFREA panel and related discussions.

As a small community bank primarily in a rural area, our ability to support the real estate loan needs of consumers, especially low-to-moderate income folks, is very important to us.

With the continued evolution of technology, its growing usage including Automated Valuation Models (AVM) for Real Estate - is to be expected. Technology has the potential to increase information availability, broaden the range of information available to a greater population, expedite processes and generate cost savings.

As with the expansion and establishment of any automated process, ensuring fairness in its development and application is appropriate. Thus, the consideration of fairness of AVMs is generally warranted.

However, I believe that the CFPB needs to focus more on the inputs for AVMs before making decisions on fairness issues within AVMs and their outputs. AVMs are agnostic toward the interpretation of the data provided to its programing. The AVM output is simply reflecting the data entered. As the old saying goes…the CFPB would do well to consider the (data) source(s).

Generally, numbers and data for AVMs come from the historic work of Real Estate Appraisers, Real Estate Agents and Developers, who have influenced, interpreted and perhaps established real estate values along many ranges of service. Working to ensure data integrity throughout the process for market “influencers” is essential. Having said that, perhaps it is the Appraiser that ends up contributing the most influence toward market value through their interpretation of the market data.

There are some key statistics to consider about real estate appraisers as well:

- In 2007 there were 98,450 Appraisers. According to Zippa, in 2021 there were 30,548 active appraisers. Over 200% shrinkage in the number of appraisers in fourteen (14) years.
- 32.0% of all Real Estate Appraisers are women, while **62.9%** are **men**.
- The average age of an employed Real Estate Appraiser is **50** years old.
- The most common ethnicity of Real Estate Appraisers is White (84.8%), followed by Hispanic or Latino (6.6%) and Black or African American (3.8%).
- Approximately 50% leave the profession within four (4) years.

Despite the growing volume of housing and needs for related services, the number of appraisers continues to decline~~.~~ *Many rural areas have no licensed or certified appraisers available as evidenced by the U.S. Bureau Of Labor Statistics.*

In addition to real estate appraisals for loans, a primary function performed by appraisal firms, is to assist in the establishment of tax values for local government.

The age, demographic makeup, and physical location of appraisers in major metropolitan areas calls into question the fairness of these tax assessed numbers in minority and rural areas of the country. I believe this needs to be explored by the CFPB as tax basis for property establishes a general benchmark for property values.

The Bureau is considering a 12-month implementation period after issuance of an eventual interagency final rule. I believe implementation would likely involve integrating multiple systems, as well as HMDA data or MSA data and feel a longer implementation period to do so could take up to three years for our institution.

In my opinion the outdated model for individuals to become appraisers is the primary reason for the growing shortage of appraisers…thereby fueling the interest for using AVMs. This current appraiser licensing model requires extensive hours of mentoring and study, with the promise of modest compensation and increasing scrutiny. Additionally, it was created before the internet, online resources and or consideration of the usage of entities such as community colleges for training mediums. It is no wonder the appraisal industry is facing such challenging times.

The makeup of appraisers and their location is not conducive to expanding industry opportunities to people of color or in rural areas due to the mentoring aspect of the current appraiser licensing system; which is akin to indentured servitude, eliminating people of modest means to explore this career opportunity.

Beyond that, the current appraiser model is monopolistic. Meaning, it is the concept of having a person (appraiser) assist in developing and creating more competition for the very business (appraisals) they themselves are pursuing. Assisting in creating one's direct competition is not realistic.

Being overly concerned about AVMs without investigating a primary underlying reason for their usage (lack of appraisers) is much like a doctor prescribing aspirin for pain without examining the patient.

Until the CFPB fully studies the underlying issue of appraiser shortage, the question of fairness of AVMs - while well intentioned - will not address the issue of appraiser personal demographics which do not reflect America demographically nor geographically.

Below are links for information utilized in the aforementioned comments and attached a study from the US Appraisal Institute.

Our Bank would much prefer using a local person to perform an appraisal versus using an AVM.

However, the non-availability of appraisers coupled with growing costs may require that AVMs are our sole resource for interpreting real estate values.

We hope that the efforts of the CFPB will bring attention to expanding the number of appraisers and expand availability into communities throughout the U.S.

That unto itself will create greater fairness of AVM outputs.

In conclusion it should also be noted that the acceptance of AVM's in the mortgage/banking industry is still developing. Regulatory requirements, investor guidelines and certain lending programs are not accepting of AVM's...and actually demand an appraisal.

The standardization of the AVM process (from data entry to analysis output), by the CFPB and other Regulators, would assist greatly in a wider acceptance of the AVM approach. Such standardization (similar to the GSE's posture toward underwriting and appraisal waivers) would help to eliminate ambiguity and would ensure an even playing field for all involved; including low-to-moderate income families, Community Banks and the financial industry as a whole.

Most Sincerely,

Leton L Harding
President & CEO
Powell Valley National Bank

[Property Appraisers and Assessors : Occupational Outlook Handbook : U.S. Bureau of Labor Statistics (bls.gov)]

[PowerPoint Presentation (appraisalinstitute.org)]

[Real Estate Appraiser Demographics and Statistics [2022]: Number of Real Estate Appraisers In The US (zippia.com)]

[Black appraisers call out industry's racial bias and need for systemic change (nbcnews.com)]

"The information contained in this email is confidential and may contain proprietary and/or personal information. It is meant solely for the intended recipient. Access to this email by anyone other than the intended recipient is unauthorized. If you are not the intended recipient, any processing of the email or the information contained therein (including disclosure,

copying, distribution, storage) or any action taken or omitted in reliance on this, is prohibited and may be unlawful. No liability or responsibility is accepted if information or data is, for whatever reason corrupted or does not reach its intended recipient. No warranty is given that this email is free of viruses. The views expressed in this email are, unless otherwise stated, those of the author and not those of Powell Valley National Bank or its management. Powell Valley National Bank reserves the right to monitor, intercept and block emails addressed to its users or take any other action in accordance with its email use policy."

Statement Submitted to the Consumer Financial Protection Bureau
SBREFA Session for Automated Valuation Model (AVM)
Rulemaking
March 15-16, 2022

Statement Submitted by Richard Jones, President and CEO, Randall State Bank

April 6, 2022

Consumer Financial Protection Bureau
1700 G St. NW
Washington, DC 20552

RE: AVM SBREFA Panel Written Feedback

Dear Sir or Madam,

As a local community banker and small entity representative (SER), I appreciate the opportunity to provide written feedback based on my experience and participation on the Small Business Regulatory Enforcement Fairness Act (SBREFA) Review Panel that focused on an upcoming rulemaking relating to the evaluation of automated valuation models (AVMs) used during the mortgage origination process. Coming from a relatively small community bank, I hope my perspective will help inform the Consumer Financial Protection Bureau's (CFPB) proposals as they weigh the unique challenges faced by small community lenders that are trying to best serve their customers and stay active in the challenging and competitive mortgage market.

My community bank, Randall State Bank is a $57 million dollar bank in Central Minnesota. We strive to make sure everyone in our community achieves the dream of homeownership and use all the tools at our disposal to ensure that every step of the mortgage application and approval process is fair, transparent, efficient, and without any bias. This is certainly the case with regard to appraisals and property evaluation more broadly. AVMs are a critical part of this process as we make underwriting decisions and determine properties with comparable value.

Community banks like my own do comprehensive due diligence when selecting third party vendors like AVMs and numerous others. However, given that AVMs are a relatively new and niche product that rely on complex algorithms often hidden behind a "black box," – yet are nonetheless a useful and sometimes crucial tool for small mortgage lenders as they determine the value of collateral – small entities should be exempt from onerous and costly evaluation requirements for in-house evaluations made on mortgage loans held in portfolio.

Recommendations

1. Exempt Lenders from Fair Lending Evaluation Requirements for Portfolio Loans

It is certainly important that AVMs adhere to specific quality control standards and rely on data that does not result in inadvertent discrimination based on race, gender, or ethnicity. As you know, AVMs use complex algorithmic systems to determine a property evaluation, and the quality of the output is only as good as the models and data used by the AVM. However, requiring lending institutions, particularly smaller entities like my own, to assess and evaluate the models for potential fair lending concerns, prior to their use, would be unreasonable, redundant, and extremely costly. It would likely increase fees and result in additional staffing requirements to perform AVM analysis. Small lenders do not have access to the data being used by an AVM, nor do they have the knowledge or expertise to determine the accuracy or reverse-engineer the algorithms to assess any fair lending red flags.

Moreover, lending institutions already adhere to the requirements of the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act, so the prospect of an additional fair lending requirements applicable to AVM evaluation would be especially redundant and onerous, likely resulting in more community banks electing not to use AVMs or exiting the mortgage business altogether. The onus should be shifted to the CFPB or similarly capable organization to ensure that the providers of AVMs are adhering to robust fair lending standards.

2. Portfolio Loans Under $400k Should Not Be Subject to AVM Evaluation Standards

As you know, in 2019, the Federal Deposit Insurance Corp., the Office of the Comptroller of the Currency, and the Board of Governors of the Federal Reserve determined that home mortgage loans not guaranteed or insured by a government sponsored agency or exceeding a $400,000 sales price threshold, are not required to have an appraisal. We believe that it makes sense to apply this same threshold to portfolio loans evaluated in-house by an AVM. In other words, a portfolio loan under $400k that was evaluated by an AVM should not be subject to evaluation standards outlined in a proposed rule. A growing segment of the industry, including community banks, are starting to rely on AVMs to measure and account for the risks for mortgage loans they hold in portfolio.

Thanks again for the opportunity to participate in the SBREFA. As an SER, it is crucial to stay engaged in the rulemaking process on this important issue.

Best regards,

Richard Jones
President and CEO
Randall State Bank
Richard.jones@randallstatebank.com
320-749-2265

Statement Submitted to the Consumer Financial Protection Bureau
SBREFA Session for Automated Valuation Model (AVM)
Rulemaking
March 15-16, 2022

Statement Submitted by Lauren MacVay, President and CEO, True North FCU

Small Business Advisory Review Panel for Automated Valuation Model (AVM) Rulemaking

Written Feedback

Submitted by:
Lauren MacVay
True North Federal Credit Union

Thank you for the opportunity to provide written commentary on select questions in follow up to the SBREFA panel hearings last month. I wanted to comment generally that while the questions frequently asked for detailed costs, but I found them very difficult to provide with any degree of reliability, as the nature of the controls that would be required by regulation remain unclear.

Q3

Does your small entity currently have quality control processes in place for AVMs? If so, please describe those processes, including how they function, what costs (one-time or fixed, and variable) are associated with their implementation and oversight, and whether they differ based on AVM use, *e.g.*, making underwriting decisions versus portfolio monitoring. Are there specific complexities or costs that are different for AVMs used in making underwriting decisions versus for other AVM uses?

We are able to somewhat validate AVM values through a comparison to appraisal and assessment values. We have long been comparing appraisals to assessment, so that we have an understanding of where assessments fall in relation to market value. We have started placing AVMs into that analysis and get a feel for whether AVMs are establishing value out of line with appraised values. The cost of doing this process is a small amount of staff time, but primarily the cost of the AVMs pulled when we have appraisals to establish a baseline. I would estimate between \$3000 - \$5000 a year to perform this assessment.

Further, when using an AVM to establish value, we do require digital photographs of the property to ensure condition is reasonable.

When using AVMs for investor mortgage programs, the investors require results above a certain confidence score, as well the use of specific AVM models.

Q4

How often does your small entity use AVMs in making underwriting decisions? Does your small entity use AVMs for other purposes, such as monitoring the quality or performance of mortgage loans or mortgage-backed securities? If so, how often are AVMs used for those other purposes?

- Presently, AVMs can be used to establish values in home equity lending for loans up to $100,000. There has not been a high volume of loans originated this way to date.

- Further, policy states that appraisals must be less than 6 months old, but AVMs can be used to extend that appraised value for another 6 months.

- AVMs may be pulled as a valuation point when evaluating collection paths on real estate loans in default.

- Finally, we use AVMS in mortgage lending when required by the investor.

Q8

What are the advantages and disadvantages for small entities of using AVMs to review completed determinations versus using other non-AVM methods of review?

AVMs are more reliable than tax assessment for some markets, and far cheaper than a field or desk review of an appraisal. We are required by our First Mortgage Quality Control program to do those and spend approximately $6,000 per year validating appraisal values.

Q11

Would coverage of appraisers' use of AVMs potentially discourage use of AVMs by small entities as a valuation tool?

If an appraiser use of AVMs were to trigger additional quality control requirements by originators, and AVM usage by appraisers was common in a given market, it could drive small originators out of that market. If the quality control program requirements were sufficiently burdensome, the small originator would not be able to use AVMs and would not be able to use appraisers. They would have no option to but to stop originating mortgages.

Further, if we were required to perform QC on the AVM result and didn't have that infrastructure, that would force us to pick and choose our appraisers. This is already a regulated processes and we would have to ensure we were in compliance with appraisal selection rules when selecting only appraisers who do not use AVMs.

Finally, if only allowed to use appraisers who do not use AVMs, that would impact our selection (which is already limited in small and rural markets) and drive up our wait times, which are already weeks long. Further, costs would very probably go up as those appraisers would be able to charge more depending on the number in the market. This has a direct negative affect on consumers.

Not including Appraisals that include AVMs would put the due diligence burden on the appraiser, where it already belongs. Including Appraisals with AVMs into this regulation would have a disproportionate and negative impact on small originators.

Q12

What would be the advantages and disadvantages for small entities of the first alternative (*i.e.*, covering AVMs in transactions like refinancings but not in loan modifications that do not result in

a new mortgage origination) versus the second alternative (*i.e.*, broadly covering changes to the terms of an existing mortgage so long as a covered institution or its service provider uses the AVM to determine the collateral worth)? Please also provide any alternatives for consideration.

There is little advantage in option 2, extending the regulation to loan modifications that do not result in a new origination. When working with borrowers seeking a loan modification, speed and cost matter. An AVM may be a quick and reliable way to assuring the lender that there is adequate equity in the property to support the modification that the borrower is needing. Imposing QC requirements on servicers who are attempting to value properties for loan modifications will only disincentivize them from doing a new valuation on the property, which may lead to poor outcomes for the borrower. Conversely, the lender may require an appraisal before making its decision, driving costs up for the borrower, who may already be in financial distress.

Q18

What would be the advantages and disadvantages for small entities of excluding a mortgage originator's use of an AVM for appraisal waiver purposes in transactions where the secondary market issuer's use of an AVM is covered instead?

Waiver programs offered by investors add significant value to the borrower. They result in a faster refinance at lower cost. If the Quality Control program requirements are put in place for small originators, many will be pushed out of the market of offering those loans, which is a huge competitive disadvantage. Large originators, who have that QC infrastructure already in place, will be able to offer faster, cheaper refinance options to borrowers. In the end, borrowers will be left with less choice, which in the long term will result in higher costs as competition is driven out of the market.

Further, some small originators use the GSE underwriting systems to underwrite and approve, even if the loan ends up in the originators portfolio. If those waiver loans require an AVM QC program, small originators will have to stop that practice if they cannot reasonably comply with the QC program requirements.

Q19

Please provide feedback and information, including supporting data, on the advantages and disadvantages to small entities of defining the term "mortgage originator" in section 1125 to cover persons who are "loan originators" for purposes of Regulation Z §1026.36(a)(1). Please also provide any alternatives for consideration and explain the advantages and disadvantages of such alternatives.

The definition of "loan originators" per Reg Z is so broad as to provide no relief for small lenders. In order to ensure that additional compliance burden doesn't put small lenders out of the market, regulation should be limited by asset size and/or volume. Small institutions that are then exempt from compliance could use the regulation as guidance for best practices to the extent feasible and commensurate with their use and risk position. The Small Servicer definition is 5,000 loans, which seems to be a viable threshold in this context as well. This step will ensure that small entities, with close ties to communities, are not pushed out of the mortgage market.

Q26

From your experience, is there a difference between consumer-purpose and business-purpose mortgage lending regarding the relative prevalence of AVMs and in-person appraisals used to determine the worth of the collateral? Do you expect this relative usage to change in the next five years and, if so, how? Please provide any supporting feedback and information, including supporting data.

In our experience, AVMs in business purpose loans are more common than in consumer. Conversely, appraisals for business purpose loans are far, far more expensive and time consuming. The use of AVMs allows us to keep borrowing costs for our small business borrowers low, and allow a reasonable loan turnaround time. Inclusion of business purpose loans in this regulation, would potentially limit our small business owner's ability to use their homes to support their business endeavors at reasonable cost.

Q28

Would limiting coverage of the AVM requirements to dwelling loans secured by real property be significantly less burdensome for small entities than extending coverage to all dwelling-secured loans? Please provide any feedback and information, including supporting data, to support your response.

The definition of dwelling should be restricted to real property. Otherwise, boats and motor homes, which are common sources of housing in our market, would be under the umbrella of this regulation. At present, we do comply with RESPA when we are aware that applicants are living in or intend to live in the boat and motorhomes collateralizing their loans. We would have to do the same here. We value those pieces of collateral through NADA and Kelly Blue Book, and surely it is not the intent of the CFPB to require us to extend the quality control program to those resources as well? If so, I cannot see how we could possibly comply.

Q31

Would small entities be assisted by the CFPB adapting the Guidelines for use by CFPB-regulated institutions and adopting them as guidance rather than adopting specific requirements to implement the statutory quality control factors?

Yes, guidelines are far more helpful than more detailed and specific requirements. First, guidelines would allow us to risk base our controls, whereas detailed and specific requirements create a one size fits all regime in which the damage from the "cure" may be far worse that the ill it is attempting to cure.

Second, guidelines would allow us as an industry to learn and evolve with best practices, whereas prescribed controls at the outset will limit growth, knowledge and experience. As was very apparent during our conversation, this is a complex topic with many potential ramifications that cannot yet be seen clearly. To prescribe specific controls at this point could have significant unintended consequences. Guidelines would give an opportunity for us all to learn about the impact of this regulation on our ecosystem and still have the flexibility to respond appropriately to create programs that are in the best interests of the consumer.

Q34

Should the CFPB allow each institution to tailor its methodology to the nature of its risk exposure, size, business activities, and the extent and complexity of its use of AVMs? Do you have suggestions on the best way to do so?

First, the CFPB should have a minimum trigger before compliance is required. This is a common approach in many regulations effecting real estate lending compliance, and there are strong policy reasons to continue that approach. Failure to apply it here will significantly disadvantage small community lenders, driving more and more mortgage volume towards large, national lenders. In the end, the disenfranchisement of community lenders just ends up meaning generic product choices at higher costs for consumers.

Second, any requirement should be appropriate to the risk, and this is a practice with which we are very familiar. Regulated depository institutions already have Credit Risk Management requirements. In our Credit Union, we do a semi-annual analysis of all portfolios, from origination to loss trends, as well as a deeper annual analysis of any portfolio that is 100% or more of our net worth value. We also have Fair lending policies, procedures and testing.

Thirdly, not all markets are the same, and the regulation should let us tailor a program that acknowledges that and lets us continue to serve our communities. For example, Alaska is a unique market with low sales volumes in many areas, and as a result it can be difficult to obtain consistently high confidence scores on AVMs. However, as a community institution, we have in depth personal experience and understanding in our markets and can supplement a low confidence score with our understanding of the local market. If we do not have the ability to do that, the result is higher costs to remote communities.

Q35

What are the advantages and disadvantages for small entities of specifying a quality control factor on nondiscrimination? Would there be an impact on your costs? Please explain. Are there other alternative approaches the CFPB should consider? Why or why not? What is the basis for this recommendation?

Including non-discrimination as a quality control factor would be a huge disadvantage to small entities. The threshold issue is that we do not do enough volume to do a statistically relevant analysis that would tell us if we did have a discriminatory impact outcome.

If we ignore the fact that our data sample would be too small to be relevant, we are still faced with the fact that we have no way to even do the analysis. Given the level of complexity and the fact that we probably could simply not do it accurately, the regulation would probably drive us out of AVM usage for any covered purposes.

Q40

How much time do you estimate your small entity would need to prepare for compliance with an eventual final rule? Are there any particular aspects of the CFPB's options under consideration that could be particularly time consuming or costly for your small entity to implement? Are there any factors outside your small entity's control that would affect its ability to prepare for compliance?

Of course, the answer here depends on the nature of the regulation proposed. If the approach taken lets us establish controls that are appropriate to our risk, implementation will be more feasible. However, if the non-discriminatory provision is included, complexity goes up drastically. Without that provision, it will take at least 24 months to get integration with our Loan origination and reporting systems in place. With that provision it will take significantly longer, as integration to whatever data source will help determine discriminatory impact adds additional complexity. And of course, that's assuming we do not determine that our best course is to opt out of using AVMs entirely.

Statement Submitted to the Consumer Financial Protection Bureau
SBREFA Session for Automated Valuation Model (AVM)
Rulemaking
March 15-16, 2022

Statement Submitted by Jack Thompson, President and CEO, Legacy Mortgage LLC

Greetings,
The following are my comments regarding AVM's.

While I agree, technology advances and big data mining will allow for the use if AVM's, I believe much work needs to be done on standardization and agreements with industry players such as the agencies, HUD and VA concerning the long term impacts of cyclical and market swings when it comes to establishing the true value and condition of a property as the security for covered loans. Rulemaking needs to consider this as using AVM's is such in an early stage.

1. Currently many lenders and vendors have developed AVM's that are very different in scope and confidence. The use of AVM's for servicing valuation, HELOCs , and second mortgage is I believe very different than relying on an AVM for valuing a property on a covered loan. The rule making should be detailed to point these differences out and applied appropriately depending on what the AVM is being used for. As for covered first mortgages, the CFPB should call for minimum standards and standardization of any AVM mode used to valuate properties.
2. As a small lender, it would be impossible for our company to develop a reliable AVM, keep it updated and implement it properly. We would have to rely on third party vendors and an accepted FNMA/ Freddie Mac approved AVM. From a vendor management point of view, we would not have the skill set or man power to monitor if a AVM vendor met the rule making criteria. I believe that if the agencies are going to purchase mortgages that relied on AVM for property valuation, then the agencies need to be involved in the AVM approval process. I believe many small lenders will opt out of AVM's unless they can be assured of a reliable solution and set of rules that is not burdensome. In the event of default or fair lending exam, the agencies must have the confidence that the AVM was accurate in both cases.
3. AVM's also present the opportunity to discourage discrimination, however a small lender would not be able to confirm if the AVM is using AI or algorithms that were blind to race or area.
4. The bottom line for small lenders, is that the rules need to written in a way that a small lender can properly oversee and be confident in their use without incurring a great deal of costs or risks.

Thank you

Jack Thompson
President, CEO | **Legacy Mortgage**

Statement Submitted to the Consumer Financial Protection Bureau
SBREFA Session for Automated Valuation Model (AVM)
Rulemaking
March 15-16, 2022

Statement Submitted by Joanne Todd, President and CEO, Northeast Family FCU

Good Afternoon,

Thank you for including me in the SBREFA panel to develop Automated Valuation Model regulations. Northeast Family Federal Credit Union is a $110million asset credit union with 20 employees serving a low income field of membership. In 2021 we closed 71 real estate secured loans totalling $8.8million. We kept all of these loans in our portfolio. We are a small lender with few employees who cover many services. We do not have dedicated compliance staff.

AVMs are important to our credit union. They offer efficiency and affordability, which is a benefit to consumer/members as they want the convenience of closing as soon as practical and the lower cost. AVMs provide reasonable assurance of the value of the collateral and we use them on loans where we can absorb some risk of a valuation variance. For these reasons, we look forward to continued use of AVMs. If the proposed quality control standards improve the reliability and accuracy of the valuation while maintaining the low cost and speed, we welcome improvements and may expand our use of AVMs as we may be more confident in the valuation. Currently, we limit AVM use to mortgages below $200,000 and less than 80% LTV.

Our concerns are primarily:

1. Compliance burden
    a. The definitions of terms (mortgage, dwelling, etc) should be kept consistent from reg to reg, as much as possible. As a small business, it is burdensome to keep track of the variety of different definitions for each regulation.
    b. Flexibility – policy and procedure standards should be scalable and flexible to all size lenders.
    c. Options – we feel options are good for innovation and flexibility. At the same time, as a small lender with limited compliance resources, something like a ‘safe harbor policy or procedure’ may provide a more viable compliance solution
2. Price – regulations that lead to cost increases that are not offset by benefits will hurt the consumer
3. Efficiency – regulations that lead to slower AVMs will hurt the consumer

We are concerned about the unintended consequences of regulations that often put small businesses at a competitive disadvantage. Regulatory burden results in consolidation as small institutions cannot support growing compliance costs. Regulations also lead to commodity services where all providers offer similar products because the regulations to not allow the flexibility to be innovative. This too leads to consolidation as all institutions offer the same products and only institutions with scale can control compliance costs and offer a less costly commodity. Fewer lenders who offer less innovation hurts the consumer and the economy.

Thank you again for the opportunity to be a participant in this thoughtful process and for listening to the voice of small entities.

Joanne Todd
President
Northeast Family Federal Credit Union

Statement Submitted to the Consumer Financial Protection Bureau
SBREFA Session for Automated Valuation Model (AVM)
Rulemaking
March 15-16, 2022

Statement Submitted by Kurt Weidner, Mortgage Broker/Owner, Weidner Financial

Good morning:
I was 1 of 2 mortgage brokers invited to participate in the AVM panel. I thought that the panel was formed to provide "pros and cons" of using AVMs, and possible risks/ramifications of using AVMs to the housing market and overall economy.
Turns out the panel was formed more for Banks/Credit Unions/Mortgage Banks to oversee the accuracy/validity of an AVM.

So, here is my input regarding AVMs from a mortgage broker's perspective:
1). understand the limits brokers face in selecting and testing AVMs – As a general rule, mortgage brokers don't use AVMs. We don't service loans, don't have a portfolio to value, and don't select the type of property valuation method when originating a mortgage. The lender, or Automated Underwriting System dictate the valuation method (full appraisal, exterior only, appraisal waiver). If an AVM were to be allowed for loan origination (which I have never seen), due to Appraiser Independence Requirements (AIR), the mortgage broker would not choose the company performing the AVM, and thus have no direct contact or business relationship with the AVM provider. These are done through the lender's approved Appraisal Management Companies (AMCs).
The only instance where I could see a broker wanting an AVM would be for a ballpark valuation for a potential refinance candidate. However, with online alternatives (Zillow, Redfin, Realtor.com), an AVM has become superfluous.

2). whether you think brokers should be covered by the rule (and why) – Mortgage brokers should not be covered by the rule for the reasons given above.

3). potential impact on your business if brokers were covered by the rule – It would be virtually impossible for mortgage brokers to be required to "vet" Appraisal Management Companies (AMC) and thus the algorithms/data used by their AVM providers.

Q41. For what purposes do you currently use AVMs to determine the value of residential property? – As stated above, mortgage brokers don't use AVMs.

