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Federal Regulators Act to Enhance Property Valuations During Mortgage Origination Process

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On July 17 and 18, 2024, federal financial regulators adopted rules and guidance setting forth expectations in the mortgage industry that originators properly oversee use of automated valuation models (AVMs) and entertain applicant challenges to appraisals during the application process. The AVM rule and reconsideration of value (ROV) guidance reflect a continued focus at the federal level on ensuring the appropriateness of valuations to support the mortgage lending process and putting in place controls to mitigate risk of appraisal bias.

Automated valuation models (AVMs)

The final rule

On July 17, 2024, the Consumer Financial Protection Bureau (CFPB), Office of the Comptroller of the Currency (OCC), Federal Reserve Board (FRB), Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA) and Federal Housing Finance Agency (FHFA) issued a final rule requiring mortgage originators and secondary market participants to implement quality control standards regarding the use of AVMs in assessing property values in connection with credit transactions and securitization determinations. In issuing the final rule, the agencies indicated that, although AVMs have the potential to reduce bias because they typically involve less human discretion over important credit decisions, they also can lead to more widespread discrimination because of the high volume of valuations that a single – but faulty – AVM can process.

Accordingly, under the final rule, covered institutions will be required to adopt policies, practices, procedures and control systems (such as internal and external audits and risk, quality control and quality assurance reviews) designed to:

- Ensure a high level of confidence in AVM estimates.
- Protect against the manipulation of data.
- Seek to avoid conflicts of interest.
- Require random sample testing and reviews.
- Comply with applicable nondiscrimination laws.

Coverage

The final rule applies to AVMs used in connection with "credit decisions" by mortgage originators and "covered securitization determinations" by secondary market issuers. A "mortgage originator" means any person who, for direct or indirect compensation or gain, or in the expectation of direct or indirect compensation or gain, takes a residential mortgage loan application, assists a consumer in obtaining or applying to obtain a residential mortgage loan, or offers or negotiates terms of a residential mortgage loan, and includes any person who represents to the public that they can or will do the same. Consistent with the proposed rule, the final rule applies to using AVMs in connection with "credit decisions" – i.e., decisions regarding whether and under what terms to originate, modify, terminate or make other changes to a mortgage, including decisions whether to extend new or additional credit or to change the credit limit on a line of credit.

A "secondary market issuer" is "any party that creates, structures, or organizes a mortgage-backed securities transaction." For purposes of these issuers, the rule applies to "covered securitization determinations," which mean determinations of whether to waive an appraisal requirement in connection with a secondary market mortgage purchase or determinations related to structuring and marketing initial offerings of mortgage-backed securities. Therefore, the final rule does not govern the use of AVMs in monitoring mortgage performance, reviewing the quality of already completed value determinations or the development of an appraisal by a licensed or certified appraiser.

Reconsiderations of value (ROVs)

On July 18, 2024, the same group of federal regulators (with the exception of the FHFA) issued final guidance addressing ROVs for residential real estate transactions. ROVs, as defined under the final guidance, are requests from a financial institution to an appraiser or other preparer of a valuation report to reassess the value of a residence contained in an initial valuation. The final guidance emphasizes that a financial institution's use of third parties in the valuation process does not absolve the financial institution from complying with applicable laws and regulations. It also provides examples of policies and procedures that a financial institution can implement to identify, address and mitigate discrimination risk when obtaining ROVs. Among other things, the guidance indicates that financial institutions should consider obtaining ROVs in response to consumer complaints about valuations, establish a process to inform consumers of the ways in which they can raise concerns about valuations before a final credit decision is made, and standardize triggers for obtaining ROVs to increase consistent treatment of consumer concerns regarding valuations.

What's next?

The final rule and final guidance reflect regulators' continued focus on appraisal bias in the mortgage industry, which builds on the Federal Financial Institutions Examination Council (FFIEC) guidance issued in February 2024 that sets forth the compliance framework that lenders must apply to assess and evaluate the risk of discrimination in appraisal practices. As a result, financial institutions should anticipate heightened regulatory expectations around policies and procedures for managing the appraisal process and be prepared to adopt updated policies and procedures implementing the new AVM quality control standards – a process that may take significant time as financial institutions navigate the challenges associated with establishing controls over algorithms developed and maintained by third parties. Although the interagency guidance on ROVs does not have the force or effect of law, financial institutions also should evaluate existing policies and procedures to identify opportunities to incorporate the examples described in the final guidance.

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