Q42. Do you develop the AVM yourself or do you procure the software from a third party? – If a mortgage broker were to use an AVM, it would be through a third party (typically, an AMC

Q43. What are your costs associated with AVM use? Are there recurring or variable costs associated with your use of AVMs? Were there any one-time or initial costs associated with your use of AVMs? – As a mortgage broker, an AVM would be charged by the AMC, much like an appraisal.

Q4. How often does your small entity use AVMs in making underwriting decisions? Does your small entity use AVMs for other purposes, such as monitoring the quality or performance of mortgage loans or mortgage-backed securities? If so, how often are AVMs used for those other purposes? – Mortgage brokers basically never use an AVM.

Q3. Does your small entity currently have quality control processes in place for AVMs? If so, please describe those processes, including how they function, what costs (one-time or fixed, and variable) are associated with their implementation and oversight, and whether they differ based on AVM use, e.g., making underwriting decisions versus portfolio monitoring. Are there specific complexities or costs that are different for AVMs used in making underwriting decisions versus for other AVM uses? – This topic does not pertain to mortgage brokers.

Q19. Please provide feedback and information, including supporting data, on the advantages and disadvantages to small entities of defining the term “mortgage originator” in section 1125 to cover persons who are “loan originators” for purposes of Regulation Z 15 § 1026.36(a)(1). Please also provide any alternatives for consideration and explain the advantages and disadvantages of such alternatives. – Yes, a mortgage broker is a “loan originator”, but neither controls nor makes any decision regarding the valuation method for a transaction.

Q20. Please provide feedback and information, including supporting data, on the advantages and disadvantages to small entities of defining the term “mortgage originator” in section 1125 to cover persons who are “creditors” for purposes of Regulation Z § 1026.2(a)(17). Please also provide any alternatives for consideration and explain the advantages and disadvantages of such alternatives – Again, a mortgage broker is a “loan originator” but is not the ultimate decision maker. The lender/investor dictates what type of property valuation method will be used for a given transaction. Furthermore, per section 1125, the QC standards for the AVM should fall on the lender/investor since they will be choosing the third party vendor. The mortgage broker has no interface with the AMC nor the AVM methodology.

I hope this information is helpful. I’ve been in the residential lending industry in California since 1989. The vast majority of my career was spent as a wholesale account executive, working for large national banks. Mortgage brokers were my customers for 25+ years.

I am happy to answer any questions or to provide more feedback if needed.

I truly appreciate the opportunity to work with this group!
Sincerely,

Kurt Weidner
Broker/Owner
Weidner Financial

APPENDIX C: LIST OF MATERIALS PROVIDED TO SMALL ENTITY REPRESENTATIVES

In advance of the Panel Outreach Meetings, the Bureau provided each of the SERs with the materials listed below.

- Small Business Advisory Review Panel For Automated Valuation Model (AVM) Rulemaking Outline Of Proposals And Alternatives Under Consideration (Feb. 23, 2022).

- Small Business Advisory Review Panel For Automated Valuation Model (AVM) Rulemaking Discussion Guide for Small Entity Representatives (Feb. 23, 2022).

(See Appendix D and Appendix E, respectively.)

In addition to the above materials, SERs also received a copy in advance of the presentation materials for the Panel Outreach Meetings. (See Appendix F).

APPENDIX D: OUTLINE OF PROPOSALS AND ALTERNATIVES UNDER CONSIDERATION

See attached.

SMALL BUSINESS ADVISORY REVIEW PANEL FOR AUTOMATED VALUATION MODEL (AVM) RULEMAKING

OUTLINE OF PROPOSALS AND ALTERNATIVES UNDER CONSIDERATION

February 23, 2022

Contents

I. Introduction

In the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),[1] Congress directed the Consumer Financial Protection Bureau (CFPB or we), along with the Board of Governors of the Federal Reserve System (Board), the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Federal Housing Finance Agency (FHFA) (collectively, the agencies), to develop regulations for quality control standards for automated valuation models (AVMs),[2] which are "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] Specifically, the Dodd-Frank Act added section 1125 to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA);[4] that section requires that AVMs meet quality control standards designed to: (1) ensure a high level of confidence in the estimates produced by automated valuation models; (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.[5]

The statute provides that the eventual section 1125 rule will be enforced by the FDIC, Board, NCUA, and OCC (collectively, prudential agencies) with respect to insured banks, savings associations, and credit unions (collectively, financial institutions), as well as federally regulated subsidiaries that financial institutions own and control.[6] The statute gives the CFPB, as well as the Federal Trade Commission and State attorneys general, enforcement authority with respect to other non-depository participants in the market.[7]

AVMs are being used with increasing frequency. This trend is being driven in part by advances in database and modeling technology and the availability of larger property datasets. Research indicates that 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.[8]

However, the use of AVMs may introduce risks, including issues with data integrity and accuracy. Moreover, like algorithmic systems generally, there are concerns that AVMs may reflect bias in design and function or through the use of biased data and may introduce potential fair lending risk.[9] We believe it is important to mitigate fair lending risk in AVMs and to encourage institutions to implement robust compliance management systems that prevent, identify, and correct violations of nondiscrimination laws. As described in part III.F.2, to address potential fair lending risk in models, we are considering proposing, pursuant to section 1125(a)(5), a requirement that covered institutions establish policies, practices, procedures, and control systems to ensure that their AVMs comply with applicable nondiscrimination laws (we refer to this as a "fifth factor").

FIRREA section 1125 applies to mortgages secured by a consumer's principal dwelling and focuses on the importance of ensuring AVM credibility and integrity. For consumers, obtaining a mortgage is one of the most important financial decisions they will ever make and it is a crucial component of access to homeownership, which can be a key building block of consumer wealth. Overvaluing a home potentially can lead the consumer to take on an increased amount of debt that raises risk to the consumer's financial well-being. On the other hand, undervaluing a home can result in a consumer being denied access to credit for which the consumer is otherwise qualified or offered credit at less favorable terms.[10]

The agencies listed above are working together to develop a proposed rule to implement FIRREA section 1125. However, while agencies generally are required to consider whether the rules they propose will have a significant economic impact on a substantial number of small entities, pursuant to the Regulatory Flexibility Act (RFA),[11] an amendment to the RFA added by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) imposes additional requirements on the CFPB with respect to small entities.[12] Prior to issuing a proposed rule, the CFPB must comply with additional procedural requirements to assess the impact on small entities that are likely to be directly affected by the proposals under consideration. As explained below, these additional SBREFA requirements include collecting small entities' advice and recommendations on the potential impacts of the proposals under consideration and feedback on regulatory alternatives to minimize these impacts.

II. The SBREFA Process

SBREFA directs the CFPB to convene a Small Business Review Panel (Panel) when it is considering proposing a rule that could have a significant economic impact on a substantial number of small entities. The Panel includes representatives from the CFPB, the Office of Information and Regulatory Affairs in the Office of Management and Budget, and the Chief Counsel for Advocacy of the Small Business Administration (Advocacy). Advocacy is an independent office within the Small Business Administration (SBA).

The Panel is required to collect advice and recommendations from small entities or their representatives (referred to as small entity representatives, or SERs) that are likely to be subject to a regulation that the CFPB is considering proposing (in this case, development of the CFPB's proposal also will involve continuing work on an interagency basis with the Board, OCC, FDIC, NCUA, and FHFA). For this purpose, the RFA defines "small entities" as small businesses, small organizations, and small governmental jurisdictions. The term "small business" has the same meaning as "small business concern" under section 3 of the Small Business Act (SB Act); thus, to determine whether a business is a small entity the CFPB looks to the SBA's size standards.[13] The term "small organization" is defined as any not-for-profit enterprise which is independently owned and operated and is not dominant in its field. The term "small governmental jurisdiction" is defined as the governments of cities, counties, towns, townships, villages, school districts, or special districts, with a population of less than 50,000.[14]

Small entities likely to be directly affected by some of the proposals under consideration within the meaning of SBREFA include real estate credit companies, secondary market financing companies, other non-depository credit intermediation companies that originate mortgages, mortgage loan brokers, and other non-depository institutions related to credit intermediation such as mortgage loan servicers. The maximum size standard for any of these non-depository institutions to be considered small is $41.5 million in average annual receipts, though several have lower thresholds.[15] In addition to non-depository institutions for which the statute gives the

CFPB enforcement authority, the CFPB has identified several categories of small depository institutions whose use of AVMs may be directly affected, including commercial banking institutions, savings institutions, credit unions, and other depository institutions related to credit intermediation with assets of $600 million or less.[16]

During the Panel outreach meeting, SERs will provide the Panel with important advice and recommendations on the potential impacts on small entities of the proposals under consideration. The SERs also may provide feedback on regulatory alternatives to minimize these impacts on small entities. In addition, the RFA directs the CFPB to collect the advice and recommendations of SERs concerning whether the proposals under consideration might increase the cost of credit for small entities and alternatives that accomplish the stated objectives of applicable statutes and which minimize any such increase.[17]

Within 60 days of convening, the Panel is required to complete a report on the input received from the SERs during the Panel process. The CFPB will consider the SERs' feedback and the Panel's report as the CFPB prepares the eventual proposed rule on an interagency basis with the Board, OCC, FDIC, NCUA, and FHFA. Once the proposed rule is published, the CFPB is required to place the Panel's final report in the public rulemaking record. The CFPB also welcomes further feedback from the SERs during the public comment period on the proposed rule.

This SBREFA Panel process is an opportunity to obtain input from the SERs on proposals under consideration for AVM quality control standards pursuant to FIRREA section 1125. The CFPB has prepared this Outline of Proposals and Alternatives Under Consideration (Outline) to provide background to the SERs and to facilitate the Panel process. However, the Panel process is only one step in this interagency rulemaking process where the CFPB, as well as the Board, OCC, FDIC, NCUA, and FHFA, have FIRREA section 1125 rulemaking authority. The Panel process should not be construed to represent the views or recommendations of the other agencies involved in the rulemaking. No institution will be required to comply with new regulatory requirements before a proposed rule is published, public comment is received and reviewed by the agencies, a final rule is issued, and the implementation period designated in the final rule concludes.

The CFPB welcomes written feedback from SERs and other stakeholders on this Outline. Please email any such comments to *2022-SBREFA-AVM@cfpb.gov*. The CFPB requests written feedback from SERs by April 8, 2022 in order to be considered and incorporated into the Panel Report. The CFPB requests that other stakeholders wanting to provide written feedback do so no later than May 13, 2022.

Please note that written feedback from SERs will be appended to the Panel Report. Feedback from other stakeholders also may be subject to public disclosure. Do not include personally identifiable information (PII), such as account numbers or Social Security numbers, or names of other individuals. SERs and other stakeholders considering submitting proprietary or confidential business information should contact *2022-SBREFA-AVM@cfpb.gov* in advance to discuss whether and how that information should be provided.

III. Proposals and Alternatives Under Consideration

The purpose of this Outline and the convening of the Panel is to obtain feedback from the selected SERs to inform the CFPB's next major step in implementing FIRREA section 1125, which is to issue a proposed rule together with the Board, OCC, FDIC, NCUA, and FHFA.

FIRREA section 1125 pertains to determining the collateral worth of a mortgage, which implicates important consumer protection and public policy interests and is the subject of other Federal laws and regulations. For example, title XI of FIRREA and the prudential agencies' implementing regulations require a licensed or certified appraiser for certain transactions.[18] Section 129H of the Truth in Lending Act (TILA)[19] and its implementing regulations require lenders to obtain an appraisal by a certified or licensed appraiser—and in some cases two appraisals—for certain higher-risk transactions (termed "higher-priced mortgage loans" or "HPMLs" in the regulations).[20]

In addition to these Federal laws and regulations requiring a licensed or certified appraiser for various transactions, other Federal laws and regulations broadly address determining the collateral worth of a mortgage, whether using an appraisal, AVM, or other method. For consumer credit transactions secured by a consumer's principal dwelling, TILA section 129E[21] and its implementing regulations require valuation independence by, for example, prohibiting material misrepresentation of property value and conflicts of interest for persons preparing valuations or performing valuation management functions.[22] Title XI of FIRREA, as amended by the Dodd-Frank Act, provides that, "[i]n conjunction with the purchase of a consumer's principal dwelling, broker price opinions may not be used as the primary basis to determine the value of a piece of property for the purpose of a loan origination of a residential mortgage loan secured by such piece of property."[23] Section 701(e) of the Equal Credit Opportunity Act (ECOA)[24] and its implementing regulation, Regulation B, generally require creditors to provide applicants for first-lien loans on a dwelling with copies of written valuations developed in connection with an application.[25] Moreover, in part III.F.2 below we discuss how valuations are subject to other provisions of ECOA and other Federal nondiscrimination laws.

Throughout this Outline, we list questions we would like SERs to answer regarding options under consideration. These questions are numbered sequentially throughout this Outline for ease of reference, and begin here:

> Q1. Are there any relevant Federal laws or rules which may duplicate, overlap, or conflict with the options under consideration beyond the FIRREA, TILA, and ECOA laws and implementing regulations discussed herein? How might the options under consideration for implementing FIRREA section 1125 impact other aspects of small entities' compliance with Federal law or rules?

In this part III, we first discuss key issues under the FIRREA section 1125 definition of "automated valuation model" which may determine the scope of transactions covered by an eventual proposed rule. Key definitional issues include: what AVM uses "determine the collateral worth," what are "mortgage originators" and "secondary market issuers," what is a "mortgage," and what constitutes a "consumer's principal dwelling."

Next, we discuss our views of general options for AVM quality control standards, including, on the one hand, a principles-based option that may increase regulated institutions' flexibility and, on the other hand, a prescriptive option with more detailed and specific requirements that may reduce potential compliance uncertainty. We also discuss a potential option for specifying an express nondiscrimination quality control factor for AVMs. Finally, we address options for an implementation period for the eventual final rule under FIRREA section 1125.

A. Defining AVMs used to "determine" the collateral worth

FIRREA section 1125 defines AVMs as computerized models "used by mortgage originators and secondary market issuers to determine the collateral worth" of certain mortgages.[26] Depending on how that phrase in the statute is implemented, the rule's quality control requirements might cover a variety of AVM uses by mortgage originators and secondary market issuers.

In part III.A.1 below, we first discuss the option of focusing on AVMs used for making underwriting decisions regarding the value of collateral. Then, in parts III.A.2 through 5, we discuss options regarding more specific types of AVM uses.

In addition to the options in part III.A, we note that several other key words in the statute will determine whether or not a particular AVM use is covered by the rule's quality control requirements. For example, a mortgage originator (as discussed in part III.B)—or a secondary market issuer (as discussed in part III.C)—along with a mortgage (as discussed in part III.D) secured by a consumer's principal dwelling (as discussed in part III.E) are all necessary to trigger coverage under FIRREA section 1125.

> Q2. Please provide feedback and information, including supporting data, on the options we are considering for implementation of the statutory phrase "to determine the collateral worth"? Besides the options discussed in parts III.A.1 through 5 below, are there any alternative approaches we should consider?

1. AVMs used for making underwriting decisions

We are considering proposing that AVMs are covered when used for making underwriting decisions regarding the value of collateral rather than broadly covering AVMs used to produce *any* valuation estimate. We preliminarily believe such an approach may better accomplish the objectives of FIRREA section 1125 to the extent that underwriting decisions entail a more official valuation than the estimates generated for other activities such as marketing or portfolio monitoring.

FIRREA section 1125 focuses on AVMs used to "determine" the collateral worth,[27] which we preliminarily believe refers to AVMs used to make decisions that affect the terms and conditions of consumer credit. The word "determine" is not defined in the statute but, for example, the first definition in *Black's Law Dictionary* under the entry "determination" is "[t]he act of deciding something officially."[28]

Q3. Does your small entity currently have quality control processes in place for AVMs? If so, please describe those processes, including how they function, what costs (one-time or fixed, and variable) are associated with their implementation and oversight, and whether they differ based on AVM use, *e.g.*, making underwriting decisions versus portfolio monitoring. Are there specific complexities or costs that are different for AVMs used in making underwriting decisions versus for other AVM uses?

Q4. How often does your small entity use AVMs in making underwriting decisions? Does your small entity use AVMs for other purposes, such as monitoring the quality or performance of mortgage loans or mortgage-backed securities? If so, how often are AVMs used for those other purposes?

Q5. Please provide feedback and information, including supporting data, on the option to potentially focus on AVMs used for making underwriting decisions. Besides making underwriting decisions, does your use of AVMs have a direct impact on consumers?

2. Reviews of already completed determinations

Where there is already a completed determination of collateral value (completed determination), we are considering proposing to expressly not cover AVMs used in subsequent reviews of that completed determination. A completed determination is often an appraisal.[29] In certain transactions not requiring a licensed or certified appraiser, a completed determination might entail, for example, an AVM supplemented with a report of the property's actual physical condition. We preliminarily believe an AVM used to develop a completed determination may be distinguishable from an AVM subsequently used to review a completed determination.

We preliminarily believe that expressly not covering AVMs used in reviews of completed determinations may accomplish the objectives of FIRREA section 1125 to the extent that the underlying completed determination is what the creditor relies on "to determine the collateral worth," with the *review* serving a separate and independent quality control function (*i.e.*, to assure the quality of the completed determination). For this reason, we are considering proposing that an AVM used for such review activities is not being used "to determine the collateral worth" and is not covered by the rule.

Moreover, we are considering whether mortgage originators and secondary market issuers, and in particular small entities, might reduce their use of AVMs to review completed determinations depending on compliance costs of an eventual rule implementing FIRREA section 1125. If such reduction occurred, the quality control of the underlying completed determinations might suffer, which could be contrary to the quality assurance objectives of the statute.

Q6. Please provide feedback and information, including supporting data, on the option of expressly not covering AVMs used in subsequent reviews of completed determinations.

Q7. How often does your small entity use AVMs to subsequently review completed determinations? Does your small entity have quality control processes for that type of

AVM use? If so, do they differ from AVM quality control processes when AVMs are used for other purposes?

Q8. What are the advantages and disadvantages for small entities of using AVMs to review completed determinations versus using other non-AVM methods of review?

Q9. What compliance costs would cause your small entity to stop or decrease your use of AVMs to perform quality control reviews of completed determinations?

3. Developing an appraisal by a certified or licensed appraiser

We are considering proposing that an AVM is not covered when used by a certified or licensed appraiser (appraiser) who is already subject to quality control standards under other Federal and State regulation and supervision. As discussed in parts III.B and C below, FIRREA section 1125 applies to AVMs used by "mortgage originators" and "secondary market issuers," respectively.[30] Appraisers generally would not be mortgage originators or secondary market issuers; thus, appraisers themselves generally would not be covered by the eventual rule. But to the extent that an appraiser is in an employment or third-party service provider relationship with a mortgage originator or secondary market issuer, an eventual rule implementing FIRREA section 1125 might require the mortgage originator itself (or the secondary market issuer itself) to ensure that AVMs used by the appraiser adhere to quality control standards.[31] However, we preliminarily believe a mortgage originator's (or secondary market issuer's) responsibility for an AVM used by an appraiser may be distinguishable from a mortgage originator's (or secondary market issuer's) responsibility for an AVM used by other types of employees or service providers. Thus, we are considering proposing that an AVM is not covered when a mortgage originator (or secondary market issuer) relies on an appraisal developed by a certified or licensed appraiser, notwithstanding that the appraiser used the AVM in developing an appraisal.

We preliminarily believe that not covering AVMs used by appraisers to develop an appraisal may be consistent with the objectives of title XI of FIRREA, which contains FIRREA section 1125.[32] This would reflect the fact that appraisals already are subject to quality control standards under Federal and State regulation and supervision as described below. In addition, an appraiser must make a valuation conclusion that is independently supportable and credible and does not rely solely on an AVM to determine the value of the underlying collateral under the Uniform Standards of Professional Appraisal Practice (USPAP).[33] The USPAP have been incorporated by reference into various Federal and State laws, including title XI of FIRREA.[34]

Title XI of FIRREA defines the term "written appraisal" as a written statement used in connection with a federally related transaction that is independently and impartially prepared by a licensed or certified appraiser setting forth an opinion of the defined value of an adequately described property as of a specific date, supported by presentation and analysis of relevant market information.[35] Most lenders require an appraisal before they will originate a mortgage, although the GSEs are increasingly offering appraisal waivers for certain qualifying loans, as discussed in part III.A.5.

FIRREA requires minimum criteria for real property appraisers to obtain a State license or certification.[36] At a minimum, appraisers must be licensed or certified in order to provide appraisals for federally related transactions, but many States require credentialing to provide other appraisals as well.[37] Appraisers must meet certain education, experience, and examination requirements to obtain a State license or certification. Section 1102 of FIRREA established the Appraisal Subcommittee of the Federal Financial Institutions Examination Council (the subcommittee).[38] The functions of the subcommittee include monitoring the requirements established by States for the certification and licensing of appraisers.[39]

USPAP standards and appraiser credentialing already provide a significant degree of quality control over the work of appraisers.[40] In light of these existing quality control measures, we preliminarily believe that excluding appraisals from the scope of the eventual rule might minimize the impacts on small entities while accomplishing the objectives of section 1125.

> Q10. From your experience, how often are AVMs used by certified or licensed appraisers to develop appraisal valuations? What would the impact of the rule be on small entities if it did not cover AVMs when used by certified or licensed appraisers to develop appraisal valuations?
>
> Q11. Would coverage of appraisers' use of AVMs potentially discourage use of AVMs by small entities as a valuation tool?

4. Post-origination

i. Loan modifications and other changes to existing loans

We are seeking advice and recommendations from small entities regarding cases where an AVM is used in deciding whether to change the terms of an existing loan. We currently are considering two alternatives. Under the first alternative, we are considering proposing that the rule cover AVMs used in transactions that result in the consumer receiving a new mortgage origination. Under this option, the rule would cover transactions like refinancings, but not transactions like loan modifications that do not result in a new mortgage origination. Under the second alternative, we are considering proposing that the rule cover any AVM used to decide whether to change the terms of an existing mortgage even if the change does not result in a new mortgage origination, so long as a "mortgage originator" or "secondary market issuer," or a service provider acting on behalf of a mortgage originator or a secondary market issuer, uses the AVM "to determine the collateral worth of a mortgage secured by a consumer's principal dwelling."[41]

We preliminarily believe that the first alternative may be consistent with options we are considering for the definition of the term "mortgage originator." As discussed below in part III.B, we are considering proposing a definition of "mortgage originator" that would include servicers only in certain transactions where the servicer engages in activities that result in a mortgage origination. Those transactions would include transactions that obligate a different consumer on an existing debt (given that from this consumer's perspective the existing debt is a new obligation)[42] as well as transactions that constitute "refinancings" under section

Regulation Z § 1026.20(a).[43] Under Regulation Z § 1026.20(a), a "refinancing" generally occurs "when an existing obligation that was subject to [subpart C of Regulation Z] is satisfied and replaced by a new obligation undertaken by the same consumer."[44]

For similar reasons, we also preliminarily believe that the first alternative also may be consistent with options we are considering for the definition of the term "secondary market issuer." As discussed in greater detail in part III.C, we are considering options for defining the term "secondary market issuer" to include entities that issue residential mortgage-backed securities (RMBS) or, alternatively, to include an issuer, guarantor, insurer, or underwriter of RMBS; but those options for defining "secondary market issuer" would not include a servicer. Because the definition of "secondary market issuers" would not include servicers, the first alternative in this part III.A.4.i would result in coverage of AVMs when the secondary market issuer is engaged in activity that results in a mortgage origination, such as a refinancing, rather than activity that is more typically that of a servicer.

Under the second alternative, we are considering proposing that the rule cover any AVM used to decide whether to change the terms of an existing mortgage even if the change does not result in a new mortgage origination, so long as a mortgage originator or secondary market issuer, or a service provider acting on behalf of a mortgage originator or a secondary market issuer, uses an AVM to determine the collateral worth of a mortgage secured by a consumer's principal dwelling. We preliminarily believe such an option may be consistent with the reference in section 1125 to "mortgage originators and secondary market issuers" because an institution that meets the definition of a "mortgage originator" at the time of mortgage origination, or the definition of "secondary market issuer" at the time of RMBS issuance, may, either directly or through a service provider, subsequently use AVMs in decisions to determine the collateral worth of a mortgage secured by a consumer's principal dwelling.

> Q12. What would be the advantages and disadvantages for small entities of the first alternative (*i.e.*, covering AVMs in transactions like refinancings but not in loan modifications that do not result in a new mortgage origination) versus the second alternative (*i.e.*, broadly covering changes to the terms of an existing mortgage so long as a covered institution or its service provider uses the AVM to determine the collateral worth)? Please also provide any alternatives for consideration.

ii. **Credit line reductions or suspensions**

We understand that creditors use AVMs to monitor home equity lines of credit (HELOCs), which are often held in portfolio, and AVM outputs can factor into a decision to reduce or suspend a borrower's credit line in accordance with the terms of an initial credit agreement (a reduction or suspension decision).[45] Such reduction or suspension decisions are distinct from decisions to change the terms of a credit agreement, which is discussed above in part III.A.4.i.

One potential option we are considering is to expressly not cover AVMs used to make reduction or suspension decisions for HELOCs. As discussed below in parts III.B and C, we are considering potential definitions of the terms "mortgage originator" and "secondary market issuer" that are focused on mortgage origination and securities issuance activities, rather than activities relating to mortgage servicing. We likewise are considering proposing that reduction or suspension decisions would not be covered so long as they were made in accordance with *an initial agreement* and did not involve a new mortgage origination. Unlike reductions and suspensions, increases to a home equity credit line typically require a new mortgage origination and would therefore be covered as discussed above in part III.A.4.i.

In contrast with the first option, another potential option we are considering is to broadly cover reduction or suspension decisions whenever the institution making the reduction or suspension decision is a mortgage originator or secondary market issuer—or their service provider—and the AVM is used to determine the collateral worth of a mortgage secured by a consumer's principal dwelling. We preliminarily believe that this option may be consistent with the second alternative being considered in part III.A.4.i above, because an institution that meets the definition of a "mortgage originator" at the time of mortgage origination, or the definition of "secondary market issuer" at the time of RMBS issuance, may, either directly or through a service provider, subsequently use AVMs in reduction or suspension decisions to determine the collateral worth of a mortgage secured by a consumer's principal dwelling. We note that section 1125 references AVMs used by "mortgage originators and secondary market issuers," but does not expressly reference AVMs used by mortgage servicers. As a result, this option would cover mortgage originators and secondary market issuers when they—or a servicer acting on their behalf—service their mortgages, but would not cover entities that subsequently acquire the mortgage if such institution is not a mortgage originator or secondary market issuer. For example, under this option, in instances where a covered institution sold the mortgage and transferred the servicing to another entity that is not itself a mortgage originator or secondary market issuer, an AVM used by the subsequent institution would not be covered.

> Q13. What are the advantages and disadvantages for small entities of the option to exclude decisions to reduce or suspend a HELOC as provided in an initial credit agreement from the scope of section 1125 versus the alternative option that covers reduction or suspension decisions more broadly?

iii. **Securitization**

A potential option we are considering for the proposal to implement the statutory phrase "to determine the collateral worth" is excluding a secondary market issuer's use of an AVM in the offer and sale of residential mortgage-backed securities (securitization). This discussion is separate from a secondary market issuer's use of an AVM in a mortgage loan origination (as discussed in part III.A.5) to determine the collateral worth of a mortgage secured by a consumer's principal dwelling. For example, even if securitization were excluded, when a Government Sponsored Enterprise (GSE) has relied on a proprietary computer model to offer an appraisal waiver to a lender originating a mortgage loan, the GSEs' use of the model would be subject to the eventual AVM rule.

We are considering whether certain statutory and policy considerations weigh for or against excluding securitizations from the scope of the eventual rule, including whether doing so could potentially minimize the impacts on small entities while accomplishing the statutory objectives.

The definition of an AVM in FIRREA section 1125 does not expressly include or exclude AVMs used in securitization.

If securitization usually relies on the valuations provided by mortgage originators "to determine the collateral worth" rather than relying on any AVM use by secondary market issuers, it is possible that including securitization in the scope of the eventual rule might only cover a small amount of incremental AVM usage. In that case, we are considering whether the benefits of covering the few instances where secondary market issuers use AVMs "to determine the collateral worth" in securitization potentially do not warrant the potential costs or other compliance risks for those entities.

On the other hand, section 1125 expressly covers "secondary market issuers," and securitization is a substantial part of secondary market issuers' involvement with mortgage markets. We are considering whether ensuring quality control standards for AVMs used by secondary market issuers in connection with securitization could help prevent a distortion of demand for mortgages that may incentivize originators to over- or under-invest in certain segments in the market.

> Q14. What would be the impact of the rule on small entities if securitization was excluded from the scope of the eventual rule?
>
> Q15. Does your small entity offer and sell mortgage-backed securities? If so, does your small entity use AVMs to produce any estimates of the collateral worth of a mortgage secured by a consumer's principal dwelling in connection to the securitization process? What quality control standards does your small entity already have in place for AVMs used in securitization?

Excluding AVMs used in securitization is one of various, non-mutually exclusive options discussed in this Outline that could potentially minimize the impacts on small entities while accomplishing the statutory objectives. For example, as discussed in part III.A.2 above, we preliminarily believe that expressly not covering AVMs used in reviews of completed determinations would mitigate compliance burden for small secondary market issuers. As discussed in part III.F.1 below, in contrast to a prescriptive rule with more detailed and specific requirements, the option of a flexible, principles-based rule regarding AVM quality control standards may, among other things, mitigate compliance burden for small secondary market issuers because institutions could tailor their quality controls for AVMs as appropriate for the size and risk profile of the institution.

> Q16. How might coverage of AVMs used in securitization by the eventual rule change the secondary mortgage market for small entities? In particular, would covering AVMs used in securitization have the potential to affect the cost or availability of credit for small entity consumers?
>
> Q17. If the eventual rule covered AVMs used in securitization, how might the potential impacts on small entities be mitigated by one or more of the other options we are considering in this Outline? Besides the options discussed in this Outline, are there any alternative approaches we should consider for mitigating potential impacts on securitization for small entities?

5. Certain AVM use related to appraisal waiver loans

We are considering whether to implement the statutory phrase "to determine the collateral worth" to exclude a mortgage originator's use of certain AVMs for transactions where the secondary market issuer's use of an AVM is covered instead.

Appraisal waivers are offers to waive the appraisal requirement for originations.[46] In the current market, appraisal waivers are primarily issued by GSEs. To determine if a loan qualifies for a waiver, the mortgage originator provides a purchase price or estimated value of the property to the secondary market issuer along with loan characteristics.[47] The data is then processed through the secondary market issuer's internal AVM and compared with listed use and loan-to-value ratio requirements. The secondary market issuer then determines whether the estimated value satisfies the requirements for a waiver given the property characteristics and any other relevant factors.[48] When an appraisal waiver is exercised by a mortgage originator, the GSE accepts the estimate submitted as the market value and provides relief from enforcement of representations and warranties on the value of the property.[49]

The proportion of GSE loans using appraisal waivers increased from less than 10 percent prior to June 2019 to an average of 36 percent during 2020, in part due to the COVID-19 pandemic.[50] Appraisal waivers can shorten loan manufacture time,[51] remove an obstruction to refinancing,[52] and eliminate the cost of traditional appraisals.[53] A 2018 FHFA report on appraisal waivers concluded that due to their modest size and stringent eligibility standards the risks of the GSE appraisal waiver programs were small.[54] Despite an increasing proportion of GSE loans using appraisal waivers, in its 2020 Request For Information on Appraisal Related Policies, FHFA acknowledged that because the majority of appraisal waivers are offered on rate and term refinance loans already held by GSEs, the lower borrower payments can reduce credit risk.[55] However, in the same report, FHFA cited risks stemming from increased repayment speeds on mortgage securities, loss of ability to assess recent property condition, decline in accuracy of appraisal data, increased model error, erosion of loan quality, and potential gaming by lenders.[56]

We are considering proposing to exclude a mortgage originator's use of certain AVMs for transactions where the secondary market issuer's use of an AVM is covered instead. We are considering two potential options.

To the extent that a mortgage originator does not "determine the collateral worth" in appraisal waiver settings, one option is to exclude the mortgage originator's use of the secondary market issuer's AVM for appraisal waiver programs. We recognize that when a mortgage originator applies for an appraisal waiver, the mortgage originator typically does not have access to the secondary market issuer's underlying AVM. Under this option, the secondary market issuer, and not the mortgage originator, would be responsible for ensuring compliance with quality control standards.

To the extent that a mortgage originator does not "determine the collateral worth" in appraisal waiver settings, a second option is to exclude the mortgage originator's use of any AVM used exclusively to determine whether a loan qualifies for an appraisal waiver program or to generate a value estimate exclusively for an appraisal waiver program. If the mortgage originator's use of an AVM in the appraisal waiver process is excluded from the scope of the rule, the secondary market issuer's use of an AVM would still be covered by the rule. As discussed in part III.C below, we are considering proposing a definition of "secondary market issuer" to include entities such as guarantors, insurers, or underwriters of RMBS that are not necessarily RMBS issuers.

> Q18. What would be the advantages and disadvantages for small entities of excluding a mortgage originator's use of an AVM for appraisal waiver purposes in transactions where the secondary market issuer's use of an AVM is covered instead?

B. Defining "mortgage originators"

FIRREA section 1125 covers AVMs used by "mortgage originators," but does not define the term.[57] We are considering options for a definition of "mortgage originator" that seek to minimize the potential impacts on small entities, while achieving the objectives of section 1125 and maintaining consistency with other defined terms in the eventual rule.[58] These include options that would be consistent with the Truth in Lending Act (TILA)[59] and Regulation Z.[60] We preliminarily believe that using a definition of "mortgage originator" that draws heavily from other consumer financial laws, such as TILA and Regulation Z, may provide participants in the mortgage lending market with a greater degree of clarity regarding whether they would be considered "mortgage originators" for purposes of a rule implementing section 1125.

1. General definition of mortgage originator

We are considering proposing a definition of "mortgage originator" under section 1125 that would cover persons[61] who are "loan originators" for purposes of Regulation Z § 1026.36. Regulation Z defines "loan originator" as a person who:

> in expectation of direct or indirect compensation or other monetary gain or for direct or indirect compensation or other monetary gain, performs any of the following activities: takes an application, offers, arranges, assists a consumer in obtaining or applying to obtain, negotiates, or otherwise obtains or makes an extension of consumer credit for another person; or through advertising or other means of communication represents to the public that such person can or will perform any of these activities.[62]

We further are considering proposing a definition of "mortgage originator" under section 1125 that would cover persons who are "creditors" for purposes of Regulation Z § 1026.2(a)(17).[63]

Regulation Z provides that "creditor" means, in part, "[a] person who regularly extends consumer credit that is subject to a finance charge or is payable by written agreement in more than four installments (not including a down payment), and to whom the obligation is initially payable, either on the face of the note or contract, or by agreement when there is no note or contract."

> Q19. Please provide feedback and information, including supporting data, on the advantages and disadvantages to small entities of defining the term "mortgage originator" in section 1125 to cover persons who are "loan originators" for purposes of Regulation Z

§ 1026.36(a)(1). Please also provide any alternatives for consideration and explain the advantages and disadvantages of such alternatives.

Q20. Please provide feedback and information, including supporting data, on the advantages and disadvantages to small entities of defining the term "mortgage originator" in section 1125 to cover persons who are "creditors" for purposes of Regulation Z § 1026.2(a)(17). Please also provide any alternatives for consideration and explain the advantages and disadvantages of such alternatives.

2. Defining mortgage originator to cover servicers under limited circumstances

We further are considering proposing a definition of "mortgage originator" under section 1125 that, under limited circumstances, would cover persons who are "servicers" for purposes of Regulation Z § 1026.36(c).

As explained in part III.B.1 above, we are considering proposing a definition of the term "mortgage originator" that covers persons who are "loan originators" under Regulation Z. Though the definition of "loan originator" under Regulation Z generally excludes servicers, it includes servicers and their employees, agents, or contractors when they perform loan origination activities with respect to any transactions that constitute "refinancings" under Regulation Z § 1026.20(a) or that change an obligor.[64] For example, under Regulation Z, a "refinancing" generally occurs "when an existing obligation that was subject to [subpart C of Regulation Z] is satisfied and replaced by a new obligation undertaken by the same consumer."[65] For purposes of section 1125, we likewise are considering proposing a definition of "mortgage originator" that would cover persons who are servicers for purposes of Regulation Z § 1026.36(c), but only to the extent that they perform loan origination activities for transactions (i) that constitute refinancings under Regulation Z § 1026.20(a) or (ii) that change an obligor on an existing debt.

Q21. Please provide feedback and information, including supporting data, on the advantages and disadvantages to small entities of defining the term "mortgage originator" in section 1125 to cover persons who are "servicers" for purposes of Regulation Z § 1026.36(c) to the extent that they perform loan origination activities for purposes of Regulation Z § 1026.36(a)(1) with respect to transactions (i) that constitute refinancings under Regulation Z § 1026.20(a) or (ii) that change an obligor on an existing debt. Please also provide any alternatives for consideration and explain the advantages and disadvantages of such alternatives.

C. Defining "secondary market issuers"

FIRREA Section 1125 does not define the term "secondary market issuer" and the term does not appear elsewhere in the Dodd-Frank Act or FIRREA.[66] We are considering options for a definition of "secondary market issuer" that are consistent with other relevant portions of the Dodd-Frank Act, and could potentially minimize the impacts on small entities while achieving the objectives of section 1125.

One option is to define the term "secondary market issuer" to include only entities that issue RMBS. A second option is to define the term more broadly to mean an issuer, guarantor, insurer, or underwriter of RMBS. We preliminarily believe that the appropriate definition of "secondary market issuer" may rely in part on whether AVMs used in securitization are covered by the eventual proposed rule, as discussed in part III.A.4.iii above.

The secondary market uses AVMs for multiple purposes. One main use of AVMs by the secondary market is in the offer and sale of RMBS (securitization) by RMBS issuers. A second main use of AVMs by the secondary market is determining whether a property satisfies the requirements for an appraisal waiver during mortgage origination, as discussed in part III.A.5. We understand that for some mortgages an appraisal waiver is issued by an RMBS issuer, who will incorporate those mortgages into a pool underlying the RMBS; but for other mortgages, an appraisal waiver may not be issued by an RMBS issuer but, rather, by a guarantor, insurer, or underwriter of RMBS.

We preliminarily believe that a broader definition of "secondary market issuers" could provide greater regulatory consistency among RMBS issuers, guarantors, insurers, and underwriters. A broader definition of the term may also be more consistent with other relevant provisions of the Dodd-Frank Act. Section 1473 of the Dodd-Frank Act,[67] which added section 1125 to title XI of FIRREA, also added section 1124, to establish minimum requirements for the registration and supervision of appraisal management companies (AMCs).[68] For purposes of section 1124, section 1121 defines an AMC with reference to an institution that performs services "[i]n connection with valuing properties collateralizing mortgage loans or mortgages incorporated into a securitization," when such services are authorized by, among others, a "principal in the secondary mortgage markets."[69] In implementing section 1124, the agencies published a final rule in 2015 that defines the term "secondary mortgage market participant" as "a guarantor or insurer of mortgage-backed securities, or an underwriter or issuer of mortgage-backed securities."[70] While the terms "secondary mortgage market participant" and "secondary market issuer" differ, both sections 1124 and 1125 address secondary mortgage markets. Both sections also provide rulemaking authority to the same agencies.[71] We are considering whether aligning the definition of "secondary market issuer" with the existing definition of "secondary mortgage market participant" could provide increased clarity and, as noted above, the appropriate definition may rely in part on whether AVMs used in securitization are covered by the eventual proposed rule, as discussed in part III.A.4.iii above.

Q22. Please provide feedback and information, including supporting data, on whether one of the "secondary market issuer" definitions under consideration would be less burdensome for small entities to implement and to administer than the other?

D. Defining "mortgage"

In addition to covering AVMs used by "mortgage originators," section 1125(d) of FIRREA further limits coverage to AVMs used "to determine the collateral worth of a mortgage secured by a consumer's principal dwelling."[72] The word "mortgage" is not defined in the statute. To clarify the type of transactions that this statutory language encompasses, we are considering proposing two alternative definitions of "mortgage."

The first alternative we are considering proposing would be to define "mortgage" as an extension of credit secured by a dwelling.[73] We preliminarily believe focusing on extensions of credit is consistent with other provisions in title XIV of the Dodd-Frank Act.[74]

The second alternative we are considering proposing would be to define the term "mortgage" as a 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 dwelling. This second definition may better implement the statutory objectives by including security interests arising under installment land contracts and any other security interests that may not be understood as credit. We note that terms such as "mortgage originator," discussed in part III.B above, may need to be adjusted to include these types of transactions if this definition of "mortgage" is used.

> Q23. Please provide feedback and information, including supporting data, on whether one of the "mortgage" definitions under consideration would be less burdensome for small entities to implement and to administer than the other? Please also provide any alternatives for consideration and explain the advantages and disadvantages of such alternatives.

> Q24. Are AVMs commonly used with installment sales contracts or similar transactions? How often are they used and in what way? On what are you basing your answer?

E. Defining "consumer's principal dwelling"

FIRREA section 1125(d) defines an AVM by reference to "a mortgage secured by a consumer's principal dwelling."[75] Neither FIRREA section 1125 nor title XI of FIRREA[76] defines "consumer's principal dwelling." We are considering whether using a definition that is derived from existing related regulatory requirements could minimize the potential impacts on small entities while achieving the objectives of FIRREA section 1125. Specifically, we are considering proposing to base a definition of "consumer's principal dwelling" generally on how the phrase is used in the CFPB's provisions on valuation independence codified in Regulation Z § 1026.42. The valuation independence regulation applies to certain credit transactions secured by the "consumer's principal dwelling" but also does not define the phrase. This part III.E discusses how Regulation Z's valuation independence regulation uses each component of the phrase "consumer's principal dwelling" and asks questions relating to their use in the AVM rulemaking.

1. Coverage of "consumers"

We are considering proposing a definition that would consider a consumer to be a natural person to whom credit is offered or extended.

Like FIRREA section 1125, the Regulation Z valuation independence regulation states that it applies only to transactions secured by the consumer's principal dwelling.[77] TILA defines "consumer," when used with reference to a credit transaction, as "characteriz[ing] the transaction as one in which the party to whom credit is offered or extended is a natural person, and the money, property, or services which are the subject of the transaction are primarily for personal, family, or household purposes."[78] Regulation Z defines "consumer" for general TILA purposes as a "natural person to whom consumer credit is offered or extended" and explains that for certain purposes the term includes "a natural person in whose principal dwelling a security interest is or will be retained or acquired, if that person's ownership interest in the dwelling is or will be subject to the security interest."[79]

Unlike TILA, however, FIRREA section 1125 does not generally limit its coverage to consumer transactions that are primarily for personal, family, or household purposes. In order to retain consistency with the broader scope of FIRREA section 1125, if we propose a TILA-based definition of "consumer's principal dwelling," we are also considering proposing language that clarifies that the definition does not exclude mortgages for which the proceeds are used for other purposes, as long as the mortgage is secured by a consumer's principal dwelling.[80]

> Q25. Please provide feedback and information, including supporting data, on whether the term "consumer" should extend to individuals who are not a party to whom credit is offered or extended, but who have an ownership interest in and use the secured property as their principal dwelling. Please also provide feedback and information, including supporting data, about additional costs or benefits, if any, that would result for small entities from a more inclusive designation of who is a "consumer."
>
> Q26. From your experience, is there a difference between consumer-purpose and business-purpose mortgage lending regarding the relative prevalence of AVMs and in-person appraisals used to determine the worth of the collateral? Do you expect this relative usage to change in the next five years and, if so, how? Please provide any supporting feedback and information, including supporting data.

2. Coverage of "dwelling"

FIRREA section 1125(c)(2) grants enforcement authority to certain agencies, including the CFPB, over "participants in the market for appraisals of 1- to 4-unit single-family residential real estate."[81] The focus on 1- to 4-residential units is also seen in several TILA mortgage-related provisions, such as the valuation independence requirements, that are subject to the general TILA definition of "dwelling." TILA defines "dwelling" as meaning a residential structure or mobile home which contains one to four family housing units, or individual units of condominiums or cooperatives."[82]

For purposes of defining "consumer's principal dwelling" in the AVM rule, we are considering proposing to treat "dwelling" as meaning a residential structure that contains one to four units, whether or not that structure is attached to real property, and including an individual condominium unit, a cooperative unit, a manufactured home, and any other structure used as a residence, regardless of whether the structure is classified as personalty under State law. This treatment would be generally consistent with how the TILA term "dwelling" is implemented in Regulation Z.[83]

Alternatively, we are considering proposing to limit the treatment of "dwelling" to transactions in which the dwelling is secured by real property. This approach to coverage would be consistent with certain other mortgage-related authorities we exercise, such as Real Estate Settlement Procedures Act requirements applicable to federally related mortgage loans, which under Regulation X are defined to cover loans for residential structures or manufactured homes only if the loans will be secured by a lien on real property.[84]

> Q27. Please provide feedback and information, including supporting data, on the approach we are considering in defining "dwelling" along with an explanation and supporting data for any alternative approaches we should consider.

> Q28. Would limiting coverage of the AVM requirements to dwelling loans secured by real property be significantly less burdensome for small entities than extending coverage to all dwelling-secured loans? Please provide any feedback and information, including supporting data, to support your response.

3. Limiting coverage to "principal" dwelling

As discussed above, the requirements for both the AVM quality control standards in FIRREA section 1125 and the valuation independence requirements in TILA and Regulation Z reference a consumer's "principal" dwelling.[85]

i. "Principal" dwelling

We are considering proposing, as part of the definition of "consumer's principal dwelling" a clarification that the consumer can reside in only one principal dwelling at a time. This clarification would be consistent with the Regulation Z valuation independence regulation, which provides in commentary that the term has the same meaning as in several other Regulation Z provisions.[86] These provisions further explain that a vacation or other second home would not be a principal dwelling. We also are considering proposing a similar clarification about secondary residences in the definition of the general term "consumer's principal dwelling."

> Q29. Please provide feedback and information, including supporting data, on the approach we are considering in defining a "principal" dwelling. Please also provide any alternatives for consideration and explain, including supporting data, the advantages, and disadvantages for small entities of these alternatives.

ii. Treatment of new construction

Because of the nature of mortgage transactions involving the construction of new residential real estate, the CFPB is considering addressing coverage of these transactions in its AVM proposal. Specifically, we are considering proposing that, if a consumer seeks financing for a dwelling under construction or to be constructed and that will become the consumer's principal dwelling upon or within a year following completion of construction, the transaction secured by the new dwelling would be considered a transaction secured by a "principal" dwelling, even before occupancy. This approach would be generally consistent with Regulation Z § 1026.42, which provides in commentary that the term "primary dwelling" has the same meaning as the term is used in several other Regulation Z provisions that adopt a similar approach to new construction.[87]

> Q30. Are there additional categories of dwellings or transactions that should be considered for addressing in a proposal on how to designate "principal" dwelling for the purposes of implementing the FIRREA section 1125 AVM quality control standards? If so, how should each of the additional categories be addressed? Please provide an explanation and any data available to support your suggestions.

F. Scope of eventual rule requirements

1. Quality control standards generally

As explained above, section 1125(a) of FIRREA requires that AVMs 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; (4) require random sample testing and reviews; and (5) account for any other such factor that the agencies determine to be appropriate. Section 1125(b) requires the agencies to promulgate regulations to implement these quality control standards. In regard to the first four factors, the CFPB is considering proposing two alternative methods for compliance.

In the first alternative for compliance with the quality control factors, the CFPB is considering proposing to require regulated institutions to adopt and maintain their own policies, practices, procedures, and control systems to ensure that AVMs used for covered transactions adhere to quality control standards designed to meet those factors, but not proposing specific requirements for those policies, practices, procedures, and control systems. For the second alternative regarding the quality control factors, the CFPB is considering proposing a prescriptive rule with more detailed and specific requirements in regard to the first four factors. (The CFPB is also considering proposing that the fifth factor listed above be specified to require compliance with applicable nondiscrimination laws; that issue will be discussed in the section immediately following this one.)

The CFPB notes that the first four statutory quality control factors appear to be consistent with several agencies' existing guidance regarding models. For example, the OCC, Board, FDIC, and NCUA issued the *Interagency Appraisal and Evaluation Guidelines* (Guidelines), which contain guidance for institutions seeking to establish policies, practices, procedures, and control systems to ensure the accuracy, reliability, and independence of AVMs.[88] In addition, the CFPB notes that the quality control factors required by the statute also appear to be consistent with the principles on model risk management issued by the OCC, Board, and FDIC (Model Risk Guidance), which outlines supervisory guidance on the validation and testing of computer-based financial models.[89] The CFPB also understands that, while not a party to the Model Risk

Guidance, the NCUA monitors the model risk and data validation efforts of credit unions through its supervisory approach based on the principles of the Guidelines and NCUA's expectations for effective risk management. The first four statutory quality control factors also appear to be consistent with the FHFA's model risk management guidance in the development, validation, and use of models.[90]

To increase regulated institutions' flexibility, and in light of agencies' existing guidance regarding models discussed above, the CFPB is considering proposing a principles-based rule that requires regulated institutions to adopt and maintain their own AVM policies, practices, procedures, and control systems to satisfy the statutory quality control factors. Subject to further consideration to ensure practicality, enforceability, and statutory consistency, the CFPB preliminarily believes that different policies, practices, procedures, and control systems may be appropriate for institutions with different business models and risk profiles, and a more prescriptive rule potentially could unduly restrict institutions' efforts to tailor their risk management practices accordingly. Similarly, as the technology underlying AVMs continues to evolve, a prescriptive rule that details specific quality control requirements could potentially become outdated in a relatively short time. In addition, a rule that includes prescriptive standards for AVM use may present significant burden for small entities in fulfilling these prescriptive requirements. This could lead to reduced use of AVMs by small entities. Furthermore, as noted earlier, several agencies have existing guidance regarding use of models already in place to assist regulated institutions in designing their own standards to meet the first four statutory factors, which the CFPB could adapt as guidance, rather than adopting specific requirements. Accordingly, a rule that requires institutions to develop and maintain their own policies, practices, procedures, and control systems designed to satisfy the statutory factors may more effectively carry out the objectives of section 1125 than a more detailed, prescriptive rule, while imposing less regulatory burden than a prescriptive rule.

Alternatively, although a flexible and principles-based rule may provide the advantages described above, the CFPB is also considering whether to propose a prescriptive rule, which would propose more detailed and specific requirements to aid compliance with the first four statutory factors for the institutions it regulates. A prescriptive rule may aid compliance by providing lenders and regulators with more certainty on how to fulfill the quality control standards.

The CFPB notes that it has not issued AVM-specific guidance similar to that issued by the other agencies. Because the other agencies may already have provided sufficient guidance to their regulated institutions to help ensure compliance, the CFPB is considering proposing that the more detailed and specific requirements under the second alternative apply only to those institutions that the statute places under the authority of the CFPB. The CFPB is further considering proposing to include such requirements in an appendix or official commentary appended to the CFPB's rule alone, which would allow for consistency in the main regulatory text proposed by all the agencies.

Q31. Would small entities be assisted by the CFPB adapting the Guidelines for use by CFPB-regulated institutions and adopting them as guidance rather than adopting specific requirements to implement the statutory quality control factors?

Q32. Would a more prescriptive rule be helpful to small entities? Would it present heightened regulatory burden? Why?

As explained above, under the second alternative the CFPB is considering proposing to include an appendix or official commentary presenting quality controls for AVMs to specify how CFPB-regulated institutions would address the statutory quality control factors (as restated in the main regulatory text proposed by all the agencies). Examples of potential requirements for each quality control factor are provided below. The CFPB and the other agencies recognize that model risk management practices will vary from institution to institution. Therefore, as the other agencies do with their guidance, the CFPB is considering whether to clarify that the practical application of the quality control requirements would be commensurate with an institution's risk exposures, size, business activities, and the extent and complexity of its use of AVMs. In addition, SERs should be aware that the examples below do not present the full requirements that the CFPB would consider proposing, which would be based on the agencies' existing valuation guidance.

Under the first statutory quality control factor, institutions must ensure a high level of confidence in the estimates produced by AVMs. For this factor, the CFPB is considering proposing specific requirements that would address, for example, risks that AVMs may suffer from fundamental errors and may produce inaccurate outputs when viewed against the design objective and intended business uses, as well as risks that AVMs may be used incorrectly or inappropriately.

Under the second quality control factor, institutions must protect against the manipulation of data in connection with AVMs. The CFPB is considering proposing specific requirements to ensure that institutions, for example, provide appropriate management oversight of the availability, usability, integrity, and security of the data used.

The third quality control factor requires that the use of AVMs must seek to avoid conflicts of interest. For this factor, the CFPB is considering proposing specific requirements to ensure that an institution's AVM model governance program, for example, provides certainty that the persons who develop, select, validate, or monitor an AVM are all independent of the loan origination or securitization process.

Under the fourth quality control factor, institutions must require random sample testing and reviews of AVMs. The CFPB is considering proposing specific requirements ensuring that an institution establishes ongoing AVM validation through random sample testing and reviews. These specific requirements would address, for example, the specifications for such testing and reviews to address whether a particular AVM is appropriate for a given transaction or lending activity, considering associated risks.

Q33. Do the examples of specific requirements described for the first four statutory factors appear likely to aid your small entity in implementation of those factors? Are there specific requirements that you believe should be included, consistent with the statutory factors? Does your small entity anticipate facing any specific complexities or costs associated with specific requirements?

Q34. Should the CFPB allow each institution to tailor its methodology to the nature of its risk exposure, size, business activities, and the extent and complexity of its use of AVMs? Do you have suggestions on the best way to do so?

2. Specifying a nondiscrimination quality control factor

As explained above, section 1125(a)(5) of FIRREA provides the agencies the discretion to account for any other such factor that the agencies determine to be appropriate.[91] The CFPB is considering proposing that we specify that nondiscrimination quality control criteria are appropriate under this fifth statutory factor, for the reasons described in this section.

While compliance with applicable nondiscrimination laws with respect to AVMs may be encompassed within three of the first four statutory quality control factors, the first four statutory factors do not expressly address quality control standards designed to protect against unlawful discrimination. However, algorithmic systems such as AVMs are subject to Federal nondiscrimination laws,[92] including the Equal Credit Opportunity Act (ECOA)[93] and the Fair Housing Act (FHAct).[94]

ECOA and its implementing Regulation B bar discrimination on a prohibited basis in any aspect of a credit transaction.[95] This prohibition extends to using different standards to evaluate collateral,[96] which would include the design or use of an AVM in a way that would treat an applicant differently on a prohibited basis or result in unlawful discrimination against an applicant on a prohibited basis.

The CFPB has recognized the following methods of proving lending discrimination under ECOA and Regulation B: overt evidence of discrimination, evidence of disparate treatment, and evidence of disparate impact.[97] Overt evidence of discrimination exists when a creditor blatantly discriminates on a prohibited basis.[98] Disparate treatment occurs when a creditor treats an applicant differently based on a prohibited basis such as race or national origin.[99] Disparate impact occurs when a creditor employs facially neutral policies or practices that have an adverse effect or impact on a member of a protected class unless the facially neutral policies or practices meet a legitimate business need that cannot reasonably be achieved by means that are less disparate in their impact.[100]

A creditor that uses an AVM model in connection with any aspect of a credit transaction may violate ECOA and Regulation B if, for example, the model uses a prohibited basis (or proxy for a prohibited basis) as an input in the model, or the use of the model has an adverse impact on members of a protected class either that does not meet a legitimate business need or where that need could be reasonably achieved through alternative means that are less disparate in their impact, such as use of an alternative variable(s) within the model or an alternative model.

We are considering the potential positive and negative consumer and fair lending implications of the use of AVMs. AVMs leverage various types of data and modeling techniques, generating a property value within seconds. The speed of AVMs offers advantages for borrowers, such as lower cost originations and faster closings. Additionally, because AVMs typically involve less human interaction than do appraisals, AVMs have the potential to reduce certain types of discrimination (*e.g.*, overt or intentional discrimination). Yet, like algorithmic systems generally, there are concerns that AVMs may reflect bias in design and function or through the use of biased data and may introduce fair lending risk.[101]

The "black box" nature of many algorithms, including those used in AVMs, introduces additional fair lending concern. The complex interactions that machine learning algorithms engage in to form a decision can be so opaque that they are not easily audited or understood.[102] This makes it challenging to prevent, identify, and correct discrimination.

Moreover, algorithmic systems—including AVMs—can replicate historical patterns of discrimination or introduce new forms of discrimination because of the way a model is designed, implemented, and used.[103] For example, in the healthcare context, a widely used algorithm for determining which hospital patients required additional care allocated Black patients less care than similarly situated White patients.[104] Bias occurred because the algorithm used health costs as a proxy for health needs, but previous unequal access to care meant that less money was spent caring for Black patients than for White patients.[105] Thus, the algorithm falsely concluded that Black patients were healthier than equally sick White patients.[106] The number of Black patients selected for additional care would have nearly doubled if the bias had been eliminated.[107]

Algorithmic bias concerns may arise with AVMs if, for example, the model systematically over- or undervalues properties in neighborhoods of color. Such a result hurts borrowers and entire communities. Overvaluing a home can potentially lead the consumer to take on an increased amount of debt that raises risk to the consumer's financial well-being. On the other hand, undervaluing a home can result in a consumer being denied access to credit for which the consumer otherwise qualified, potentially resulting in a canceled sale, or offered credit at less favorable terms.[108]

Thus, the CFPB is considering including an AVM quality control factor focused on nondiscrimination given the risk of bias in algorithmic systems. It is critical for AVM model risk to be mitigated with proper fair lending controls and governance.

The agencies have issued a number of documents addressing how institutions may identify and manage fair lending risk. For example, the OCC, Board, FDIC, NCUA, and CFPB have issued statements and other materials setting forth principles the agencies will consider to identify discrimination.[109] The OCC, Board, FDIC, NCUA, and CFPB also recently underscored the importance of robust consumer compliance review in an Interagency Policy Statement on the Use of Alternative Data in Credit Underwriting.[110] Specifically, the agencies emphasized that "[r]obust compliance management includes appropriate testing, monitoring and controls to ensure consumer protection risks are understood and addressed."[111] In addition, we have published procedures for CFPB examiners to use to assess an institution's fair lending related risks and controls related to the use of models—including, potentially, AVMs—in the credit decision process.[112] Thus, we preliminarily believe requiring institutions using AVMs to adopt fair lending compliance policies and practices would be consistent with current fair lending guidance.

As stated above and for all the reasons discussed, we are considering proposing to specify a fifth quality control factor to require regulated institutions to adopt policies, practices, procedures, and control systems designed to ensure that AVMs used for covered transactions comply with applicable nondiscrimination laws. We preliminarily believe standards designed to ensure compliance with applicable nondiscrimination laws may help ensure the accuracy, reliability, and independence of AVMs for all consumers and users. While institutions have a preexisting obligation to comply with Federal nondiscrimination requirements, including ECOA and the FHAct, a specific quality control factor under section 1125(a)(5) would create an independent requirement for institutions to establish policies and procedures to mitigate against fair lending risk in their use of AVMs.

If such a quality control factor is added, we are considering proposing that institutions would have the flexibility to design fair lending policies, practices, procedures, and control systems tailored to their business model, as explained in part III.F.1 concerning the first four statutory quality control factors. Controls need to be commensurate with an institution's risk exposures, size, business activities, and the extent and complexity of its use of AVMs. Subject to further consideration to ensure practicality, enforceability, and statutory consistency, we preliminarily believe that different fair lending policies, practices, procedures, and control systems may be appropriate for institutions with different business models and risk profiles, and a more prescriptive rule potentially could unduly restrict institutions' efforts to tailor their fair lending risk management practices accordingly. Similarly, as the technology underlying AVMs continues to evolve, a rule that prescribes specific fair lending quality control requirements could potentially become outdated in a relatively short time.

As an alternative, for reasons similar to the discussion in part III.F.1 concerning the first four quality control factors, we are also considering whether to take a more prescriptive approach and propose specific requirements for the fifth quality control factor on fair lending. In regard to the fifth factor, for example, such prescriptive requirements could address risks that lending decisions based on AVM outputs generate unlawful disparities, by specifying methods of AVM development (*e.g.*, data sources, modeling choices) and AVM use cases. As explained in the previous part, we are considering proposing to include such requirements in an appendix or official commentary appended to the CFPB's rule.

As an alternative to adopting a fifth factor, we are considering whether compliance with applicable nondiscrimination laws with respect to AVMs is already encompassed within three of the first four statutory quality control factors requiring a high level of confidence in the estimates produced by AVMs, protection against the manipulation of data, and random sample testing and reviews, such that delineation of a nondiscrimination factor is not necessary.

> Q35. What are the advantages and disadvantages for small entities of specifying a quality control factor on nondiscrimination? Would there be an impact on your costs?

Please explain. Are there other alternative approaches the CFPB should consider? Why or why not? What is the basis for this recommendation?

Q36. Does your small entity consider fair lending risk when using AVMs? Please describe your AVM oversight and testing capabilities. Are additional regulatory tools, guidance, or resources needed? Why or why not?

Q37. If your small entity uses a third-party service provider for AVMs, what type of fair lending review, if any, do you conduct of the third-party model?

Q38. What would the start-up and ongoing costs be for your small entity to implement fair lending policies and procedures for AVMs? If these potential costs are difficult to quantify, you are invited to describe these costs qualitatively, such as small, medium, or large as well as outline breakdown of costs. Are there any particular complexities you anticipate under any of the alternatives presented?

Q39. Please provide your small entity's perspective on any of the following potential fair lending issues:

- Risks and benefits of underlying AVM methodologies, *e.g.*, repeat sales indices and mark-to-market, hedonic price models, appraiser emulation;
- How neighborhood characteristics and amenities (*e.g.*, nearby parks and trails, transit access, grocery stores) should be incorporated in an AVM model;
- Ensuring unbiased input data;
- Data accuracy and integrity;
- Use of comparables;
- Geographic segmentation;[113]
- Identifying and quantifying disparities;
- Identifying proxies for prohibited basis characteristics;
- Techniques to measure and monitor for potential discrimination in AVMs; and
- Addressing historical incidences of appraisal bias that may be perpetuated through AVMs.

G. Implementation period

We are considering a 12-month implementation period after issuance of an eventual interagency final rule. A 12-month period would be consistent with title XIV of the Dodd-Frank Act.[114]

We seek input from the SERs on how long small entities would need to conform their practices to the options under consideration. As noted in part II above, no institution will be required to comply with new regulatory requirements before a proposed rule is published, public comment is received and reviewed by the agencies, a final rule is issued, and the implementation period designated in the final rule concludes.

Q40. How much time do you estimate your small entity would need to prepare for compliance with an eventual final rule? Are there any particular aspects of the CFPB's options under consideration that could be particularly time consuming or costly for your small entity to implement? Are there any factors outside your small entity's control that would affect its ability to prepare for compliance?

IV. Potential Impacts on Small Entities

A. Overview

The Regulatory Flexibility Act (RFA) generally requires an agency to consider the economic impact rules will have on small entities.[115] In order to estimate the total potential impact on small entities, the CFPB needs to ascertain the number of small entities that would be affected by the options under consideration and the costs that those entities would incur to comply with the options' requirements.

Computing the number of affected small entities requires knowing the extent to which small entities regulated by the CFPB—small non-depositories—use AVMs and how their use would be affected by the options. Section 1125 of FIRREA divides covered entities into mortgage originators and secondary market issuers that use AVMs for covered purposes. However, given the extent of available data, the CFPB is not able to reliably ascertain the prevalence of AVM use among small mortgage originators or small secondary market issuers.

The CFPB also lacks data and information to quantify costs associated with complying with the options and how much costs would vary across small entities. The CFPB seeks feedback and information from the SERs about how options under consideration may change one-time and ongoing costs associated with the use of AVMs.

The CFPB's preliminary qualitative assessment is that the options under consideration would primarily impact small entities via one-time costs and that ongoing costs would be largely unchanged. However, evolving use cases may require updating policies and procedures, which would entail new costs. Nevertheless, the CFPB encourages contributions of data and other factual information to inform its assessment of potential compliance costs and other impacts on small entities. Specifically, the CFPB seeks feedback and information, including supporting data, from SERs on the following:

Q41. For what purposes do you currently use AVMs to determine the value of residential property?

Q42. Do you develop the AVM yourself or do you procure the software from a third party?

Q43. What are your costs associated with AVM use? Are there recurring or variable costs associated with your use of AVMs? Were there any one-time or initial costs associated with your use of AVMs?

If you develop the AVM independently,

Q43A. How many staff do you task to AVM development? How many person-hours per year do you devote to AVM development and implementation?

Q43B. Do you source the AVM model data internally or procure it elsewhere?

Q43C. If you procure third-party data, what features do you procure? How many loans does the data have? What are your costs of procurement, including licensing costs and costs per data point or loan?

Q44. Do you have policies and procedures in place for your use of AVMs in mortgage lending?

If yes,

Q44A. What are the goals of the policies and procedures?

Q44B. As part of the policies and procedures, what discretion does your staff have to override the AVM in case they disagree with its predictions?

Q44C. How did you develop the policies and procedures? How many person-hours per year did you commit to development? If you contracted an outside vendor, did the vendor provide tailored policies and procedures tailored for your entity? If so, how much did those services cost?

Q44D. If applicable, who conducts review of the policies and procedures? How often are the policies and procedures updated and for what reasons? What is your estimated annual cost (in terms of person-hours and in dollar terms) of conducting the review?

Q44E. Are there particular situations (*e.g.*, loan dollar thresholds) where you determine that utilization of an AVM is necessary?

Q45. What type of oversight and review of the AVM do you conduct for both business purposes and compliance with regulation? Do you test and validate the AVM predictions yourself or contract an outside vendor? If you contract an outside vendor, what services does the vendor provide and how much do those services cost?

If you test and validate AVM predictions internally, Q45A. How many staff do you assign to testing and validating AVM predictions? How many person-hours per year do you devote to testing and validating AVM predictions?

Q45B. How do you test model predictions? How do you select data to test the models?

Q45C. If the AVM predictions are deemed to be unreliable, what do you use as an alternative?

B. Small entities covered by the options under consideration

The CFPB has identified certain types of small entities that may be subject to the AVM rule options under consideration and regulated by the CFPB for purposes of the RFA. Specifically, the CFPB has identified several categories of non-depository institutions whose use of AVMs may be covered under the revenue criteria established by the Small Business Administration:[116]

- Real estate credit[117] companies with average annual receipts of $41.5 million or less;
- Secondary market financing companies[118] with average annual receipts of $41.5 million or less;
- Other non-depository credit intermediation[119] companies that originate mortgages with average annual receipts of $41.5 million or less;
- Mortgage and nonmortgage loan brokers with average annual receipts of $8 million or less;[120] and
- Other activities related to credit intermediation[121] such as mortgage loan servicers with average annual receipts of $22 million or less.

Across these five industries, 87 percent to 96 percent of entities' annual receipts would qualify them as small (Table 1).

Table 1: Number and share of non-depository entities by revenue thresholds

	Number of Entities	Fraction of Entities
A. Potentially Small Entities		
Real estate credit (522292)		
< $40M (Revenue)	2,872	87%
< $50M (Revenue)	2,904	88%
Secondary market financing (522294)		
< $15M (Revenue)	101	88%
< $100M (Revenue)	106	92%
All Other Non-depository Credit Intermediation (522298)		
< $40M (Revenue)	5,292	98%
< $50M (Revenue)	5,300	99%
Mortgage and Nonmortgage Loan Brokers (522310)		
< $7.5M (Revenue)	6,609	97%
< $10M (Revenue)	6,643	98%
Other Activities Related to Credit Intermediation (522390)		
< $20M (Revenue)	3,595	95%
< $25M (Revenue)	3,610	96%
B. Large Entities		
Real estate credit (522292)		
> $50M (Revenue)	385	12%
Secondary market financing (522294)		
> $100M (Revenue)	9	8%
All Other Non-depository Credit Intermediation (522298)		
> $50M (Revenue)	122	5%
Mortgage and Nonmortgage Loan Brokers (522310)		
> $10M (Revenue)	166	2%
Other Activities Related to Credit Intermediation (522390)		
> $25M (Revenue)	162	4%

Source: U.S. Census Bureau, 2017 Economic Census, *The Number of Firms and Establishments, Employment, Annual Payroll, and Receipts by Industry and Enterprise Receipts Size: 2017* (May 28, 2021), https://www2.census.gov/programs-surveys/susb/tables/2017/us_6digitnaics_rcptsize_2017.xlsx. The tabulations and shares were computed according to available enterprise size cells.

However, not all small entities use AVMs. The CFPB believes that AVM use is more prevalent among larger entities but is not aware of publicly available data that both identify whether non-depositories use AVMs for covered purposes and their revenues, data that would be necessary to reliably quantify the number of institutions that may be affected by the options under consideration. The CFPB anticipates learning more about small non-depositories' use of AVMs through the SBREFA process. Although only the CFPB is subject to the SBREFA requirement among the agencies collaborating on the AVM rulemaking, other small depository institutions whose use of AVMs may be covered if their assets are $600 million or less, as established by the SBA.[122]

C. CFPB review of compliance processes and costs

The CFPB preliminarily believes that the primary costs of the options under consideration are one-time costs. As noted above, the CFPB is considering proposing a rule that supplements the first four statutory factors with a fifth factor which would require regulated institutions to adopt policies, practices, procedures, and control systems designed to ensure that AVMs used for covered transactions comply with applicable nondiscrimination laws. Here, the CFPB considers the compliance costs associated with the first four statutory factors and, separately, with the fifth potential factor.

Lacking direct or indirect data on costs associated with verifying compliance with the options under consideration, the CFPB is limited to inferring typical costs from alternative sources. These estimates may be inaccurate if verifying compliance is more complex than CFPB forecasts. The estimates may also be inaccurate in describing the breadth of AVM uses in mortgage origination and correspondingly the costs. For typical hourly labor costs, the Bureau draws upon aggregated data from the Bureau of Labor Statistics and the Bureau of Economic Analysis. To estimate the personnel hours required to verify compliance, the CFPB draws upon information derived from a survey of financial institutions used to support the Small Business Lending Data Collection rulemaking, which specifies data points that financial institutions must collect and report in association with applications for small business loans. During the Small Business Lending Data Collection rulemaking process, the CFPB surveyed institutions on the number of personnel-hours they would require for compliance-related tasks, including drafting policies and procedures and legal review. The CFPB classified entities by their origination volumes and estimated that small entities would be Type A (zero to 150 originations) or Type B (151 to 999 originations).[123]

The Small Business Lending Data Collection proposed rule is different in scope and objective from the AVM rulemaking. However, the CFPB uses the Small Business Lending Data Collection proposed rule's one-time cost survey to inform its estimates of personnel hours for two reasons. First, though the Small Business Lending Data Collection proposed rule imposes new reporting requirements on financial institutions, the personnel requirements for drafting policies and procedures may be largely similar. Second, the CFPB is aware of no other sources of information or data that would allow it to quantify the necessary costs or personnel hours for complying with regulations that require quality control policies and procedures.[124] If the hours estimates derived from the survey are poor approximations for the hours required to comply to an eventual AVM rule, the CFPB's cost estimates will be proportionately affected.

For entities that have existing policies and procedures that govern their use of AVMs, these costs are likely limited to legal costs associated with verifying compliance with the eventual final rule. Entities may face lower costs to comply with the first four factors because compliance with current industry standard practices may be sufficient. While the non-depository entities supervised by the CFPB are not subject to the Guidelines issued by the prudential regulators in 2010, the CFPB preliminarily believes that the principles laid out in the Guidelines are considered an industry standard.

In November 2021, employees in the Legal Services industry earned on average $50 per hour.[125] In 2020, compensation costs represented approximately 50 percent of total value added in the legal services industry.[126] Thus, a simple estimate for an average hour of legal services is $100 per hour, which includes non-labor fixed costs and overhead (*e.g.*, computers, office real estate, etc.) and profits.

The Small Business Lending Data Collection proposed rule's one-time cost survey estimated 69 hours were required for legal compliance and review for Type A depository institutions on the lower end of origination volumes.[127] If verifying compliance of policies and procedures with the AVM rule required 69 average hours of legal services, then the implied labor cost (including overhead) would be approximately $7,000. The same institutions also reported $3,300 in non-salary direct expenses.[128] Combined, the total cost would be roughly $10,000.

The CFPB's cost estimates are sensitive to its assumptions. For example, if verifying compliance requires relatively more higher-wage personnel (*e.g.*, lawyers) and relatively fewer lower-wage personnel (*e.g.*, paralegals), then the costs would necessarily be larger. For instance, if verifying compliance primarily required the work of lawyers, then average labor costs would be closer to $70 per hour, by itself increasing the $10,000 estimate to approximately $13,000.[129] If costs reflected purely labor costs without overhead, profits, or non-salary expenses (as may be the case if small entities have in-house legal teams), then costs may be closer to $3,000.[130] The CFPB does not have information on the number or composition of legal personnel that would be required to verify compliance.

The estimates similarly vary with different assumptions about the requisite number of hours required to verify compliance with policies and procedures. Verifying compliance is likely to be more expensive for small entities that use AVMs for more diverse purposes, which may require additional hours of legal consultation. If CFPB underestimates the required number of hours, then the costs would necessarily be larger. In the Small Business Lending Data Collection proposed rule's one-time cost survey, Type B institutions reported an average of 35 required hours and non-depositories reported an average of 55 required hours. The CFPB seeks quantitative or qualitative information from the SERs that would help it compute how costs and personnel requirements associated with compliance vary across small entities.

Notably, the existing Guidelines do not directly discuss applicable nondiscrimination law, which would be covered by the fifth factor under consideration. The CFPB seeks feedback from the SERs on whether current policies governing use of AVMs conform to the Guidelines and whether current policies also ensure that AVM use specifically complies with nondiscrimination laws.

To the extent that small entities' current policies and use of AVMs would comply with the options under consideration, the CFPB does not anticipate the eventual final rule to substantially increase costs. However, for those small entities without policies and procedures concerning AVM use or that deem their policies and procedures insufficient to comply with the eventual final rule, entities would bear costs of drafting and vetting new policies and procedures.

Entities will likely have to spend time and resources reading and understanding the regulation, developing the required policies and procedures for their employees to follow to ensure compliance in addition to engaging a legal team to review their draft policies and procedures. Costs associated with drafting compliant policies and procedures are likely to be higher for institutions who use AVMs for a more diverse set of circumstances. Such entities would likely need to tailor guidance for each specific use case to "ensure a high level of confidence."[131]

Respondents to the Small Business Lending Data Collection proposed rule's one-time cost survey reported the estimated number of hours associated with developing policies and procedures. Type A depository institutions estimated an average 65 required personnel-hours and no non-salary direct expenses.[132] Applying the estimated cost of legal services implies a total cost of about $7,000.[133] Other types of institutions generally reported fewer required hours, but nevertheless, drafting policies and procedures for AVM use may require more labor than those required for the Small Business Lending Data Collection proposed rule. The CFPB seeks feedback on the number of hours small entities would have to devote to developing policies and procedures.

Small entities will also likely have to implement training of staff that utilize AVM output for covered purposes. Correspondingly, costs associated with training will likely be higher for entities that use AVMs for many purposes. However, while training is an ongoing cost, small entities will incur training costs regardless of an eventual AVM rule. The costs attributable to the eventual rule are those associated with changing existing training practices, corresponding analogously to the Small Business Lending Data Collection proposed rule's one-time cost survey on hours associated with training staff. Entities with the lowest origination volume reported an average of 60 hours of required personnel hours.[134] If labor costs to update training practices costs the $100 per hour in Legal Services, this suggests a total cost of roughly $6,000.[135] Type B and Type C respondents to the one-time cost survey with larger origination volumes reported higher labor demands associated with training, an average of 72 and 108 hours, respectively.

The options under consideration cover the use of the AVM, not its development. As such, the CFPB preliminarily believes that small entities will likely incur most of the costs outlined above regardless of whether they develop an AVM on their own or procure one from a third party. In the latter case, the CFPB anticipates that most third parties would be able to provide institution-specific policies, procedures, and training as a service that accompanies the AVM. While entities are ultimately responsible for policies' and procedures' compliance with the eventual final rule, third parties may tailor their services to ensure compliance. Whether small entities' costs increase depends ultimately on whether third party service providers pass along costs. For example, costs may increase if each third-party service provider has to commit 200 labor hours of legal services to customizing policies and procedures for each small entity. Costs may not increase if third-party service providers can sell the same general set of policies and procedures to many small entities with little modification.

[1] Public Law 111-203, 124 Stat. 1376 (2010).

[2] Dodd-Frank Act section 1473(q), 124 Stat. 2198 (codified at 12 U.S.C. 3354).

[3] 12 U.S.C. 3354(d).

[4] Public Law 101-73, 103 Stat. 183 (1989). The full text of FIRREA section 1125, as added by section 1473(q) of the Dodd-Frank Act, 124 Stat. 2198, is included as appendix A.

[5] 12 U.S.C. 3354(a).

[6] 12 U.S.C. 3354(c). *See also* 12 U.S.C. 3350(6) (defining "Federal financial institutions regulatory agencies") and (7) (defining "financial institution").

[7] 12 U.S.C. 3354(c). Unlike the CFPB, the Federal Trade Commission and State attorneys general do not have FIRREA section 1125 rulemaking authority. 12 U.S.C. 3354(b).

[8] U.S. Dep't of the Treasury, *A Financial System the Creates Economic Opportunities: Nonbank Financials, Fintech and Innovation*, at 103 (July 2018), https://home.treasury.gov/sites/default/files/2018-08/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financials-Fintech-and-Innovation.pdf.

[9] *See, e.g.*, Andreas Fuster *et al.*, *Predictably Unequal? The Effects of Machine Learning on Credit Markets*, 77 J. of Fin. 5 (Feb. 2022), 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), https://brookings.edu/research/to-stop-algorithmic-bias-we-first-have-to-define-it/; Reva Schwartz *et al.*, *A Proposal for Identifying and Managing Bias in Artificial Intelligence*, Nat'l Inst. of Standards & Tech., U.S. Dep't of Com. (June 2021), https://nvlpubs.nist.gov/nistpubs/SpecialPublications/NIST.SP.1270-draft.pdf.

[10] *See, e.g.*, *Appraisals for Higher-Priced Mortgage Loans*, 78 FR 10367, 10417 (Feb. 13, 2013) (inflated valuations can "lead consumers to borrowing that would not be supported by their true home value" and deflated valuations "can lead consumers to be eligible for a narrower class of loan products that are priced less advantageously").

[11] 5 U.S.C. 601 *et seq*.

[12] Public Law 104-121, 110 Stat. 857 (1996) (5 U.S.C. 609) (amended by Dodd-Frank Act section 1100G).

[13] U.S. Small Bus. Admin., *Table of Small Business Standards Matched to North American Industry Classification System Codes* (effective Aug. 19, 2019), https://www.sba.gov/sites/default/files/2019-08/SBA%20Table%20of%20Size%20Standards_Effective%20Aug%2019%2C%202019_Rev.pdf.

[14] See 5 U.S.C. 601(3) through (6).

[15] The CFPB believes the types of small businesses discussed above are most commonly represented by the following North American Industry Classification System (NAICS) codes, together with the maximum average annual receipts to be considered a small entity under each NAICS code:

522292—Real estate credit—$41.5 million
522294—Secondary market financing—$41.5 million
522298—Other non-depository credit intermediation—$41.5 million
522310—Mortgage and nonmortgage loan brokers—$8 million
522390—Other activities related to credit intermediation—$22 million

[16] The NAICS codes for these types of depository institutions are 522110, 522120, 522130, and 522190.

[17] 5 U.S.C. 603(d)(2)(B).

[18] *See, e.g.*, 12 U.S.C. 3331; 75 FR 77450, 77465 (Dec. 10, 2010); 12 CFR 34.43(a)(1) through (14) (OCC); 12 CFR 225.63(a)(1) through (15) (Board); 12 CFR 323.3(a)(1) through (14) (FDIC); 12 CFR 722.3(a)(1) through (6) (NCUA).

[19] 15 U.S.C. 1639h (added by Dodd-Frank Act section 1471).

[20] CFPB: 12 CFR 1026.35(a) and (c); OCC: 12 CFR part 34, subpart G and 12 CFR part 164, subpart B; Board: 12 CFR 226.43; NCUA: 12 CFR 722.3(a); FHFA: 12 CFR part 1222, subpart A. The FDIC adopted the CFPB's version of the regulations. *See* 78 FR 10368, 10370 (Feb. 13, 2013).

[21] 15 U.S.C. 1639e (added by Dodd-Frank Act section 1472).

[22] CFPB: 12 CFR 1026.42; Board: 12 CFR 226.42; *see* 75 FR 66554 (Oct. 28, 2010) (interim final rule); 75 FR 80675 (Dec. 23, 2010) (correction). TILA section 129E(g)(2) directed the Board to issue an interim final rule. 15 U.S.C. 1639e(g)(2).

[23] Dodd-Frank Act section 1473(r), 124 Stat. 2198-99 (codified at 12 U.S.C. 3355) (adding section 1126 to FIRREA). Under FIRREA section 1126, a "broker price opinion" means "an estimate prepared by a real estate broker, agent, or sales person that details the probable selling price of a particular piece of real estate property and provides a varying level of detail about the property's condition, market, and neighborhood, and information on comparable sales, but does not include an automated valuation model." 12 U.S.C. 3355(b).

[24] 15 U.S.C. 1691(e) (amended by Dodd-Frank Act section 1474).

[25] 12 CFR 1002.14.

[26] 12 U.S.C. 3354(d). As discussed below, FIRREA section 1125 focuses on mortgages "secured by a consumer's principal dwelling." *Id.*

[27] *Id.*

[28] *Determination*, *Black's Law Dictionary* (11th ed. 2019).

[29] As discussed in part III above, other Federal laws and implementing regulations require appraisals for certain transactions.

[30] 12 U.S.C. 3354(d).

[31] *See generally* Bureau of Consumer Fin. Prot., *Compliance Bulletin and Policy Guidance; 2016–02, Service Providers* (Oct. 31, 2016), https://www.consumerfinance.gov/documents/1385/102016_cfpb_OfficialGuidanceServiceProviderBulletin.pdf ("[T]he mere fact that a supervised bank or nonbank enters into a business relationship with a service provider does not absolve the supervised bank or nonbank of responsibility for complying with Federal consumer financial law to avoid consumer harm.").

[32] *See* Dodd-Frank Act section 1473(q), 124 Stat. 2198 (adding FIRREA section 1125).

[33] *See* Appraisal Standards Bd., *Advisory Opinion 18* (rev. Sept. 16, 1998), https://www.workingre.com/advisory-opinion-18-ao-18/.

[34] *See* 12 U.S.C. 3353(a)(3), 3339.

[35] 12 U.S.C. 3350(10).

[36] 12 U.S.C. 3345.

[37] *See* Appraisal Inst., *The Appraisal Profession*, https://www.appraisalinstitute.org/appraisal-profession/ (last visited Nov. 18, 2021).

[38] 12 U.S.C. 3310.

[39] *See generally* Appraisal Subcomm. of the Fed. Fin. Inst. Examination Council, *2020 Annual Report* (June 14, 2021), https://www.asc.gov/Documents/AnnualReports/2020%20ASC%20Annual%20Report.pdf (listing the subcommittee's findings from its State compliance reviews).

[40] Excluding the use of an AVM by a certified or licensed appraiser in developing an appraisal from the scope of the eventual rule would not exclude the use of AVMs in the process of preparing evaluations, which are required for certain exempt transactions under the interagency appraisal regulations.

[41] 12 U.S.C. 3354(d).

[42] *See* 78 FR 11279, 11308 (Feb. 15, 2013) (discussing amendment to Regulation Z comment 36(a)-1.iii).

[43] *See* 12 CFR 1026.36(a)(1)(i)(E).

[44] *But see* 12 CFR 1026.20(a)(1) through (5) (exceptions to the general definition).

[45] For transactions covered by Regulation Z § 1026.40, creditors' ability to suspend further advances or reduce the credit limit is subject to certain limitations.

[46] Fannie Mae, *Fannie Mae Single Family Selling Guide* (Oct. 6, 2021), https://singlefamily.fanniemae.com/media/29306/display.

[47] Fannie Mae, *Appraisal Waivers Fact Sheet* (Dec. 4, 2018), https://singlefamily.fanniemae.com/media/5916/display.

[48] Fannie Mae, *Appraisal Waivers*, https://singlefamily.fanniemae.com/originating-underwriting/appraisal-waivers; Freddie Mac, *Automated Collateral Evaluation Now Available for Purchase Transactions* (Aug. 18, 2017), https://sf.freddiemac.com/articles/news/automated-collateral-evaluation-now-available-for-purchase-transactions.

[49] Fannie Mae, *Appraisal Waivers Fact Sheet* (Dec. 4, 2018), https://singlefamily.fanniemae.com/media/5916/display; Freddie Mac, Guide Section 5601.9, *Seller representations and warranties regarding the mortgaged premises* (June 21, 2021), https://guide.freddiemac.com/app/guide/section/5601.9.

[50] Am. Enter. Inst., *Prevalence of GSE Appraisal Waivers* (July 2021), https://www.aei.org/research-products/report/prevalence-of-gse-appraisal-waivers/.

[51] Freddie Mac, *Automated Collateral Evaluation (ACE)*, https://sf.freddiemac.com/tools-learning/loan-advisor/our-solutions/ace-automated-collateral-evaluation (last visited Oct. 25, 2021).

[52] Urban Inst., *Appraisal Waivers Have Helped Homeowners Find Payment Flexibility Amid Pandemic-Induced Economic Struggles* (Oct. 15, 2020), https://www.urban.org/urban-wire/appraisal-waivers-have-helped-homeowners-find-payment-flexibility-amid-pandemic-induced-economic-struggles.

[53] American Enterprise Institute data show a total of 3.24 million waivers issued in 2020. When multiplied by the average cost of an appraisal from HomeAdvisor ($348), consumers saved $1.13 billion in 2020.

[54] Fed. Hous. Fin. Agency, *An Overview of Enterprise Appraisal Waivers* (Sept. 14, 2018), https://www.fhfaoig.gov/sites/default/files/WPR-2018-006.pdf.

[55] Fed. Hous. Fin. Agency, *Request for Information on Appraisal-Related Policies, Practices, and Processes* (Dec. 28, 2020), https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/RFI-Appraisal-Related-Policies.pdf.

[56] *Id.*

[57] 12 U.S.C. 3354(d).

[58] For example, in addition to covering AVMs used by "mortgage originators," section 1125(d) of FIRREA further limits coverage to AVMs used "to determine the collateral worth of a mortgage secured by a consumer's principal dwelling." As discussed in part III.D below, we are considering various potential options for the definition of the term "mortgage." Depending on the definition of "mortgage" ultimately adopted, we may need to adjust the definition of "mortgage originator" accordingly.

[59] 15 U.S.C. 1601 *et seq.*

[60] 12 CFR 1026.1 *et seq.*

[61] Regulation Z § 1026.2(a)(22) defines the term "person" to mean "a natural person or an organization, including a corporation, partnership, proprietorship, association, cooperative, estate, trust, or government unit."

[62] 12 CFR 1026.36(a)(1). However, section 1026.36(a)(1) further states that the term "loan originator" does not include:

> (A) A person who does not take a consumer credit application or offer or negotiate credit terms available from a creditor, but who performs purely administrative or clerical tasks on behalf of a person who does engage in such activities. (B) An employee of a manufactured home retailer who does not take a consumer credit application, offer or negotiate credit terms available from a creditor, or advise a consumer on credit terms (including rates, fees, and other costs) available from a creditor. (C) A person that performs only real estate brokerage activities and is licensed or registered in accordance with applicable State law, unless such person is compensated by a creditor or loan originator or by any agent of such creditor or loan originator for a particular consumer credit transaction subject to this section. (D) A seller financer that meets the criteria in [§ 1026.36(a)(4) or (a)(5)], as applicable. (E) A servicer or servicer's employees, agents, and contractors who offer or negotiate terms for purposes of renegotiating, modifying, replacing, or subordinating principal of existing mortgages where consumers are behind in their payments, in default, or have a reasonable likelihood of defaulting or falling behind. This exception does not apply, however, to a servicer or servicer's employees, agents, and contractors who offer or negotiate a transaction that constitutes a refinancing under § 1026.20(a) or obligates a different consumer on the existing debt.

[63] Except for purposes of Regulation Z § 1026.36(f) and (g) (relating to loan originator qualification requirements and certain loan document disclosure requirements respectively), the term "loan originator" under Regulation Z § 1026.36(a)(1) only covers "creditors" to the extent they engage in table funding. *See* 12 CFR 1026.36(a)(1)(i). Therefore, the CFPB is considering proposing a definition under section 1125 that would cover persons who are "loan originators" for purposes of Regulation Z, including "creditors" that satisfy the definition of loan originator and regardless of whether they engage in table funding.

[64] *See* 12 CFR 1026.36(a)(1)(i)(E).

[65] *But see* 12 CFR 1026.20(a)(1) through (5) (exceptions to the general definition).

[66] Public Law 101-73, 103 Stat. 183 (1989).

[67] 124 Stat. 2190.

[68] 124 Stat. 2192 (codified at 12 U.S.C. 3353).

[69] 12 U.S.C. 3350(11).

[70] 80 FR 32657, 32680 (June 9, 2015).

[71] Rulemaking authority for sections 1124 and 1125 is codified at 12 U.S.C. 3353 and 3354, respectively.

[72] 12 U.S.C. 3354(d). Section 1125(d) of FIRREA does not distinguish between mortgages secured by a first lien and those secured by a subordinate lien. *See id.*

[73] See part III.E below for a discussion of the scope of the term "dwelling" being considered for proposal by the CFPB.

[74] Section 1473(q), which added section 1125 to FIRREA, is in title XIV of the Dodd-Frank Act. Various other provisions in title XIV focus on extensions of credit. *See, e.g.*, Dodd-Frank Act section 1401, 124 Stat. 2138 (referencing consumer "credit" transactions when defining "residential mortgage loan").

[75] 12 U.S.C. 3354(d).

[76] 12 U.S.C. 3331 through 3356.

[77] Regulation Z comment 42(a)-2.

[78] 15 U.S.C. 1602(i).

[79] Regulation Z § 1026.2(a)(11). Regulation Z § 1026.2(a)(12) defines "consumer credit" to mean "credit offered or extended to a consumer primarily for personal, family, or household purposes."

[80] For example, Regulation Z § 1026.12(a) includes language that applies TILA requirements limiting issuance of credit cards "[r]egardless of the purpose for which a credit card is to be used, including business, commercial, or agricultural use."

[81] 12 U.S.C. 3354(c)(2). The Board, FDIC, OCC, and NCUA, defined as "Federal financial institutions regulatory agencies" by 12 U.S.C. 3350(6), have enforcement authority for AVM quality control standards applicable to the institutions and subsidiaries for which they are the primary Federal supervisors. 12 U.S.C. 3354(c)(1).

[82] 15 U.S.C. 1602(w).

[83] Regulation Z § 1026.2(a)(19). *See also* Regulation Z comments 2(a)(19)-2 ("dwelling" does not include recreational vehicles, campers, and similar structures that are not used as residences) and 23(a)(1)-3 ("dwelling" includes structures that are classified as personalty under State law).

[84] *See* Regulation X § 1024.2(b) (federally related mortgage loan) and 1024.5(b)(4).

[85] TILA section 1639e; Regulation Z § 1026.42(a).

[86] Regulation Z comment 42(b)(2)-1.

[87] *Id*.

[88] 75 FR 77450 (Dec. 10, 2010).

[89] *See* Off. of Comptroller of the Currency, *Supervisory Guidance on Model Risk Management*, OCC Bulletin 2011-12 (Apr. 4, 2011), https://www.occ.gov/news-issuances/bulletins/2011/bulletin-2011-12.html; Bd. of Governors of the Fed. Reserve Sys., SR Letter 11-7 (Apr. 4, 2011), https://www.federalreserve.gov/supervisionreg/srletters/sr1107.htm; Fed. Deposit Ins. Corp., *Guidance on Model Risk Management*, FDIC FIL-22-2017 (June 7, 2017), https://www.fdic.gov/news/financial-institution-letters/2017/fil17022.html.

[90] *See* Fed. Hous. Fin. Agency, *Model Risk Management Guidance*, FHFA Advisory Bulletin 2013-07 (Nov. 20, 2013), https://www.fhfa.gov/SupervisionRegulation/AdvisoryBulletins/Pages/AB-2013-07-Model-Risk-Management-Guidance.aspx.

[91] 12 U.S.C. 3354(b).

[92] Algorithmic systems such as AVMs may also be subject to State and local nondiscrimination laws.

[93] 15 U.S.C. 1691 *et seq*.

[94] 42 U.S.C. 3601 *et seq*. The FH Act prohibits unlawful discrimination in all aspects of residential real estate-related transactions, including appraisals of residential real estate. 42 U.S.C. 3605 (prohibiting discrimination because of race, color, religion, national origin, sex, disability, or familial status in residential real estate-related transactions); 3605(b)(2) (defining "real estate-related transactions" to include the "selling, brokering, or appraising of residential real property"); *see also* 24 CFR part 100. The FH Act gives the Department of Housing and Urban Development (HUD) the authority and responsibility for administering and enforcing the Act, including the authority to conduct formal adjudications of Fair Housing Act complaints and the power to promulgate rules to interpret and carry out the Act. The Department of Justice and HUD are jointly responsible for enforcing the FH Act.

[95] 15 U.S.C. 1691(a) (prohibiting discrimination on the basis of race, color, religion, national origin, sex or marital status, age (provided the applicant has the capacity to contract), because all or part of the applicant's income derives from any public assistance program, or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act); *see also* 12 CFR part 1002.

[96] *See* Interagency Task Force on Fair Lending, *Policy Statement on Discrimination in Lending*, 59 FR 18266, 18268 (Apr. 15, 1994), https://www.govinfo.gov/content/pkg/FR-1994-04-15/html/94-9214.htm (Interagency Policy

Statement on Discrimination in Lending) (noting that under both ECOA and the Fair Housing Act, a lender may not, because of a prohibited factor, use different standards to evaluate collateral).

[97] *See* Bureau of Consumer Fin. Prot., *CFPB Bulletin 2012-04 (Fair Lending), Lending Discrimination* (Apr. 18, 2012), https://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf (concurring with Interagency Policy Statement on Discrimination in Lending).

[98] *See* Interagency Policy Statement on Discrimination in Lending at 18268.

[99] *See* Regulation B comment 4(a)-1 (stating that "[d]isparate treatment on a prohibited basis is illegal whether or not it results from a conscious intent to discriminate"); Bureau of Consumer Fin. Prot., *Equal Credit Opportunity Act (ECOA) Examination Procedures*, at 1 (Oct. 30, 2015), https://files.consumerfinance.gov/f/documents/201510_cfpb_ecoa-narrative-and-procedures.pdf (ECOA Examination Procedures); *see also* Interagency Policy Statement on Discrimination in Lending at 18268.

[100] *See* Regulation B comment 6(a)-2; ECOA Examination Procedures at 1; *see also* Interagency Policy Statement on Discrimination in Lending at 18269.

[101] *See, e.g.*, Andreas Fuster *et al.*, *Predictably Unequal? The Effects of Machine Learning on Credit Markets*, 77 J. of Fin. 5 (Feb. 2022), 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), http://brookings.edu/research/to-stop-algorithmic-bias-we-first-have-to-define-it/; Reva Schwartz *et al.*, *A Proposal for Identifying and Managing Bias in Artificial Intelligence*, Nat'l Inst. of Standards & Tech., U.S. Dep't of Com. (June 2021), https://nvlpubs.nist.gov/nistpubs/SpecialPublications/NIST.SP.1270-draft.pdf.

[102] Yavar Bathaee, *The Artificial Intelligence Black Box and the Failure of Intent and Causation*, 31 Harv. J.L. & Tech. 890 (2018), https://jolt.law.harvard.edu/assets/articlePDFs/v31/The-Artificial-Intelligence-Black-Box-and-the-Failure-of-Intent-and-Causation-Yavar-Bathaee.pdf.

[103] FinRegLab, *The Use of Machine Learning for Credit Underwriting* (Sept. 2021), at 77, https://finreglab.org/wp-content/uploads/2021/09/The-Use-of-ML-for-Credit-Underwriting-Market-and-Data-Science-Context_09-16-2021.pdf; Nicol Turner Lee *et al.*, *Algorithmic Bias Detection and Mitigation: Best Practices and Policies to Reduce Consumer Harms*, Brookings Inst. (May 22, 2019), https://www.brookings.edu/research/algorithmic-bias-detection-and-mitigation-best-practices-and-policies-to-reduce-consumer-harms/.

[104] Ziad Obermyer *et al.*, *Dissecting Racial Bias in an Algorithm Used to Manage the Health of Populations*, Science, Vol. 366, Issue 6464 (Oct. 25, 2019), https://www.science.org/doi/abs/10.1126/science.aax2342.

[105] *Id.*

[106] *Id.*

[107] *Id.*

[108] *See, e.g.*, Appraisals for Higher-Priced Mortgage Loans, 78 FR 10367, 10417 (Feb. 13, 2013) (inflated valuations can "lead consumers to borrowing that would not be supported by their true home value" and deflated valuations "can lead consumers to be eligible for a narrower class of loan products that are priced less advantageously").

[109] *See, e.g.*, Interagency Policy Statement on Discrimination in Lending; Interagency Fair Lending Examination Procedures (Aug. 2009), https://www.ffiec.gov/PDF/fairlend.pdf; Bureau of Consumer Fin. Prot., *Examination Procedures—ECOA* (Oct. 2015), https://files.consumerfinance.gov/f/documents/201510_cfpb_ecoa-narrative-and-procedures.pdf.

[110] *Interagency Statement on the Use of Alternative Data in Credit Underwriting* (Dec. 2019), https://files.consumerfinance.gov/f/documents/cfpb_interagency-statement_alternative-data.pdf; Bureau of Consumer Fin. Prot., *Supervisory Highlights: Summer 2013*, 5-11 (Aug. 2013), https://files.consumerfinance.gov/f/201308_cfpb_supervisory-highlights_august.pdf (discussing the pillars of a well-functioning CMS).

[111] *Id.*

[112] Bureau of Consumer Fin. Prot., *ECOA Baseline Review Module* 2, 6 (Apr. 2019), https://files.consumerfinance.gov/f/documents/cfpb_supervision-and-examination-manual_ecoa-baseline-exam-procedures_2019-04.pdf (providing instructions to CFPB examiners on evaluating a financial institution's use of models for fair lending related risks and controls).

[113] In order to account for differences in neighborhood characteristics and amenities, AVMs often run separate models for different geographic areas. Thus, the models produce different weights, such as value per amenity. The value of a property that sits between the border of two neighborhoods with different property values may vary widely, depending on which model weights are applied.

[114] Section 1473(q) of the Dodd-Frank Act added section 1125 to FIRREA, which directs the agencies to develop regulations for AVM quality control standards. Dodd-Frank Act section 1473(q), 124 Stat. 2198 (codified at 12 U.S.C. 3354). Section 1473(q) is in title XIV of the Dodd-Frank Act and section 1400(c) of the Dodd-Frank Act states that the "regulations required to be prescribed under this title [XIV] or the amendments made by this title shall . . . take effect not later than 12 months after the date of issuance of the regulations in final form." Dodd-Frank Act section 1400(c), 124 Stat. 2136 (codified at 15 U.S.C. 1601 note); *see also* 78 FR 78519, 78524 (Dec. 26, 2013) ("The Dodd-Frank Act . . . requires that regulations required under Title XIV take effect not later than 12 months after the date of issuance of the regulations in final form.") (citation and internal quotation marks omitted).

[115] 5 U.S.C. 601 *et seq.*

[116] *See* Table of Small Business Standards, *supra* note 13.

[117] The 2017 six-digit NAICS code for institutions in the "Real estate credit" industry is 522292.

[118] The 2017 six-digit NAICS code for institutions in the "Secondary market financing" industry is 522294.

[119] The 2017 six-digit NAICS code for institutions in the "Other non-depository credit intermediation" industry is 522298.

[120] The 2017 six-digit NAICS code for institutions in the "Mortgage and nonmortgage loan brokers" industry is 522310.

[121] The 2017 six-digit NAICS code for institutions in the "Other activities related to credit intermediation" industry is 522390.

[122] The 2017 four-digit NAICS code for depository institutions is 5221. According to the Bureau's analysis of bank and credit union call report data in 2018, approximately 83 percent of depository institutions have assets below $600 million. Bureau of Consumer Fin. Prot., *Small Business Advisory Review Panel for Consumer Financial Protection Bureau Small Business Lending Data Collection Rulemaking: Outline of Proposals Under Consideration and Alternatives Considered* (Sept. 15, 2020), at 44, https://files.consumerfinance.gov/f/documents/cfpb_1071-sbrefa_outline-of-proposals-under-consideration_2020-09.pdf.

[123] *See id.* at 48.

[124] In a review of the academic literature, the CFPB was unable to find estimates that would reliably inform costs associated with drafting or verifying compliance of policies and procedures related to AVMs. The CFPB seeks feedback or references that could improve its estimates.

[125] U.S. Bureau of Labor Stat., *Employment and Earnings Table B-3a*, https://www.bls.gov/web/empsit/ceseeb3a.htm#ce_ee_table3a.f.1 (modified Jan. 7, 2022).

[126] U.S. Bureau of Econ. Analysis, *Compensation of employees: Domestic private industries: Legal services Vintage: 2022-01-25/Gross Domestic Product: Legal Services (NAICS 5411) in the United States Vintage: 2021-10-01*, https://alfred.stlouisfed.org/graph/?g=Lci4 (last visited Jan. 25, 2022).

[127] Small Business Lending Data Collection under the Equal Credit Opportunity Act (Regulation B), 86 FR 56356, 56556 (Oct. 8, 2021).

[128] *Id*.

[129] U.S. Bureau of Labor Stat., *Occupational Employment and Wages—23-1011 Lawyers* (May 2020), https://www.bls.gov/oes/current/oes231011.htm ($70 per hour times mark-up factor of 2 times 69 hours + $3,300 non-salary direct expenses = $12,960).

[130] $50 per hour times 69 hours = $3,450.

[131] 12 U.S.C. 3354(a).

[132] 86 FR 56356, 56556 (Oct. 8, 2021).

[133] $50 per hour times mark-up factor of 2 times 65 hours = $6,500.

[134] *Id*.

[135] $50 per hour times mark-up factor of 2 times 60 hours = $6,000.

Appendix A: Section 1125 of FIRREA

12 USC 3354.

"SEC. 1125. AUTOMATED VALUATION MODELS USED TO ESTIMATE COLLATERAL VALUE FOR MORTGAGE LENDING PURPOSES.

"(a) IN GENERAL.—Automated valuation models shall adhere to quality control standards designed to—

"(1) ensure a high level of confidence in the estimates produced by automated valuation models;

"(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 listed in subsection (b) determine to be appropriate.

"(b) ADOPTION OF REGULATIONS.—The Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau of Consumer Financial Protection, in consultation with the staff of the Appraisal Subcommittee and the Appraisal Standards Board of the Appraisal Foundation, shall promulgate regulations to implement the quality control standards required under this section.

"(c) ENFORCEMENT.—Compliance with regulations issued under this subsection shall be enforced by—

"(1) 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; and

"(2) with respect to other participants in the market for appraisals of 1-to-4 unit single family residential real estate, the Federal Trade Commission, the Bureau of Consumer Financial Protection, and a State attorney general.

"(d) AUTOMATED VALUATION MODEL DEFINED.—For purposes of this section, the term 'automated valuation model' means 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.".

APPENDIX E: DISCUSSION GUIDE FOR SMALL ENTITY REPRESENTATIVES

See attached.

SMALL BUSINESS ADVISORY REVIEW PANEL FOR AUTOMATED VALUATION MODEL (AVM) RULEMAKING

DISCUSSION GUIDE FOR SMALL ENTITY REPRESENTATIVES

February 23, 2022

Contents

I. Introduction

To help frame discussion of issues and cost of credit matters in the upcoming Small Business Review Panel (Panel) meeting with small entity representatives (SERs) for the automated valuation model (AVM) rulemaking, we are providing this list of questions, on which the Consumer Financial Protection Bureau (CFPB or we) seeks your advice, input, and recommendations. As you think about these questions, it may be helpful to refer to the "Outline of Proposals and Alternatives Under Consideration" (Outline) enclosed with this document.

The Dodd-Frank Act requires the CFPB to comply with the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), which directs the CFPB to convene a Panel when it is considering proposing a rule that could have a significant economic impact on a substantial number of small entities.[1] The Panel includes representatives from the CFPB, the Office of Information and Regulatory Affairs in the Office of Management and Budget, and the Chief Counsel for Advocacy of the Small Business Administration (Advocacy). The Office of Advocacy is an independent office within the Small Business Administration (SBA).

The Panel seeks to understand the potential economic impacts on small entities from the options under consideration discussed in the Outline. The questions are designed to identify the type of information that may help you to participate effectively in the discussion with the Panel and other small entity representatives. Some questions may not apply to you or your business. When a topic is relevant to you, please be prepared to discuss it based on your experience or knowledge of the experience of other small entities as well as other financial institutions engaged in your line(s) of business. It would also be useful to the discussion to provide specific examples of issues that have arisen in your business operations.

As you prepare for the general discussion, some of the questions suggest ways in which you might want to consider addressing the costs for the options under consideration. We welcome any quantitative information you may choose to provide in response to these questions, but these questions should not be treated as data requests. While information specific to your institution can help the discussion, we understand that you may wish to frame your response in a manner that protects your company's proprietary information, as your responses may be included in a public report. Please note that when we ask about costs or other quantitative information, we are only looking for approximations, to the best of your knowledge; we do not need you to send us documentation.

II. Proposals and Alternatives Under Consideration

In the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),[2] Congress directed the CFPB, along with the Board of Governors of the Federal Reserve System (Board), the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Federal Housing Finance Agency (FHFA) (collectively, the agencies), to develop regulations for quality control standards for AVMs,[3] which are "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] Specifically, the Dodd-Frank Act added section 1125 to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA);[5] that section requires that AVMs meet quality control standards designed to: (1) ensure a high level of confidence in the estimates produced by automated valuation models; (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]

The statute provides that the eventual section 1125 rule will be enforced by the FDIC, Board, NCUA, and OCC with respect to insured banks, savings associations, and credit unions (collectively, financial institutions), as well as federally regulated subsidiaries that financial institutions own and control.[7] The statute gives the CFPB, as well as the Federal Trade Commission and State attorneys general, enforcement authority with respect to other non-depository participants in the market.[8]

The agencies listed above are working together to develop a proposed rule to implement FIRREA section 1125. However, while agencies generally are required to consider whether the rules they propose will have a significant economic impact on a substantial number of small entities, pursuant to the Regulatory Flexibility Act (RFA),[9] an amendment to the RFA added by SBREFA imposes additional requirements on the CFPB with respect to small entities.[10] Prior to issuing a proposed rule, the CFPB must comply with additional procedural requirements to assess the impact on small entities that are likely to be directly affected by the proposals under consideration. These additional SBREFA requirements include collecting small entities' advice and recommendations on the potential impacts of the proposals under consideration and feedback on regulatory alternatives to minimize these impacts.

This SBREFA Panel process is only one step in this interagency rulemaking process where the CFPB, as well as the Board, OCC, FDIC, NCUA, and FHFA, have FIRREA section 1125 rulemaking authority. The Panel process should not be construed to represent the views or recommendations of the other agencies involved in the rulemaking.

Throughout this Discussion Guide, we list questions we would like SERs to answer regarding options under consideration. These questions are numbered sequentially for ease of reference, and begin here:

> Q1. Are there any relevant Federal laws or rules which may duplicate, overlap, or conflict with the options under consideration beyond the FIRREA, the Truth in Lending Act (TILA),[11] and Equal Credit Opportunity Act[12] laws and implementing regulations discussed in part III of the Outline? How might the options under consideration for implementing FIRREA section 1125 impact other aspects of small entities' compliance with Federal law or rules?

In this Discussion Guide, we first discuss key issues under the FIRREA section 1125 definition of "automated valuation model" which may determine the scope of transactions covered by an eventual proposed rule. Key definitional issues include: what AVM uses "determine the collateral worth," what are "mortgage originators" and "secondary market issuers," what is a "mortgage," and what constitutes a "consumer's principal dwelling."

Next, we discuss our views of general options for AVM quality control standards, including, on the one hand, a principles-based option that may increase regulated institutions' flexibility and, on the other hand, a prescriptive option with more detailed and specific requirements that may reduce potential compliance uncertainty. We also discuss a potential option for specifying an express nondiscrimination quality control factor for AVMs. Finally, we address options for an implementation period for the eventual final rule under FIRREA section 1125.

A. Defining AVMs used to "determine" the collateral worth

FIRREA section 1125 defines AVMs as computerized models "used by mortgage originators and secondary market issuers to determine the collateral worth" of certain mortgages.[13] Depending on how that phrase in the statute is implemented, the rule's quality control requirements might cover a variety of AVM uses by mortgage originators and secondary market issuers.

Q2. Please provide feedback and information, including supporting data, on the options we are considering for implementation of the statutory phrase "to determine the collateral worth"? Besides the options discussed in parts II.A.1 through 5 below, are there any alternative approaches we should consider?

1. AVMs used for making underwriting decisions

We are considering proposing that AVMs are covered when used for making underwriting decisions regarding the value of collateral rather than broadly covering AVMs used to produce *any* valuation estimate. We preliminarily believe such an approach may better accomplish the objectives of FIRREA section 1125 to the extent that underwriting decisions entail a more official valuation than the estimates generated for other activities such as marketing or portfolio monitoring.

Q3. Does your small entity currently have quality control processes in place for AVMs? If so, please describe those processes, including how they function, what costs (one-time or fixed, and variable) are associated with their implementation and oversight, and whether they differ based on AVM use, *e.g.*, making underwriting decisions versus portfolio monitoring. Are there specific complexities or costs that are different for AVMs used in making underwriting decisions versus for other AVM uses?

Q4. How often does your small entity use AVMs in making underwriting decisions? Does your small entity use AVMs for other purposes, such as monitoring the quality or performance of mortgage loans or mortgage-backed securities? If so, how often are AVMs used for those other purposes?

Q5. Please provide feedback and information, including supporting data, on the option to potentially focus on AVMs used for making underwriting decisions. Besides making underwriting decisions, does your use of AVMs have a direct impact on consumers?

2. Reviews of already completed determinations

Where there is already a completed determination of collateral value (completed determination), we are considering proposing to expressly not cover AVMs used in subsequent reviews of that completed determination. A completed determination is often an appraisal. In certain transactions not requiring a licensed or certified appraiser, a completed determination might entail, for example, an AVM supplemented with a report of the property's actual physical condition.

> Q6. Please provide feedback and information, including supporting data, on the option of expressly not covering AVMs used in subsequent reviews of completed determinations.
>
> Q7. How often does your small entity use AVMs to subsequently review completed determinations? Does your small entity have quality control processes for that type of AVM use? If so, do they differ from AVM quality control processes when AVMs are used for other purposes?
>
> Q8. What are the advantages and disadvantages for small entities of using AVMs to review completed determinations versus using other non-AVM methods of review?
>
> Q9. What compliance costs would cause your small entity to stop or decrease your use of AVMs to perform quality control reviews of completed determinations?

3. Developing an appraisal by a certified or licensed appraiser

We are considering proposing that an AVM is not covered when used by a certified or licensed appraiser (appraiser) who is already subject to quality control standards under other Federal and State regulation and supervision. As discussed in parts II.B and C below, FIRREA section 1125 applies to AVMs used by "mortgage originators" and "secondary market issuers," respectively.[14] Appraisers generally would not be mortgage originators or secondary market issuers; thus, appraisers themselves generally would not be covered by the eventual rule. But to the extent that an appraiser is in an employment or third-party service provider relationship with a mortgage originator or secondary market issuer, an eventual rule implementing FIRREA section 1125 might require the mortgage originator itself (or the secondary market issuer itself) to ensure that AVMs used by the appraiser adhere to quality control standards.[15] However, we preliminarily believe a mortgage originator's (or secondary market issuer's) responsibility for an AVM used by an appraiser may be distinguishable from a mortgage originator's (or secondary market issuer's) responsibility for an AVM used by other types of employees or service providers. Thus, we are considering proposing that an AVM is not covered when a mortgage originator (or secondary market issuer) relies on an appraisal developed by a certified or licensed appraiser, notwithstanding that the appraiser used the AVM in developing an appraisal.

> Q10. From your experience, how often are AVMs used by certified or licensed appraisers to develop appraisal valuations? What would the impact of the rule be on

small entities if it did not cover AVMs when used by certified or licensed appraisers to develop appraisal valuations?

Q11. Would coverage of appraisers' use of AVMs potentially discourage use of AVMs by small entities as a valuation tool?

4. Post-origination

i. Loan modifications and other changes to existing loans

We are seeking advice and recommendations from small entities regarding cases where an AVM is used in deciding whether to change the terms of an existing loan. We currently are considering two alternatives. Under the first alternative, we are considering proposing that the rule cover AVMs used in transactions that result in the consumer receiving a new mortgage origination. Under this option, the rule would cover transactions like refinancings, but not transactions like loan modifications that do not result in a new mortgage origination. Under the second alternative, we are considering proposing that the rule cover any AVM used to decide whether to change the terms of an existing mortgage even if the change does not result in a new mortgage origination, so long as a "mortgage originator" or "secondary market issuer," or a service provider acting on behalf of a mortgage originator or a secondary market issuer, uses the AVM "to determine the collateral worth of a mortgage secured by a consumer's principal dwelling."[16]

Q12. What would be the advantages and disadvantages for small entities of the first alternative (*i.e.*, covering AVMs in transactions like refinancings but not in loan modifications that do not result in a new mortgage origination) versus the second alternative (*i.e.*, broadly covering changes to the terms of an existing mortgage so long as a covered institution or its service provider uses the AVM to determine the collateral worth)? Please also provide any alternatives for consideration.

ii. Credit line reductions or suspensions

We understand that creditors use AVMs to monitor home equity lines of credit (HELOCs), which are often held in portfolio, and AVM outputs can factor into a decision to reduce or suspend a borrower's credit line in accordance with the terms of an initial credit agreement (a reduction or suspension decision).[17] Such reduction or suspension decisions are distinct from decisions to change the terms of a credit agreement, which is discussed above in part II.A.4.i.

One potential option we are considering is to expressly not cover AVMs used to make reduction or suspension decisions for HELOCs. As discussed below in parts II.B and C, we are considering potential definitions of the terms "mortgage originator" and "secondary market issuer" that are focused on mortgage origination and securities issuance activities, rather than activities relating to mortgage servicing. We likewise are considering proposing that reduction or suspension decisions would not be covered so long as they were made in accordance with *an initial agreement* and did not involve a new mortgage origination. Unlike reductions and suspensions, increases to a home equity credit line typically require a new mortgage origination and would therefore be covered as discussed above in part II.A.4.i.

In contrast with the first option, another potential option we are considering is to broadly cover reduction or suspension decisions whenever the institution making the reduction or suspension decision is a mortgage originator or secondary market issuer—or their service provider—and the AVM is used to determine the collateral worth of a mortgage secured by a consumer's principal dwelling. We note that section 1125 references AVMs used by "mortgage originators and secondary market issuers," but does not expressly reference AVMs used by mortgage servicers. As a result, this option would cover mortgage originators and secondary market issuers when they—or a servicer acting on their behalf—service their mortgages, but would not cover entities that subsequently acquire the mortgage if such institution is not a mortgage originator or secondary market issuer. For example, under this option, in instances where a covered institution sold the mortgage and transferred the servicing to another entity that is not itself a mortgage originator or secondary market issuer, an AVM used by the subsequent institution would not be covered.

> Q13. What are the advantages and disadvantages for small entities of the option to exclude decisions to reduce or suspend a HELOC as provided in an initial credit agreement from the scope of section 1125 versus the alternative option that covers reduction or suspension decisions more broadly?

iii. **Securitization**

A potential option we are considering for the proposal to implement the statutory phrase "to determine the collateral worth" is excluding a secondary market issuer's use of an AVM in the offer and sale of residential mortgage-backed securities (securitization). This discussion is separate from a secondary market issuer's use of an AVM in a mortgage loan origination (as discussed in part II.A.5) to determine the collateral worth of a mortgage secured by a consumer's principal dwelling. For example, even if securitization were excluded, when a Government Sponsored Enterprise (GSE) has relied on a proprietary computer model to offer an appraisal waiver to a lender originating a mortgage loan, the GSEs' use of the model would be subject to the eventual AVM rule.

> Q14. What would be the impact of the rule on small entities if securitization was excluded from the scope of the eventual rule?

> Q15. Does your small entity offer and sell mortgage-backed securities? If so, does your small entity use AVMs to produce any estimates of the collateral worth of a mortgage secured by a consumer's principal dwelling in connection to the securitization process? What quality control standards does your small entity already have in place for AVMs used in securitization?

Excluding AVMs used in securitization is one of various, non-mutually exclusive options discussed in this Discussion Guide that could potentially minimize the impacts on small entities while accomplishing the statutory objectives. For example, as discussed in part II.A.2 above, we preliminarily believe that expressly not covering AVMs used in reviews of completed determinations would mitigate compliance burden for small secondary market issuers. As discussed in part II.F.1 below, in contrast to a prescriptive rule with more detailed and specific requirements, the option of a flexible, principles-based rule regarding AVM quality control standards may, among other things, mitigate compliance burden for small secondary market issuers because institutions could tailor their quality controls for AVMs as appropriate for the size and risk profile of the institution.

> Q16. How might coverage of AVMs used in securitization by the eventual rule change the secondary mortgage market for small entities? In particular, would covering AVMs used in securitization have the potential to affect the cost or availability of credit for small entity consumers?
>
> Q17. If the eventual rule covered AVMs used in securitization, how might the potential impacts on small entities be mitigated by one or more of the other options we are considering in this Discussion Guide? Besides the options discussed in this Discussion Guide, are there any alternative approaches we should consider for mitigating potential impacts on securitization for small entities?

5. Certain AVM use related to appraisal waiver loans

Appraisal waivers are offers to waive the appraisal requirement for originations.[18] In the current market, appraisal waivers are primarily issued by GSEs. When an appraisal waiver is exercised by a mortgage originator, the GSE accepts the estimate submitted as the market value and provides relief from enforcement of representations and warranties on the value of the property.[19]

The proportion of GSE loans using appraisal waivers increased from less than 10 percent prior to June 2019 to an average of 36 percent during 2020, in part due to the COVID-19 pandemic.[20] Appraisal waivers can shorten loan manufacture time,[21] remove an obstruction to refinancing,[22] and eliminate the cost of traditional appraisals.[23] Despite an increasing proportion of GSE loans using appraisal waivers, in its 2020 Request For Information on Appraisal Related Policies, FHFA acknowledged that because the majority of appraisal waivers are offered on rate and term refinance loans already held by GSEs, the lower borrower payments can reduce credit risk.[24] However, in the same report, FHFA cited risks stemming from increased repayment speeds on mortgage securities, loss of ability to assess recent property condition, decline in accuracy of appraisal data, increased model error, erosion of loan quality, and potential gaming by lenders.[25]

We are considering proposing to exclude a mortgage originator’s use of certain AVMs for transactions where the secondary market issuer’s use of an AVM is covered instead. We are considering two potential options.

One option is to exclude the mortgage originator’s use of the secondary market issuer’s AVM for appraisal waiver programs. We recognize that when a mortgage originator applies for an appraisal waiver, the mortgage originator typically does not have access to the secondary market issuer’s underlying AVM. Under this option, the secondary market issuer, and not the mortgage originator, would be responsible for ensuring compliance with quality control standards.

A second option is to exclude the mortgage originator's use of any AVM used exclusively to determine whether a loan qualifies for an appraisal waiver program or to generate a value estimate exclusively for an appraisal waiver program. If the mortgage originator's use of an AVM in the appraisal waiver process is excluded from the scope of the rule, the secondary market issuer's use of an AVM would still be covered by the rule. Secondary market issuers could possibly include entities such as guarantors, insurers, or underwriters of residential mortgage-backed securities (RMBS) that are not necessarily RMBS issuers.

> Q18. What would be the advantages and disadvantages for small entities of excluding a mortgage originator's use of an AVM for appraisal waiver purposes in transactions where the secondary market issuer's use of an AVM is covered instead?

B. Defining "mortgage originators"

FIRREA section 1125 covers AVMs used by "mortgage originators," but does not define the term.[26] We are considering proposing a definition of "mortgage originator" under section 1125 that would cover persons[27] who are "loan originators" for purposes of Regulation Z § 1026.36.

Regulation Z defines "loan originator" as a person who:

> in expectation of direct or indirect compensation or other monetary gain or for direct or indirect compensation or other monetary gain, performs any of the following activities: takes an application, offers, arranges, assists a consumer in obtaining or applying to obtain, negotiates, or otherwise obtains or makes an extension of consumer credit for another person; or through advertising or other means of communication represents to the public that such person can or will perform any of these activities.[28]

Though the definition of "loan originator" under Regulation Z generally excludes servicers, it includes servicers and their employees, agents, or contractors when they perform loan origination activities with respect to any transactions that constitute "refinancings" under Regulation Z § 1026.20(a) or that change an obligor.[29] For example, under Regulation Z, a "refinancing" generally occurs "when an existing obligation that was subject to [subpart C of Regulation Z] is satisfied and replaced by a new obligation undertaken by the same consumer."[30] For purposes of section 1125, we likewise are considering proposing a definition of "mortgage originator" that would cover persons who are servicers for purposes of Regulation Z § 1026.36(c), but only to the extent that they perform loan origination activities for transactions (i) that constitute refinancings under Regulation Z § 1026.20(a) or (ii) that change an obligor on an existing debt.

We further are considering proposing a definition of "mortgage originator" under section 1125 that would cover persons who are "creditors" for purposes of Regulation Z § 1026.2(a)(17).

> Q19. Regulation Z provides that "creditor" means, in part, "[a] person who regularly extends consumer credit that is subject to a finance charge or is payable by written agreement in more than four installments (not including a down payment), and to whom the obligation is initially payable, either on the face of the note or contract, or by

agreement when there is no note or contract." Please provide feedback and information, including supporting data, on the advantages and disadvantages to small entities of defining the term "mortgage originator" in section 1125 to cover persons who are "loan originators" for purposes of Regulation Z § 1026.36(a)(1). Please also provide any alternatives for consideration and explain the advantages and disadvantages of such alternatives.

Q20. Please provide feedback and information, including supporting data, on the advantages and disadvantages to small entities of defining the term "mortgage originator" in section 1125 to cover persons who are "creditors" for purposes of Regulation Z § 1026.2(a)(17). Please also provide any alternatives for consideration and explain the advantages and disadvantages of such alternatives.

Q21. Please provide feedback and information, including supporting data, on the advantages and disadvantages to small entities of defining the term "mortgage originator" in section 1125 to cover persons who are "servicers" for purposes of Regulation Z § 1026.36(c) to the extent that they perform loan origination activities for purposes of Regulation Z § 1026.36(a)(1) with respect to transactions (i) that constitute refinancings under Regulation Z § 1026.20(a) or (ii) that change an obligor on an existing debt. Please also provide any alternatives for consideration and explain the advantages and disadvantages of such alternatives.

C. Defining "secondary market issuers"

We are considering options for a definition of "secondary market issuer" that are consistent with other relevant portions of the Dodd-Frank Act, and could potentially minimize the impacts on small entities while achieving the objectives of section 1125. One option is to define the term "secondary market issuer" to include only entities that issue RMBS. A second option is to define the term more broadly to mean an issuer, guarantor, insurer, or underwriter of RMBS. We preliminarily believe that the appropriate definition of "secondary market issuer" may rely in part on whether AVMs used in securitization are covered by the eventual proposed rule, as discussed in part II.A.4.iii above.

The secondary market uses AVMs for multiple purposes. One main use of AVMs by the secondary market is in the offer and sale of RMBS (securitization) by RMBS issuers. A second main use of AVMs by the secondary market is determining whether a property satisfies the requirements for an appraisal waiver during mortgage origination, as discussed in part II.A.5. We understand that for some mortgages an appraisal waiver is issued by an RMBS issuer, who will incorporate those mortgages into a pool underlying the RMBS; but for other mortgages, an appraisal waiver may not be issued by an RMBS issuer but, rather, by a guarantor, insurer, or underwriter of RMBS.

Q22. Please provide feedback and information, including supporting data, on whether one of the "secondary market issuer" definitions under consideration would be less burdensome for small entities to implement and to administer than the other?

D. Defining "mortgage"

In addition to covering AVMs used by "mortgage originators," section 1125(d) of FIRREA further limits coverage to AVMs used "to determine the collateral worth of a mortgage secured by a consumer's principal dwelling."[31] The word "mortgage" is not defined in the statute. To clarify the type of transactions that this statutory language encompasses, we are considering proposing two alternative definitions of "mortgage."

The first alternative we are considering proposing would be to define "mortgage" as an extension of credit secured by a dwelling.[32]

The second alternative we are considering proposing would be to define the term "mortgage" as a 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 dwelling. This second definition may better implement the statutory objectives by including security interests arising under installment land contracts and any other security interests that may not be understood as credit.

> Q23. Please provide feedback and information, including supporting data, on whether one of the "mortgage" definitions under consideration would be less burdensome for small entities to implement and to administer than the other? Please also provide any alternatives for consideration and explain the advantages and disadvantages of such alternatives.

> Q24. Are AVMs commonly used with installment sales contracts or similar transactions? How often are they used and in what way? On what are you basing your answer?

E. Defining "consumer's principal dwelling"

FIRREA section 1125(d) defines an AVM by reference to "a mortgage secured by a consumer's principal dwelling."[33] Neither FIRREA section 1125 nor title XI of FIRREA[34] defines "consumer's principal dwelling." We are considering whether using a definition that is derived from existing related regulatory requirements could minimize the potential impacts on small entities while achieving the objectives of FIRREA section 1125. Specifically, we are considering proposing to base a definition of "consumer's principal dwelling" generally on how the phrase is used in the CFPB's provisions on valuation independence codified in Regulation Z § 1026.42. The valuation independence regulation applies to certain credit transactions secured by the "consumer's principal dwelling" but also does not define the phrase.

1. Coverage of "consumers"

We are considering proposing a definition that would consider a consumer to be a natural person to whom credit is offered or extended.

Like FIRREA section 1125, the Regulation Z valuation independence regulation states that it applies only to transactions secured by the consumer's principal dwelling.[35] Regulation Z defines "consumer" for general TILA purposes as a "natural person to whom consumer credit is offered or extended" and explains that for certain purposes the term includes "a natural person in whose principal dwelling a security interest is or will be retained or acquired, if that person's ownership interest in the dwelling is or will be subject to the security interest."[36]

Unlike TILA, however, FIRREA section 1125 does not generally limit its coverage to consumer transactions that are primarily for personal, family, or household purposes. In order to retain consistency with the broader scope of FIRREA section 1125, if we propose a TILA-based definition of "consumer's principal dwelling," we are also considering proposing language that clarifies that the definition does not exclude mortgages for which the proceeds are used for other purposes, as long as the mortgage is secured by a consumer's principal dwelling.[37]

> Q25. Please provide feedback and information, including supporting data, on whether the term "consumer" should extend to individuals who are not a party to whom credit is offered or extended, but who have an ownership interest in and use the secured property as their principal dwelling. Please also provide feedback and information, including supporting data, about additional costs or benefits, if any, that would result for small entities from a more inclusive designation of who is a "consumer."
>
> Q26. From your experience, is there a difference between consumer-purpose and business-purpose mortgage lending regarding the relative prevalence of AVMs and in-person appraisals used to determine the worth of the collateral? Do you expect this relative usage to change in the next five years and, if so, how? Please provide any supporting feedback and information, including supporting data.

2. Coverage of "dwelling"

FIRREA section 1125(c)(2) grants enforcement authority to certain agencies, including the CFPB, over "participants in the market for appraisals of 1- to 4-unit single-family residential real estate."[38] The focus on 1- to 4- residential units is also seen in several TILA mortgage-related provisions, such as the valuation independence requirements. For purposes of defining "consumer's principal dwelling" in the AVM rule, we are considering proposing to treat "dwelling" as meaning a residential structure that contains one to four units, whether or not that structure is attached to real property, and including an individual condominium unit, a cooperative unit, a manufactured home, and any other structure used as a residence, regardless of whether the structure is classified as personalty under State law. This treatment would be generally consistent with how the TILA term "dwelling" is implemented in Regulation Z.[39]

Alternatively, we are considering proposing to limit the treatment of "dwelling" to transactions in which the dwelling is secured by real property. This approach to coverage would be consistent with certain other mortgage-related authorities we exercise, such as Real Estate Settlement Procedures Act requirements applicable to federally related mortgage loans, which under Regulation X are defined to cover loans for residential structures or manufactured homes only if the loans will be secured by a lien on real property.[40]

Q27. Please provide feedback and information, including supporting data, on the approach we are considering in defining "dwelling" along with an explanation and supporting data for any alternative approaches we should consider.

Q28. Would limiting coverage of the AVM requirements to dwelling loans secured by real property be significantly less burdensome for small entities than extending coverage to all dwelling-secured loans? Please provide any feedback and information, including supporting data, to support your response.

3. Limiting coverage to "principal" dwelling

The requirements for both the AVM quality control standards in FIRREA section 1125 and the valuation independence requirements in TILA and Regulation Z reference a consumer's "principal" dwelling.[41]

i. "Principal" dwelling

We are considering proposing, as part of the definition of "consumer's principal dwelling" a clarification that the consumer can reside in only one principal dwelling at a time. This clarification would be consistent with the Regulation Z valuation independence regulation and several other Regulation Z provisions, which further explain that a vacation or other second home would not be a principal dwelling.[42]

Q29. Please provide feedback and information, including supporting data, on the approach we are considering in defining a "principal" dwelling. Please also provide any alternatives for consideration and explain, including supporting data, the advantages, and disadvantages for small entities of these alternatives.

ii. Treatment of new construction

Because of the nature of mortgage transactions involving the construction of new residential real estate, the CFPB is considering separately addressing coverage of these transactions in its AVM proposal. Specifically, we are considering proposing that, if a consumer seeks financing for a dwelling under construction or to be constructed and that will become the consumer's principal dwelling upon or within a year following completion of construction, the transaction secured by the new dwelling would be considered a transaction secured by a "principal" dwelling, even before occupancy.

Q30. Are there additional categories of dwellings or transactions that should be considered for addressing in a proposal on how to designate "principal" dwelling for the purposes of implementing the FIRREA section 1125 AVM quality control standards? If so, how should each of the additional categories be addressed? Please provide an explanation and any data available to support your suggestions.

F. Scope of eventual rule requirements

1. Quality control standards generally

As explained above, section 1125(a) of FIRREA requires that AVMs 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; (4) require random sample testing and reviews; and (5) account for any other such factor that the agencies determine to be appropriate. Section 1125(b) requires the agencies to promulgate regulations to implement these quality control standards. In regard to the first four factors, the CFPB is considering proposing two alternative methods for compliance.

In the first alternative for compliance with the quality control factors, the CFPB is considering proposing to require regulated institutions to adopt and maintain their own policies, practices, procedures, and control systems to ensure that AVMs used for covered transactions adhere to quality control standards designed to meet those factors, but not proposing specific requirements for those policies, practices, procedures, and control systems. For the second alternative regarding the quality control factors, the CFPB is considering proposing a prescriptive rule with more detailed and specific requirements in regard to the first four factors.

The CFPB notes that the first four statutory quality control factors appear to be consistent with several agencies' existing guidance regarding models. For example, the OCC, Board, FDIC, and NCUA issued the *Interagency Appraisal and Evaluation Guidelines* (Guidelines), which contain guidance for institutions seeking to establish policies, practices, procedures, and control systems to ensure the accuracy, reliability, and independence of AVMs.[43] The CFPB also notes that it has not issued AVM-specific guidance similar to that issued by the other agencies. Because the other agencies may already have provided sufficient guidance to their regulated institutions to help ensure compliance, the CFPB is considering proposing that the more detailed and specific requirements under the second alternative apply only to those institutions that the statute places under the authority of the CFPB. However, if the CFPB chooses to propose the first alternative described above, requiring maintenance of policies, practices, procedures, and control systems to ensure that AVMs used for covered transactions adhere to quality control standards designed to meet the first four factors, but not proposing specific requirements for those policies, practices, procedures, and control systems, then the CFPB could adopt its own guidance on AVMs.

> Q31. Would small entities be assisted by the CFPB adapting the Guidelines for use by CFPB-regulated institutions and adopting them as guidance rather than adopting specific requirements to implement the statutory quality control factors?
>
> Q32. Would a more prescriptive rule be helpful to small entities? Would it present heightened regulatory burden? Why?

As explained above, under the second alternative the CFPB is considering proposing to specify how CFPB-regulated institutions would address the statutory quality control factors. Examples of potential requirements for each quality control factor are provided below. The CFPB is also considering whether to clarify that the practical application of the quality control requirements would be commensurate with an institution's risk exposures, size, business activities, and the extent and complexity of its use of AVMs.

Under the first statutory quality control factor, institutions must ensure a high level of confidence in the estimates produced by AVMs. For this factor, the CFPB is considering proposing specific requirements that would address, for example, risks that AVMs may suffer from fundamental errors and may produce inaccurate outputs when viewed against the design objective and intended business uses, as well as risks that AVMs may be used incorrectly or inappropriately.

Under the second quality control factor, institutions must protect against the manipulation of data in connection with AVMs. The CFPB is considering proposing specific requirements to ensure that institutions, for example, provide appropriate management oversight of the availability, usability, integrity, and security of the data used.

The third quality control factor requires that the use of AVMs must seek to avoid conflicts of interest. For this factor, the CFPB is considering proposing specific requirements to ensure that an institution's AVM model governance program, for example, provides certainty that the persons who develop, select, validate, or monitor an AVM are all independent of the loan origination or securitization process.

Under the fourth quality control factor, institutions must require random sample testing and reviews of AVMs. The CFPB is considering proposing specific requirements ensuring that an institution establishes ongoing AVM validation through random sample testing and reviews. These specific requirements would address, for example, the specifications for such testing and reviews to address whether a particular AVM is appropriate for a given transaction or lending activity, considering associated risks.

> Q33. Do the examples of specific requirements described for the first four statutory factors appear likely to aid your small entity in implementation of those factors? Are there specific requirements that you believe should be included, consistent with the statutory factors? Does your small entity anticipate facing any specific complexities or costs associated with specific requirements?
>
> Q34. Should the CFPB allow each institution to tailor its methodology to the nature of its risk exposure, size, business activities, and the extent and complexity of its use of AVMs? Do you have suggestions on the best way to do so?

2. Specifying a nondiscrimination quality control factor

Section 1125(a)(5) of FIRREA provides the agencies the discretion to account for any other such factor that the agencies determine to be appropriate.[44] The CFPB is considering proposing to specify a fifth quality control factor to require regulated institutions to adopt policies, practices, procedures, and control systems designed to ensure that AVMs used for covered transactions comply with applicable nondiscrimination laws. While institutions have a preexisting obligation to comply with Federal nondiscrimination requirements, including the Equal Credit Opportunity Act and the Fair Housing Act, a specific quality control factor under section 1125(a)(5) would create an independent requirement for institutions to establish policies and procedures to mitigate against fair lending risk in their use of AVMs.

In regard to the fifth factor, the CFPB is considering proposing two alternative methods for compliance. In the first alternative for compliance with the fifth factor, the CFPB is considering proposing to require regulated institutions to adopt and maintain their own policies, practices, procedures, and control systems to ensure that AVMs used for covered transactions adhere to quality control standards designed to comply with applicable nondiscrimination laws, but not proposing specific requirements for those policies, practices, procedures, and control systems. For the second alternative regarding the fifth factor, the Bureau is considering proposing a prescriptive rule with more detailed and specific requirements.

As an alternative to adopting a fifth factor, the CFPB is considering whether compliance with applicable nondiscrimination laws with respect to AVMs is already encompassed within three of the first four statutory quality control factors requiring a high level of confidence in the estimates produced by AVMs, protection against the manipulation of data, and random sample testing and reviews, such that delineation of a nondiscrimination factor is not necessary.

> Q35. What are the advantages and disadvantages for small entities of specifying a quality control factor on nondiscrimination? Would there be an impact on your costs? Please explain. Are there other alternative approaches the CFPB should consider? Why or why not? What is the basis for this recommendation?
>
> Q36. Does your small entity consider fair lending risk when using AVMs? Please describe your AVM oversight and testing capabilities. Are additional regulatory tools, guidance, or resources needed? Why or why not?
>
> Q37. If your small entity uses a third-party service provider for AVMs, what type of fair lending review, if any, do you conduct of the third-party model?
>
> Q38. What would the start-up and ongoing costs be for your small entity to implement fair lending policies and procedures for AVMs? If these potential costs are difficult to quantify, you are invited to describe these costs qualitatively, such as small, medium, or large as well as outline breakdown of costs. Are there any particular complexities you anticipate under any of the alternatives presented?
>
> Q39. Please provide your small entity's perspective on any of the following potential fair lending issues:
>
> - Risks and benefits of underlying AVM methodologies, *e.g.*, repeat sales indices and mark-to-market, hedonic price models, appraiser emulation;
> - How neighborhood characteristics and amenities (*e.g.*, nearby parks and trails, transit access, grocery stores) should be incorporated in an AVM model;
> - Ensuring unbiased input data;
> - Data accuracy and integrity;

- Use of comparables;
- Geographic segmentation;[45]
- Identifying and quantifying disparities;
- Identifying proxies for prohibited basis characteristics;
- Techniques to measure and monitor for potential discrimination in AVMs; and
- Addressing historical incidences of appraisal bias that may be perpetuated through AVMs.

G. Implementation period

We are considering a 12-month implementation period after issuance of an eventual interagency final rule. A 12-month period would be consistent with title XIV of the Dodd-Frank Act.[46]

We seek input from the SERs on how long small entities would need to conform their practices to the options under consideration. No institution will be required to comply with new regulatory requirements before a proposed rule is published, public comment is received and reviewed by the agencies, a final rule is issued, and the implementation period designated in the final rule concludes.

> Q40. How much time do you estimate your small entity would need to prepare for compliance with an eventual final rule? Are there any particular aspects of the CFPB's options under consideration that could be particularly time consuming or costly for your small entity to implement? Are there any factors outside your small entity's control that would affect its ability to prepare for compliance?

III. Potential Impacts on Small Entities

A. Overview

Computing the number of affected small entities requires knowing the extent to which small entities regulated by the CFPB—small non-depositories—use AVMs and how their use would be affected by the options. Given the extent of available data, the CFPB is not able to reliably ascertain the prevalence of AVM use among small mortgage originators or small secondary market issuers. The CFPB also lacks data and information to quantify costs associated with complying with the options and how much costs would vary across small entities.

The CFPB's preliminary qualitative assessment is that the options under consideration would primarily impact small entities via one-time costs and that ongoing costs would be largely unchanged. However, evolving use cases may require updating policies and procedures, which would entail new costs. The CFPB seeks feedback and information, including supporting data, from SERs on the following:

Q41. For what purposes do you currently use AVMs to determine the value of residential property?

Q42. Do you develop the AVM yourself or do you procure the software from a third party?

Q43. What are your costs associated with AVM use? Are there recurring or variable costs associated with your use of AVMs? Were there any one-time or initial costs associated with your use of AVMs?

If you develop the AVM independently,

Q43A. How many staff do you task to AVM development? How many person-hours per year do you devote to AVM development and implementation?

Q43B. Do you source the AVM model data internally or procure it elsewhere?

Q43C. If you procure third-party data, what features do you procure? How many loans does the data have? What are your costs of procurement, including licensing costs and costs per data point or loan?

Q44. Do you have policies and procedures in place for your use of AVMs in mortgage lending?

If yes,

Q44A. What are the goals of the policies and procedures?

Q44B. As part of the policies and procedures, what discretion does your staff have to override the AVM in case they disagree with its predictions?

Q44C. How did you develop the policies and procedures? How many person-hours per year did you commit to development? If you contracted an outside vendor, did the vendor provide tailored policies and procedures tailored for your entity? If so, how much did those services cost?

Q44D. If applicable, who conducts review of the policies and procedures? How often are the policies and procedures updated and for what reasons? What is your estimated annual cost (in terms of person-hours and in dollar terms) of conducting the review?

Q44E. Are there particular situations (*e.g.*, loan dollar thresholds) where you determine that utilization of an AVM is necessary?

Q45. What type of oversight and review of the AVM do you conduct for both business purposes and compliance with regulation? Do you test and validate the AVM predictions yourself or contract an outside vendor? If you contract an outside vendor, what services does the vendor provide and how much do those services cost?

If you test and validate AVM predictions internally, Q45A. How many staff do you assign to testing and validating AVM predictions? How many person-hours per year do you devote to testing and validating AVM predictions?

Q45B. How do you test model predictions? How do you select data to test the models?

Q45C. If the AVM predictions are deemed to be unreliable, what do you use as an alternative?

B. Small entities covered by the options under consideration

The CFPB has identified certain types of small entities that may be subject to the AVM rule options under consideration and regulated by the CFPB for purposes of the RFA. Specifically, the CFPB has identified several categories of non-depository institutions whose use of AVMs may be covered under the revenue criteria established by the Small Business Administration:[47]

- Real estate credit[48] companies with average annual receipts of $41.5 million or less;
- Secondary market financing companies[49] with average annual receipts of $41.5 million or less;
- Other non-depository credit intermediation[50] companies that originate mortgages with average annual receipts of $41.5 million or less;
- Mortgage and nonmortgage loan brokers with average annual receipts of $8 million or less;[51] and
- Other activities related to credit intermediation[52] such as mortgage loan servicers with average annual receipts of $22 million or less.

Across these five industries, 87 percent to 96 percent of entities' annual receipts would qualify them as small (Table 1).

Table 1: Number and share of non-depository entities by revenue thresholds

	Number of Entities	Fraction of Entities
A. Potentially Small Entities		
Real estate credit (522292)		
< $40M (Revenue)	2,872	87%
< $50M (Revenue)	2,904	88%
Secondary market financing (522294)		
< $15M (Revenue)	101	88%
< $100M (Revenue)	106	92%
All Other Non-depository Credit Intermediation (522298)		
< $40M (Revenue)	5,292	98%
< $50M (Revenue)	5,300	99%
Mortgage and Nonmortgage Loan Brokers (522310)		
< $7.5M (Revenue)	6,609	97%
< $10M (Revenue)	6,643	98%
Other Activities Related to Credit Intermediation (522390)		
< $20M (Revenue)	3,595	95%
< $25M (Revenue)	3,610	96%
B. Large Entities		
Real estate credit (522292)		
> $50M (Revenue)	385	12%
Secondary market financing (522294)		
> $100M (Revenue)	9	8%
All Other Non-depository Credit Intermediation (522298)		
> $50M (Revenue)	122	5%
Mortgage and Nonmortgage Loan Brokers (522310)		
> $10M (Revenue)	166	2%
Other Activities Related to Credit Intermediation (522390)		
> $25M (Revenue)	162	4%

Source: U.S. Census Bureau, 2017 Economic Census, *The Number of Firms and Establishments, Employment, Annual Payroll, and Receipts by Industry and Enterprise Receipts Size: 2017* (May 28, 2021), https://www2.census.gov/programs-surveys/susb/tables/2017/us_6digitnaics_rcptsize_2017.xlsx. The tabulations and shares were computed according to available enterprise size cells.

However, not all small entities use AVMs. The CFPB believes that AVM use is more prevalent among larger entities but is not aware of publicly available data that both identify whether non-depositories use AVMs for covered purposes and their revenues, data that would be necessary to reliably quantify the number of institutions that may be affected by the options under consideration. The CFPB anticipates learning more about small non-depositories' use of AVMs through the SBREFA process. Although only the CFPB is subject to the SBREFA requirement among the agencies collaborating on the AVM rulemaking, other small depository institutions whose use of AVMs may be covered if their assets are $600 million or less, as established by the SBA.[53]

C. CFPB review of compliance processes and costs

The CFPB preliminarily believes that the primary costs of the options under consideration are one-time costs. As noted above, the CFPB is considering proposing a rule that supplements the first four statutory factors with a fifth factor which would require regulated institutions to adopt policies, practices, procedures, and control systems designed to ensure that AVMs used for covered transactions comply with applicable nondiscrimination laws. Here, the CFPB considers the compliance costs associated with the first four statutory factors and, separately, with the fifth potential factor.

Lacking direct or indirect data on costs associated with verifying compliance with the options under consideration, the CFPB is limited to inferring typical costs from alternative sources. These estimates may be inaccurate if verifying compliance is more complex than CFPB forecasts. The estimates may also be inaccurate in describing the breadth of AVM uses in mortgage origination and correspondingly the costs. For typical hourly labor costs, the Bureau draws upon aggregated data from the Bureau of Labor Statistics and the Bureau of Economic Analysis. To estimate the personnel hours required to verify compliance, the CFPB draws upon information derived from a survey of financial institutions used to support the Small Business Lending Data Collection rulemaking, which specifies data points that financial institutions must collect and report in association with applications for small business loans. During the Small Business Lending Data Collection rulemaking process, the CFPB surveyed institutions on the number of personnel-hours they would require for compliance-related tasks, including drafting policies and procedures and legal review. The CFPB classified entities by their origination volumes and estimated that small entities would be Type A (zero to 150 originations) or Type B (151 to 999 originations).[54]

The Small Business Lending Data Collection proposed rule is different in scope and objective from the AVM rulemaking. However, the CFPB uses the Small Business Lending Data Collection proposed rule's one-time cost survey to inform its estimates of personnel hours for two reasons. First, though the Small Business Lending Data Collection proposed rule imposes new reporting requirements on financial institutions, the personnel requirements for drafting policies and procedures may be largely similar. Second, the CFPB is aware of no other sources of information or data that would allow it to quantify the necessary costs or personnel hours for complying with regulations that require quality control policies and procedures.[55] If the hours estimates derived from the survey are poor approximations for the hours required to comply to an eventual AVM rule, the CFPB's cost estimates will be proportionately affected.

For entities that have existing policies and procedures that govern their use of AVMs, these costs are likely limited to legal costs associated with verifying compliance with the eventual final rule. Entities may face lower costs to comply with the first four factors because compliance with current industry standard practices may be sufficient. While the non-depository entities supervised by the CFPB are not subject to the Guidelines issued by the prudential regulators in 2010, the CFPB preliminarily believes that the principles laid out in the Guidelines are considered an industry standard.

In November 2021, employees in the Legal Services industry earned on average $50 per hour.[56] In 2020, compensation costs represented approximately 50 percent of total value added in the legal services industry.[57] Thus, a simple estimate for an average hour of legal services is $100 per hour, which includes non-labor fixed costs and overhead (*e.g.*, computers, office real estate, etc.) and profits.

The Small Business Lending Data Collection proposed rule's one-time cost survey estimated 69 hours were required for legal compliance and review for Type A depository institutions on the lower end of origination volumes.[58] If verifying compliance of policies and procedures with the AVM rule required 69 average hours of legal services, then the implied labor cost (including overhead) would be approximately $7,000. The same institutions also reported $3,300 in non-salary direct expenses.[59] Combined, the total cost would be roughly $10,000.

The CFPB's cost estimates are sensitive to its assumptions. For example, if verifying compliance requires relatively more higher-wage personnel (*e.g.*, lawyers) and relatively fewer lower-wage personnel (*e.g.*, paralegals), then the costs would necessarily be larger. For instance, if verifying compliance primarily required the work of lawyers, then average labor costs would be closer to $70 per hour, by itself increasing the $10,000 estimate to approximately $13,000.[60] If costs reflected purely labor costs without overhead, profits, or non-salary expenses (as may be the case if small entities have in-house legal teams), then costs may be closer to $3,000.[61] The CFPB does not have information on the number or composition of legal personnel that would be required to verify compliance.

The estimates similarly vary with different assumptions about the requisite number of hours required to verify compliance with policies and procedures. Verifying compliance is likely to be more expensive for small entities that use AVMs for more diverse purposes, which may require additional hours of legal consultation. If CFPB underestimates the required number of hours, then the costs would necessarily be larger. In the Small Business Lending Data Collection proposed rule's one-time cost survey, Type B institutions reported an average of 35 required hours and non-depositories reported an average of 55 required hours. The CFPB seeks quantitative or qualitative information from the SERs that would help it compute how costs and personnel requirements associated with compliance vary across small entities.

Notably, the existing Guidelines do not directly discuss applicable nondiscrimination law, which would be covered by the fifth factor under consideration. The CFPB seeks feedback from the SERs on whether current policies governing use of AVMs conform to the Guidelines and whether current policies also ensure that AVM use specifically complies with nondiscrimination laws.

To the extent that small entities' current policies and use of AVMs would comply with the options under consideration, the CFPB does not anticipate the eventual final rule to substantially increase costs. However, for those small entities without policies and procedures concerning AVM use or that deem their policies and procedures insufficient to comply with the eventual final rule, entities would bear costs of drafting and vetting new policies and procedures.

Entities will likely have to spend time and resources reading and understanding the regulation, developing the required policies and procedures for their employees to follow to ensure compliance in addition to engaging a legal team to review their draft policies and procedures. Costs associated with drafting compliant policies and procedures are likely to be higher for institutions who use AVMs for a more diverse set of circumstances. Such entities would likely need to tailor guidance for each specific use case to "ensure a high level of confidence."[62]

Respondents to the Small Business Lending Data Collection proposed rule's one-time cost survey reported the estimated number of hours associated with developing policies and procedures. Type A depository institutions estimated an average 65 required personnel-hours and no non-salary direct expenses.[63] Applying the estimated cost of legal services implies a total cost of about $7,000.[64] Other types of institutions generally reported fewer required hours, but nevertheless, drafting policies and procedures for AVM use may require more labor than those required for the Small Business Lending Data Collection proposed rule. The CFPB seeks feedback on the number of hours small entities would have to devote to developing policies and procedures.

Small entities will also likely have to implement training of staff that utilize AVM output for covered purposes. Correspondingly, costs associated with training will likely be higher for entities that use AVMs for many purposes. However, while training is an ongoing cost, small entities will incur training costs regardless of an eventual AVM rule. The costs attributable to the eventual rule are those associated with changing existing training practices, corresponding analogously to the Small Business Lending Data Collection proposed rule's one-time cost survey on hours associated with training staff. Entities with the lowest origination volume reported an average of 60 hours of required personnel hours.[65] If labor costs to update training practices costs the $100 per hour in Legal Services, this suggests a total cost of roughly $6,000.[66] Type B and Type C respondents to the one-time cost survey with larger origination volumes reported higher labor demands associated with training, an average of 72 and 108 hours, respectively.

The options under consideration cover the use of the AVM, not its development. As such, the CFPB preliminarily believes that small entities will likely incur most of the costs outlined above regardless of whether they develop an AVM on their own or procure one from a third party. In the latter case, the CFPB anticipates that most third parties would be able to provide institution-specific policies, procedures, and training as a service that accompanies the AVM. While entities are ultimately responsible for policies' and procedures' compliance with the eventual final rule, third parties may tailor their services to ensure compliance. Whether small entities' costs increase depends ultimately on whether third party service providers pass along costs. For example, costs may increase if each third-party service provider has to commit 200 labor hours of legal services to customizing policies and procedures for each small entity. Costs may not increase if third-party service providers can sell the same general set of policies and procedures to many small entities with little modification.

[1] Public Law 104-121, 110 Stat. 857 (1996) (5 U.S.C. 609) (amended by Dodd-Frank Act section 1100G).

[2] Public Law 111-203, 124 Stat. 1376 (2010).

[3] Dodd-Frank Act section 1473(q), 124 Stat. 2198 (codified at 12 U.S.C. 3354).

[4] 12 U.S.C. 3354(d).

[5] Public Law 101-73, 103 Stat. 183 (1989).

[6] 12 U.S.C. 3354(a).

[7] 12 U.S.C. 3354(c). *See also* 12 U.S.C. 3350(6) (defining "Federal financial institutions regulatory agencies") and (7) (defining "financial institution").

[8] 12 U.S.C. 3354(c). Unlike the CFPB, the Federal Trade Commission and State attorneys general do not have FIRREA section 1125 rulemaking authority. 12 U.S.C. 3354(b).

[9] 5 U.S.C. 601 *et seq.*

[10] Public Law 104-121, 110 Stat. 857 (1996) (5 U.S.C. 609) (amended by Dodd-Frank Act section 1100G).

[11] 15 U.S.C. 1601 *et seq.*

[12] 15 U.S.C. 1691 *et seq.*

[13] 12 U.S.C. 3354(d). As discussed below, FIRREA section 1125 focuses on mortgages "secured by a consumer's principal dwelling." *Id.*

[14] 12 U.S.C. 3354(d).

[15] *See generally* Bureau of Consumer Fin. Prot., *Compliance Bulletin and Policy Guidance; 2016–02, Service Providers* (Oct. 31, 2016), https://www.consumerfinance.gov/documents/1385/102016_cfpb_OfficialGuidanceServiceProviderBulletin.pdf ("[T]he mere fact that a supervised bank or nonbank enters into a business relationship with a service provider does not absolve the supervised bank or nonbank of responsibility for complying with Federal consumer financial law to avoid consumer harm.").

[16] 12 U.S.C. 3354(d).

[17] For transactions covered by Regulation Z § 1026.40, creditors' ability to suspend further advances or reduce the credit limit is subject to certain limitations.

[18] Fannie Mae, *Fannie Mae Single Family Selling Guide* (Oct. 6, 2021), https://singlefamily.fanniemae.com/media/29306/display.

[19] Fannie Mae, *Appraisal Waivers Fact Sheet* (Dec. 4, 2018), https://singlefamily.fanniemae.com/media/5916/display; Freddie Mac, Guide Section 5601.9, *Seller representations and warranties regarding the mortgaged premises* (June 21, 2021), https://guide.freddiemac.com/app/guide/section/5601.9.

[20] Am. Enter. Inst., *Prevalence of GSE Appraisal Waivers* (July 2021), https://www.aei.org/research-products/report/prevalence-of-gse-appraisal-waivers/.

[21] Freddie Mac, *Automated Collateral Evaluation (ACE)*, https://sf.freddiemac.com/tools-learning/loan-advisor/our-solutions/ace-automated-collateral-evaluation (last visited Oct. 25, 2021).

[22] Urban Inst., *Appraisal Waivers Have Helped Homeowners Find Payment Flexibility Amid Pandemic-Induced Economic Struggles* (Oct. 15, 2020), https://www.urban.org/urban-wire/appraisal-waivers-have-helped-homeowners-find-payment-flexibility-amid-pandemic-induced-economic-struggles.

[23] American Enterprise Institute data show a total of 3.24 million waivers issued in 2020. When multiplied by the average cost of an appraisal from HomeAdvisor ($348), consumers saved $1.13 billion in 2020.

[24] Fed. Hous. Fin. Agency, *Request for Information on Appraisal-Related Policies, Practices, and Processes* (Dec. 28, 2020), https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/RFI-Appraisal-Related-Policies.pdf.

[25] *Id.*

[26] 12 U.S.C. 3354(d).

[27] Regulation Z § 1026.2(a)(22) defines the term "person" to mean "a natural person or an organization, including a corporation, partnership, proprietorship, association, cooperative, estate, trust, or government unit."

[28] 12 CFR 1026.36(a)(1). However, section 1026.36(a)(1) further states that the term "loan originator" does not include:

> (A) A person who does not take a consumer credit application or offer or negotiate credit terms available from a creditor, but who performs purely administrative or clerical tasks on behalf of a person who does engage in such activities. (B) An employee of a manufactured home retailer who does not take a consumer credit application, offer or negotiate credit terms available from a creditor, or advise a consumer on credit terms (including rates, fees, and other costs) available from a creditor. (C) A person that performs only real estate brokerage activities and is licensed or registered in accordance with applicable State law, unless such person is compensated by a creditor or loan originator or by any agent of such creditor or loan originator for a particular consumer credit transaction subject to this section. (D) A seller financer that meets the criteria in [§ 1026.36(a)(4) or (a)(5)], as applicable. (E) A servicer or servicer's employees, agents, and contractors who offer or negotiate terms for purposes of renegotiating, modifying, replacing, or subordinating principal of existing mortgages where consumers are behind in their payments, in default, or have a reasonable likelihood of defaulting or falling behind. This exception does not apply, however, to a servicer or servicer's employees, agents, and contractors who offer or negotiate a transaction that constitutes a refinancing under § 1026.20(a) or obligates a different consumer on the existing debt.

[29] *See* 12 CFR 1026.36(a)(1)(i)(E).

[30] *But see* 12 CFR 1026.20(a)(1) through (5) (exceptions to the general definition).

[31] 12 U.S.C. 3354(d). Section 1125(d) of FIRREA does not distinguish between mortgages secured by a first lien and those secured by a subordinate lien. *See id.*

[32] See part II.E below for a discussion of the scope of the term "dwelling" being considered for proposal by the CFPB.

[33] 12 U.S.C. 3354(d).

[34] 12 U.S.C. 3331 through 3356.

[35] Regulation Z comment 42(a)-2.

[36] Regulation Z § 1026.2(a)(11). Regulation Z § 1026.2(a)(12) defines "consumer credit" to mean "credit offered or extended to a consumer primarily for personal, family, or household purposes."

[37] For example, Regulation Z § 1026.12(a) includes language that applies TILA requirements limiting issuance of credit cards "[r]egardless of the purpose for which a credit card is to be used, including business, commercial, or agricultural use."

[38] 12 U.S.C. 3354(c)(2). The Board, FDIC, OCC, and NCUA, defined as "Federal financial institutions regulatory agencies" by 12 U.S.C. 3350(6), have enforcement authority for AVM quality control standards applicable to the institutions and subsidiaries for which they are the primary Federal supervisors. 12 U.S.C. 3354(c)(1).

[39] Regulation Z § 1026.2(a)(19). *See also* Regulation Z comments 2(a)(19)-2 ("dwelling" does not include recreational vehicles, campers, and similar structures that are not used as residences) and 23(a)(1)-3 ("dwelling" includes structures that are classified as personalty under State law).

[40] *See* Regulation X § 1024.2(b) (federally related mortgage loan) and 1024.5(b)(4).

[41] TILA section 1639e; Regulation Z § 1026.42(a).

[42] *See* Regulation Z comment 42(b)(2)-1.

[43] 75 FR 77450 (Dec. 10, 2010).

[44] 12 U.S.C. 3354(b).

[45] In order to account for differences in neighborhood characteristics and amenities, AVMs often run separate models for different geographic areas. Thus, the models produce different weights, such as value per amenity. The value of a property that sits between the border of two neighborhoods with different property values may vary widely, depending on which model weights are applied.

[46] Section 1473(q) of the Dodd-Frank Act added section 1125 to FIRREA, which directs the agencies to develop regulations for AVM quality control standards. Dodd-Frank Act section 1473(q), 124 Stat. 2198 (codified at 12 U.S.C. 3354). Section 1473(q) is in title XIV of the Dodd-Frank Act and section 1400(c) of the Dodd-Frank Act states that the "regulations required to be prescribed under this title [XIV] or the amendments made by this title shall . . . take effect not later than 12 months after the date of issuance of the regulations in final form." Dodd-Frank Act section 1400(c), 124 Stat. 2136 (codified at 15 U.S.C. 1601 note); *see also* 78 FR 78519, 78524 (Dec. 26, 2013) ("The Dodd-Frank Act . . . requires that regulations required under Title XIV take effect not later than 12 months after the date of issuance of the regulations in final form.") (citation and internal quotation marks omitted).

[47] *See* U.S. Small Bus. Admin., *Table of Small Business Standards Matched to North American Industry Classification System Codes* (effective Aug. 19, 2019), https://www.sba.gov/sites/default/files/2019-08/SBA%20Table%20of%20Size%20Standards_Effective%20Aug%2019%2C%202019_Rev.pdf.

[48] The 2017 six-digit NAICS code for institutions in the "Real estate credit" industry is 522292.

[49] The 2017 six-digit NAICS code for institutions in the "Secondary market financing" industry is 522294.

[50] The 2017 six-digit NAICS code for institutions in the "Other non-depository credit intermediation" industry is 522298.

[51] The 2017 six-digit NAICS code for institutions in the "Mortgage and nonmortgage loan brokers" industry is 522310.

[52] The 2017 six-digit NAICS code for institutions in the "Other activities related to credit intermediation" industry is 522390.

[53] The 2017 four-digit NAICS code for depository institutions is 5221. According to the Bureau's analysis of bank and credit union call report data in 2018, approximately 83 percent of depository institutions have assets below $600 million. Bureau of Consumer Fin. Prot., *Small Business Advisory Review Panel for Consumer Financial Protection Bureau Small Business Lending Data Collection Rulemaking: Outline of Proposals Under Consideration and Alternatives Considered* (Sept. 15, 2020), at 44, https://files.consumerfinance.gov/f/documents/cfpb_1071-sbrefa_outline-of-proposals-under-consideration_2020-09.pdf.

[54] *See id.* at 48.

[55] In a review of the academic literature, the CFPB was unable to find estimates that would reliably inform costs associated with drafting or verifying compliance of policies and procedures related to AVMs. The CFPB seeks feedback or references that could improve its estimates.

[56] U.S. Bureau of Labor Stat., *Employment and Earnings Table B-3a*, https://www.bls.gov/web/empsit/ceseeb3a.htm#ce_ee_table3a.f.1 (modified Jan. 7, 2022).

[57] U.S. Bureau of Econ. Analysis, *Compensation of employees: Domestic private industries: Legal services Vintage: 2022-01-25/Gross Domestic Product: Legal Services (NAICS 5411) in the United States Vintage: 2021-10-01*, https://alfred.stlouisfed.org/graph/?g=Lci4 (last visited Jan. 25, 2022).

[58] Small Business Lending Data Collection under the Equal Credit Opportunity Act (Regulation B), 86 FR 56356, 56556 (Oct. 8, 2021).

[59] *Id*.

[60] U.S. Bureau of Labor Stat., *Occupational Employment and Wages—23-1011 Lawyers* (May 2020), https://www.bls.gov/oes/current/oes231011.htm ($70 per hour times mark-up factor of 2 times 69 hours + $3,300 non-salary direct expenses = $12,960).

[61] $50 per hour times 69 hours = $3,450.

[62] 12 U.S.C. 3354(a).

[63] 86 FR 56356, 56556 (Oct. 8, 2021).

[64] $50 per hour times mark-up factor of 2 times 65 hours = $6,500.

[65] *Id*.

[66] $50 per hour times mark-up factor of 2 times 60 hours = $6,000.

APPENDIX F: PANEL OUTREACH MEETINGS PRESENTATION MATERIALS

See attached.

Automated Valuation Model (AVM) Rulemaking

SBREFA Panel Meetings

March 15-16, 2022

Consumer Financial Protection Bureau

Privacy Act Statement
5 U.S.C. 552a(e)(3)

The information you provide the Consumer Financial Protection Bureau (Bureau) during this session will facilitate the AVM SBREFA panel discussions.

The Bureau will make audio and video recordings of this session.

Information collected will be treated in accordance with the System of Records Notice (SORN), CFPB.022 - Market and Consumer Research Records, 83 FR 23435. Although the Bureau does not anticipate further disclosing the information provided, it may be disclosed as indicated in the Routine Uses described in the SORN. Direct identifying information will be kept private except as required by law.

This collection of information is authorized by Pub. L. No. 111-203, Title X, Sections 1013 and 1022, codified at 12 U.S.C. §§ 5493 and 5512.

Participation is voluntary. However, if you do not consent to the video recordings you will not be able to participate in the session.

MEETING LOGISTICS

Please be aware that this event, sponsored by the Consumer Financial Protection Bureau, is being recorded. The recording will include webcam images and the voices of all speakers. The recording will be shared publicly by the Bureau in a manner that the Bureau deems appropriate. Your attendance will be construed as your consent to these terms. You may turn your webcam off if you do not wish to have your image captured. Any questions or concerns can be directed to the Bureau representative hosting this event.

Connect audio

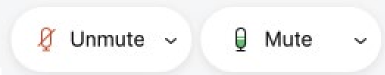
- Use your computer for audio with a headset to reduce background noise. Or have WebEx call your phone.
- If you prefer to connect to audio only:

  US Toll
  +X-XXX-XX-XXXX
  Access code
  XXXX XXX XXXX
  Password
  XXXXXXXXXXXX
  (XXXXXXXX from phones)

- If you experience audio problems, click the three dots ... at the bottom of the screen.

Mute

All **attendees are automatically muted** upon entry. Event producers will unmute attendees as needed.



Manage your view

Use the “Layout” button located near the top of the screen and to the left of “Participants” to change your view.

Speakers

If you are a presenter or panelist and are not speaking, **please mute and turn off your camera.**

Ask a question

- To ask a question during the session, click the “Raise hand” button located to the right side of your name.
- Questions will be answered in the order hands were raised.
- Please turn off your raised hand once your question has been answered.
- You can also ask a question in the chat, located on the right side of the screen. Please address your question to “All Panelists”.

Meeting etiquette

- Panel meetings will be recorded.
- "Presenters" will include SERs, and staff from the CFPB, SBA Office of Advocacy (SBA OA), and the OMB Office of Information and Regulatory Affairs (OIRA).
- When speaking, please consider using a headset to reduce background noise.
- Presenters are responsible for muting/unmuting their lines by clicking on the microphone next to their name. The microphone will be red when off, gray when on.
- All other attendees will be muted during the meeting.

Meeting etiquette (cont'd)

- Presenters are encouraged to keep their video on, by clicking the video camera icon next to their name. The camera will be blue when on, gray when off.
- To make a comment, please click the **raise your hand** function. The moderator or host will call on you by name. Once finished, please click on it again to clear it.

Meeting etiquette (cont'd)

- You can manage your view in WebEx. Full screen view allows you to see video for all presenters (this feature is best if you're using two monitors). Use the arrows in the right corner of your picture to change your view.
- All participants can utilize the **Chat** function to notify the Host of technical issues. If you wish to chat privately, open the chat box and scroll to the person you wish to communicate with; they will be the only one who can see your conversation.

Day 1 welcome

Where SBREFA fits in the rulemaking

We are here

- SBREFA pre-meetings
- SBREFA Panel meeting
- SBREFA Panel Report on input received from SERs
  - Completed ~60 days after the Panel convening
- CFPB prepares joint Notice of Proposed Rulemaking with certain other Federal agencies
- Public comment period
- CFPB and the other involved Federal agencies issue a joint Final Rule
- Implementation period
- Effective date

Determining what activities and entities would be covered

- FIRREA section 1125(d)

"(d) AUTOMATED VALUATION MODEL DEFINED.—For purposes of this section, the term 'automated valuation model' means 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.".

- Define what uses of AVMs "determine the collateral worth"
- Define what "mortgage originators" are
- Define what "secondary market issuers" are
- Define what a "mortgage" is
- Define what constitutes a "consumer's principal dwelling"

A mandate from Congress

"SEC. 1125. AUTOMATED VALUATION MODELS USED TO ESTIMATE COLLATERAL VALUE FOR MORTGAGE LENDING PURPOSES.

"(a) IN GENERAL.—Automated valuation models shall adhere to quality control standards designed to—

"(1) ensure a high level of confidence in the estimates produced by automated valuation models;

"(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 listed in subsection (b) determine to be appropriate.

Day 1 agenda

12:00 – 12:30 PM	Day 1 welcome
12:30 – 1:00 PM	Segment 1: Related Federal statutes and regulations; certain AVM uses
1:00 – 1:30 PM	Segment 2: Certain AVM uses (cont'd); defining "mortgage" and "mortgage originators"
1:30 – 2:00 PM	Segment 3: Certain AVM uses (cont'd); defining "secondary market issuers"
2:00 – 2:30 PM	Break
2:30 – 3:00 PM	Segment 4: Defining "consumer's principal dwelling"
3:00 – 3:30 PM	Segment 5: Options for AVM quality control standards generally
3:30 – 4:30 PM	Segment 6: Specifying a nondiscrimination quality control factor

Day 2 agenda

12:00 – 12:15 PM	Day 2 welcome
12:15 – 12:30 PM	Segment 7: Implementation period
12:30 – 2:30 PM	Segment 8: Potential impacts on small entities
2:30 – 3:00 PM	Break
3:00 – 4:00 PM	Closing remarks

<u>Segment 1</u>: Related Federal statutes and regulations; certain AVM uses

Related Federal statutes and regulations

- We identified the following Federal statutes that, along with their implementing regulations, are related to the options under consideration:
  - Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)
  - Truth in Lending Act (TILA)
  - Equal Credit Opportunity Act (ECOA)

Related Federal statutes and regulations (cont'd)

- Discussion prompts:
  - Are there any other relevant Federal laws or rules which may duplicate, overlap, or conflict with the options under consideration?
  - How might the options under consideration impact other aspects of compliance with Federal law or rules?

AVM uses: Making underwriting decisions

- Option under consideration:
  - AVMs are covered when used for making underwriting decisions regarding the value of collateral, rather than broadly covering AVMs used to produce *any* valuation estimate.

AVM uses: Making underwriting decisions (cont'd)

- Discussion prompts:
  - Do you use AVMs in making underwriting decisions?
  - Do you use AVMs for other purposes, such as monitoring the quality or performance of mortgage loans or mortgage-backed securities?
  - Are there specific complexities or costs that are different for AVMs used in making underwriting decisions versus for other AVM uses?

AVM uses: Reviewing completed determinations

- Option under consideration:
  - Where there is already a completed determination of collateral value, AVMs are not covered when used in subsequent reviews of that completed determination.

AVM uses: Reviewing completed determinations (cont'd)

- Discussion prompts:
  - How often do you use AVMs to subsequently review completed determinations?
  - Do you have quality control processes for that type of AVM use? If so, do they differ from AVM quality control processes when AVMs are used for other purposes?
  - What are the pros and cons of using AVMs to review completed determinations versus using non-AVM methods of review?

AVM uses: Developing appraisals

- Appraisers themselves generally would not be covered by the rule, as the statute applies to AVMs used by "mortgage originators" and "secondary market issuers"
- However, "mortgage originators" and "secondary market issuers" may be responsible for AVMs used by an appraiser (*i.e.*, if the appraiser is in an employment or service provider relationship with the mortgage originator or secondary market issuer)

AVM uses: Developing appraisals (cont'd)

- Option under consideration:
  - Neither mortgage originators nor secondary market issuers would be responsible for an AVM when used by a certified or licensed appraiser (*i.e.*, the rule would not cover such uses)

AVM uses: Developing appraisals (cont'd)

- Discussion prompts:
  - From your experience, how often are AVMs used by certified or licensed appraisers to develop appraisal valuations?
  - What would the impact of the rule be on small entities if it did not cover AVMs when used by certified or licensed appraisers to develop appraisal valuations?

Segment 2: Certain AVM uses (cont'd); defining "mortgage" and "mortgage originators"

AVM uses: Post-origination generally

- Third-party servicers themselves generally would not be covered by the rule, as the statute applies to AVMs used by "mortgage originators" and "secondary market issuers"
- However, "mortgage originators" and "secondary market issuers" may be responsible for AVMs used by a third-party servicer (*i.e.*, if the servicer is in a service provider relationship with the mortgage originator or secondary market issuer)

AVM uses: Loan modifications and other changes to existing loans

- We are considering two alternatives:
  1. Cover AVMs used in transactions that result in the consumer receiving a new mortgage origination
  2. Cover any AVM used to decide whether to change the term of an existing mortgage even if the change does not result in a new origination
     - As long as a "mortgage originator" or "secondary market issuer," or service provider acting on behalf of a mortgage originator or secondary market issuer, uses the AVM to determine the collateral worth

What would be the pros and cons of the first versus the second alternative?

AVM uses: Credit line reductions or suspensions

- We are considering two alternatives:
  1. Not cover AVMs used to determine credit line reductions or suspensions (in line with terms of the initial credit agreement)
  2. Cover AVMs **if** the institution making the reduction or suspension decision is a mortgage originator or secondary market issuer—or their service provider

What are the pros and cons of these two alternatives?

Defining “mortgage”

- In addition to covering AVMs used by “mortgage originators,” section 1125(d) further limits coverage to AVMs used “to determine the collateral worth of a **mortgage** secured by a consumer’s principal dwelling.”

Defining “mortgage” (cont’d)

- The Bureau is considering **two alternate definitions**:
  1. A mortgage is **an extension of credit secured by a dwelling** [covers market well—focuses on credit]
  2. A mortgage is **a 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 dwelling** [would cover installment land contracts and other transactions sometimes not viewed as credit]

Defining “mortgage”: Discussion prompts

- What are the pros and cons of the first alternative versus the second alternative?
  - Please also provide any further alternatives for consideration and explain the pros and cons of such alternatives.
- Are AVMs commonly used with installment sales contracts or similar transactions? How often are they used and in what way? What experiences or information sources inform your answer?

Defining “mortgage originators”

- We are considering options for a definition of “mortgage originator” that would cover persons who, for purposes of Regulation Z (the rules implementing TILA), are:
  - Loan originators;
  - Creditors; or
  - Mortgage servicers.

Defining "mortgage originators" (cont'd)

- Mortgage servicers would be covered **<u>only to the extent</u>** they perform loan origination activities for:
  - Refinancings under Regulation Z; or
  - Transactions that change an obligor on an existing debt.

Consumer Financial Protection Bureau

Defining “mortgage originators” (cont’d)

Broadly speaking, under Regulation Z:

- A “loan originator” is a person who in expectation of or for direct or indirect compensation/monetary gain:
  - Takes an application;
  - Offers, arranges, assists a consumer in obtaining or applying to obtain, negotiates, or otherwise obtains or makes an extension of consumer credit for another person; or
  - Through advertising or other means of communication represents to the public that such person can or will perform any of these activities.

Defining “mortgage originators” (cont’d)

Broadly speaking, under Regulation Z:

- A “creditor” is “[a] person who regularly extends consumer credit that is subject to a finance charge or is payable by written agreement in more than four installments (not including a down payment), and to whom the obligation is initially payable, either on the face of the note or contract, or by agreement when there is no note or contract.”

Defining “mortgage originators” (cont’d)

Broadly speaking, under Regulation Z:

- A “servicer” is “a person responsible for the servicing of a federally related mortgage loan (including the person who makes or holds such loan if such person also services the loan).”
- A “refinancing” generally occurs when an existing obligation that was subject to subpart C of Regulation Z (which relates to closed-end credit) is satisfied and replaced by a new obligation undertaken by the same consumer.

Defining "mortgage originators": Discussion prompt

- What are the pros and cons of defining the term "mortgage originator" in the proposed rule to cover persons who are:
  - "Loan originators" for purposes of Regulation Z § 1026.36(a)(1);
  - "Creditors" for purposes of Regulation Z § 1026.2(a)(17); or
  - "Servicers" for purposes of Regulation Z § 1026.36(c) under the limited circumstances described on slide 31?

<u>Segment 3</u>: Certain AVM uses (cont'd); defining "secondary market issuers"

AVM uses: Securitization

- Option under consideration:
  - Excluding AVMs used in the offer and sale of residential mortgage-backed securities (RMBS)

AVM uses: Securitization (cont'd)

- Discussion prompts:
  - What would be the impact of the rule on small entities if securitization were not excluded from the scope of the eventual rule?
  - Does your small entity offer and sell RMBS?
  - If so, does your small entity use AVMs to produce any estimates of the collateral worth of a mortgage secured by a consumer's principal dwelling in connection to the securitization process?

AVM uses: Appraisal waivers

- We are considering excluding a mortgage originator's use of certain AVMs for transactions where the secondary market issuer's use of an AVM is covered instead.

AVM uses: Appraisal waivers (cont'd)

- We are considering two non-mutually exclusive options:
  1. Exclude the mortgage originator's use of the secondary market issuer's AVM for appraisal waiver programs
  2. Exclude the mortgage originator's use of any AVM used exclusively:
     - To determine if a loan qualifies for an appraisal waiver program; or
     - To generate a value estimate exclusively for an appraisal waiver program

What are the pros and cons of these two options?

Defining "secondary market issuers"

- The secondary market uses AVMs for multiple purposes, including appraisal waivers during mortgage origination and post-origination securitization.
- We are considering two alternate definitions of "secondary market issuers"
  1. Including only entities that issue RMBS
  2. Including an issuer, guarantor, insurer, or underwriter of RMBS

What are the pros and cons of the first versus the second alternative?

Other AVM uses to “determine the collateral worth”

- Discussion prompt:
  - Besides the options we have been discussing, are there any alternative approaches we should consider for implementing the statutory phrase “to determine the collateral worth”?

Day 1 break

Segment 4: Defining "consumer's principal dwelling"

Coverage of "consumers"

- Section 1125(d) limits coverage to AVMs used with mortgages "secured by a **consumer's principal dwelling**."
  - FIRREA does not define "consumer's principal dwelling."
- We are considering basing the definition of "consumer's principal dwelling" on how the same term is used in the Regulation Z valuation independence requirements issued under TILA.
  - Unlike TILA, FIRREA section 1125 does not limit coverage generally to consumer transactions that are primarily for personal, family, or household purposes.

Coverage of "consumers" (cont'd)

- Regulation Z defines "**consumer**" as a natural person *to whom credit is offered or extended.*
  - Sometimes also includes a natural person *in whose dwelling a security interest is or will be retained or acquired.*

Coverage of “consumers”: Discussion prompts

- Should the term “consumer” extend to individuals who are not a party to whom credit is offered or extended, but who have an ownership interest in and use the secured property as their principal dwelling?
  - For example, should the rule cover an AVM used for lending to an LLC or trust where a non-obligor individual owns and uses the home as their principal dwelling?
  - What additional costs or benefits, if any, would result for small entities from a more inclusive designation of who is a “consumer?”

Coverage of "consumers": Discussion prompts (cont'd)

- From your experience, is there a difference between consumer-purpose and business-purpose mortgage lending regarding the relative use of AVMs and in-person appraisals to determine the worth of the collateral? Do you expect this relative usage to change in the next five years and, if so, how?
  - For example, what percentage of mortgages for your consumer clients is underwritten using AVMs instead of in-person appraisals? What percentage of mortgages for your commercial clients is underwritten using AVMs instead of in-person appraisals?

Coverage of "dwelling"

We are considering *two alternate* approaches to the meaning of "**dwelling**":

1. Consistent with Regulation Z, "dwelling" would mean a residential structure that contains one to four units, whether or not that structure is attached to real property or is classified as personal property under State law.
   - Would include individual condominium and cooperative units, manufactured homes, and any other structure used as a residence.
2. Alternatively, we are considering proposing to limit the treatment of "dwelling" to transactions in which the dwelling is secured by real property.

Coverage of “dwelling”: Discussion prompts

- Please provide feedback on the approach we are considering in defining “dwelling” and briefly explain any alternative approaches we should consider.
- What would be the pros and cons of limiting coverage of the AVM requirements to dwelling loans secured by real property rather than extending coverage to all dwelling-secured loans?

Limiting coverage to “principal” dwelling

We are considering clarifying that a consumer can reside in only one “**principal**” dwelling at a time.

- *E.g.*, we might explain that vacation and second homes would not be considered principal dwellings.

Limiting coverage to "principal" dwelling (cont'd)

- To address potential questions regarding new construction, we are considering proposing that:
  - If a consumer seeks financing for a dwelling under construction or to be constructed and that dwelling will become the consumer's principal dwelling within a year following completion of construction,
  - Then the transaction secured by the new dwelling would be considered a transaction secured by a "principal" dwelling, even before occupancy.

Limiting coverage to "principal" dwelling: Discussion prompts

- Please provide feedback on the approach we are considering in defining a "principal" dwelling and briefly explain any alternatives we should consider, including the advantages and disadvantages for small entities of these alternatives.
- In addition to vacation homes, second homes, and new construction, are there categories of dwellings or transactions that we should consider in clarifying "principal" dwelling? If so, how should each of the additional categories be addressed?

Segment 5: Options for AVM quality control standards generally

Options for AVM quality control standards

- Section 1125(a) requires that AVMs 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;
  4. Require random sample testing and reviews; and
  5. Account for any other such factor that the agencies determine to be appropriate.

Options for AVM quality control standards (cont'd)

- Section 1125(b) requires the agencies to write regulations to implement these quality control standards. The CFPB is considering two alternative methods for compliance.
  - **First alternative**: requiring institutions to adopt and maintain their own **policies, practices, procedures, and control systems** to ensure that AVMs used for covered transactions meet the standards, **but not proposing specific requirements** for those policies, practices, procedures, and control systems;
  - **Second alternative**: imposing more **detailed and specific requirements** in regard to the standards.

AVM quality control standards: Discussion prompts

- Would it be better for the CFPB to adopt non-binding guidance for meeting the quality control standards, or to adopt specific requirements to meet them?
- Which alternative would cause less regulatory burden for small entities to adopt and maintain? Why?

Examples of potential requirements for QC factors

- Model risk management practices will vary from institution to institution. The CFPB may clarify that the quality control requirements, examples of which are presented below, **would be tailored to an institution's risk exposures, size, business activities, and the extent and complexity of its use of AVMs**.

Examples of potential requirements for QC factors (cont'd)

1. Ensure a high level of confidence in the estimates produced
   - Example: Address risks that AVMs may suffer from fundamental errors and may produce inaccurate outputs when viewed against the design objective and intended business uses, as well as risks that AVMs may be used incorrectly or inappropriately.
2. Protect against the manipulation of data
   - Example: Ensure that institutions provide appropriate management oversight of the availability, usability, integrity, and security of the data used.

Examples of potential requirements for QC factors (cont'd)

3. Seek to avoid conflicts of interest
   - Example: Ensure that an institution's AVM model governance program provides certainty that the persons who develop, select, validate, or monitor an AVM are all independent of the loan origination or securitization process.
4. Require random sample testing and reviews
   - Example: Address the specifications for such testing and reviews to address whether a particular AVM is appropriate for a given transaction or lending activity, considering associated risks.

Potential specific QC requirements: Discussion prompts

- Should the CFPB allow each institution to tailor its methodology to the nature of its risk exposure, size, business activities, and the extent and complexity of its use of AVMs? Do you have suggestions on the best way to do so?
- Do the examples of specific requirements described for the first four statutory factors appear likely to aid your small entity in implementation of those factors? Are there specific requirements that you believe should be included, consistent with the statutory factors?

Segment 6: Specifying a nondiscrimination quality control factor

Specifying a nondiscrimination quality control factor

- Section 1125(b) allows the agencies to establish requirements to account for any other such factor that the agencies determine to be appropriate. The CFPB is considering using this authority to set a specific quality control standard on nondiscrimination. The standard would require regulated institutions to adopt policies, practices, procedures, and control systems designed to ensure that AVMs used for covered transactions comply with applicable nondiscrimination laws.
- If such a quality control standard is added, institutions would have the flexibility to design fair lending policies, practices, procedures, and control systems tailored to their business model.

Specifying a nondiscrimination quality control factor (cont'd)

- We are also considering imposing more detailed and specific requirements for the nondiscrimination quality control standard.
- In evaluating whether to adopt a specific quality control standard concerning non-discrimination, we are considering whether the other statutory standards already make it clear that compliance with applicable nondiscrimination laws is necessary to comply with the four specifically listed standards, such that we would not need to specifically add a nondiscrimination quality control standard.

Specifying a nondiscrimination quality control factor: Discussion prompts

- What are the pros and cons of specifying a quality control standard on nondiscrimination? Are there other alternative approaches the CFPB should consider?
- Does your small entity consider fair lending risk when using AVMs? Are additional regulatory tools, guidance, or resources needed?
- If you use a third-party service provider for AVMs, do you review the third-party model for fair lending issues?
- Do you currently have fair lending policies and procedures? What types of costs would be relevant for you to implement fair lending policies and procedures for AVMs specifically?

Day 2 welcome

Day 2 agenda

12:00 – 12:15 PM	Day 2 welcome
12:15 – 12:30 PM	Segment 7: Implementation period
12:30 – 2:30 PM	Segment 8: Potential impacts on small entities
2:30 – 3:00 PM	Break
3:00 – 4:00 PM	Closing remarks

Segment 7: Implementation period

Implementation period

- We are considering a 12-month implementation period after issuance of an eventual interagency final rule.
  - A 12-month period would be consistent with title XIV of the Dodd-Frank Act.
  - No institution will be required to comply with new regulatory requirements before a proposed rule is published, public comment is received and reviewed by the agencies, a final rule is issued, and the implementation period designated in the final rule concludes.

Implementation period (cont'd)

- Discussion prompts:
  - How much time do you estimate you would need to prepare for compliance with an eventual final rule?
  - Are there any particular aspects of the options under consideration that could be particularly time consuming or costly for you to implement?
  - Are there any factors outside your control that would affect your ability to prepare for compliance?

Segment 8: Potential impacts on small entities

Potential impacts on small entities

- Q: What would small entities need to do to comply?
  - A: Have policies and procedures that govern AVM use
- Two potential sources of impacts:
  - One-time costs: creating policies and procedures
  - Ongoing costs: amending with changing AVM use cases
- Two cases resulting in potentially different levels of impacts:
  - Small entity already has policies and procedures
  - Small entity does not already have policies and procedures

Potential impacts on small entities (cont'd)

Case 1: Small entity has policies and procedures

- Source of cost: verifying compliance of existing policies
- Reasons costs may be lower:
  - Existing guidance issued by prudential regulators in 2010
- Reasons costs may be higher:
  - Existing guidance does not cover nondiscrimination law
  - Evolving use cases may require revision of policies

Potential impacts on small entities (cont'd)

Case 2: Small entity does not have policies and procedures

- Potential sources of costs:
  - Identifying use cases
  - Drafting policies and procedures
    - Alternatively: procure policies from third party
  - Legal review to ensure compliance with the rule
  - Staff training

Potential impacts on small entities: Discussion prompts

- For what purposes do you currently use AVMs to determine the value of residential property?
- What are your costs associated with AVM use?
- What type of oversight and review of the AVM do you conduct for both business purposes and compliance with regulations?

SER Closing Remarks

Panel Closing Remarks

Submitting written feedback

- SERs are encouraged to submit written feedback.
- Your feedback will help inform the written SBREFA panel report.
- Deadline for SER submission is **April 8, 2022** in order to be considered and incorporated into the panel report.
- Send feedback to: 2022-SBREFA-AVM@cfpb.gov

Submitting written feedback (cont'd)

- Written feedback from SERs will be appended to the SBREFA panel report, which will be made part of the public rulemaking docket.
- If you are considering submitting proprietary or confidential business information, please contact us in advance to discuss whether and how that information should be provided.
- Written feedback will be shared with SBA OA and OIRA.

(The Bureau also encourages other stakeholders to submit written feedback. However, their feedback will not be incorporated into the SBREFA panel report. Feedback from other stakeholders is requested by May 13, 2022.)

Thank you!