U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF ADVOCACY
REGULATION • RESEARCH • OUTREACH

August 21, 2023

VIA ELECTRONIC SUBMISSION

The Honorable Rohit Chopra
Director
Consumer Financial Protection Bureau
1700 G Street NW
Washington, D.C. 20552

The Honorable Michael J. Hsu
Acting Comptroller
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Washington, DC 20219

The Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429-0002

The Honorable Ann Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

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

The Honorable Sandra L. Thompson
Director
Federal Housing Finance Agency
400 Seventh Street, SW
Washington, DC 20219

Re: Quality Control Standards for Automated Valuation Models Docket Numbers OCC-2023-0002, R-1807, NCUA-2023-0019, CFPB-2023-0025; RIN Numbers 3064-AE68, 2590-AA62

Dear Sir/Madam:

On June 21, 2023, the Office of the Comptroller of the Currency (OCC), Federal Reserve System (Federal Reserve), Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA), Consumer Financial Protection Bureau (CFPB), and Federal Housing Finance Agency (FHFA) (collectively, the agencies) published a proposed rule to implement the quality control standards for automated valuation models (AVMs) by mortgage originators and secondary market issuers.[1] These standards are mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act in determining the collateral worth of a mortgage secured by a consumer's principal dwelling. The Office of Advocacy is concerned about the potential impact of the proposed rulemaking on small entities and recommends that the agencies consider other alternatives.

I. Background

A. The Office of Advocacy

Congress established the Office of Advocacy under Pub. L. 94-305 to represent the views of small entities before federal agencies and Congress. Advocacy is an independent office within the U.S. Small Business Administration (SBA). As such, the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The Regulatory Flexibility Act (RFA),[2] as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA),[3] gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, the RFA requires federal agencies to assess the impact of the proposed rule on small entities and to consider less burdensome alternatives.

The Small Business Jobs Act of 2010 requires agencies to give every appropriate consideration to comments provided by Advocacy.[4] The agency must include a response to these written comments in any explanation or discussion accompanying the final rule's publication in the *Federal Register*, unless the agency certifies that the public interest is not served by doing so.[5]

Advocacy's comments are consistent with Congressional intent underlying the RFA, that "[w]hen adopting regulations to protect the health, safety, and economic welfare of the nation,

---

[1] 88 Fed. Reg. 40638 (June 21, 2023).
[2] 5 U.S.C. § 601 et seq.
[3] Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. §601 et seq.).
[4] Small Business Jobs Act of 2010 (PL. 111-240) §1601.
[5] *Id*.

federal agencies should seek to achieve statutory goals as effectively and efficiently as possible without imposing unnecessary burdens on the public."[6]

In addition to the outreach required through the SBREFA panel process, the Office of Advocacy performs outreach through roundtables, conference calls, and other means to develop its position on important issues such as this one. The Office of Advocacy held a roundtable with small entities on August 3, 2023, to discuss the potential impact of this NPRM and less burdensome alternatives to the rule as proposed. Advocacy's comments reflect the feedback that it received from stakeholders about the potential impact of the proposal on small businesses.

B. The Small Business Regulatory Enforcement Fairness Act Panel

Section 609 of the RFA requires the CFPB to conduct special outreach efforts to ensure that small entity views are carefully considered prior to issuing a proposed rule if the rule is expected to have a significant economic impact on a substantial number of small entities.[6] The Bureau convened a SBREFA panel on small business lending data on March 14, 2022 and conducted virtual outreach meetings with small entity representatives (SERs) on March 15-16, 2022.[7] In advance of the panel outreach meeting, the CFPB, Advocacy, and OIRA held a series of telephone conferences with the SERs to describe the small business review process, obtain important background information about each SER's current business practices, and discuss selected portions of the proposals under consideration. The panel issued its report on May 13, 2022.

C. The Proposed Rule

On June 21, 2023, the agencies published a proposed rule to implement the quality control standards for automated valuation models (AVMs) by mortgage originators and secondary market issuers. These standards are mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act in determining the collateral worth of a mortgage secured by a consumer's principal dwelling.

Under the proposal, the agencies would require institutions that engage in certain credit decisions or securitization determinations to do the following:

> 1) Adopt policies, practices, procedures, and control systems to ensure that AVMs used in these transactions to determine the value of mortgage collateral adhere to quality control standards designed to ensure a high level of confidence in the estimates produced by AVMs.
> 2) Protect against the manipulation of data.
> 3) Seek to avoid conflicts of interest.
> 4) Require random sample testing and reviews.

---

[6] *Id.*
[7] CONSUMER FIN. PROT. BUREAU, FINAL REPORT OF THE SMALL BUSINESS REVIEW PANEL ON THE CFPB'S PROPOSALS AND ALTERNATIVES UNDER CONSIDERATION FOR THE AUTOMATED VALUATION MODEL (AVM) RULEMAKING 13 (May 13, 2022), https://www.regulations.gov/document/CFPB-2023-0025-0013 [hereinafter Panel Report].

5) Comply with applicable nondiscrimination laws.

Each agency prepared its own Regulatory Flexibility Act section. The OCC and FHFA certified that the proposed rule would not have a significant economic impact on a substantial number of small entities. The Federal Reserve, FDIC, and CFPB each prepared initial regulatory flexibility analysis (IRFA).

II. The Economic Impact of the NPRM on Small Entities

The estimated economic impact of the proposed rule on small entities varies by agency. Non-depository institutions are regulated by the CFPB. FHFA regulates government sponsored enterprises. Depository institutions are regulated by the other agencies.

The OCC estimates that the compliance costs will be $21,600 per bank.[8] It will impact 661 small entities.[9] However, the OCC estimates that the proposal will only have a significant economic impact on 26 entities.[10]

Federal Reserve estimates that the proposal will have an economic impact of $15,891 per bank.[11] It will impact 472 state member banks and 2,799 bank holding companies and savings and loan holding companies.[12] It should be noted that the Federal Reserve stated that it prepared an IRFA but stated that there were no significant alternatives.[13]

The FDIC estimates that the proposed rule would apply to 2,356 FDIC-small supervised institutions, 10% of those institutions use AVMs.[14] The FDIC believes that the institutions already have guidelines in place to address the requirements of the proposed rule.[15] This assumption is based on a review of 10 years of FDIC bank examination records that found 0.2% of the examinations flagged shortcomings in AVM management practices.[16] The FDIC estimates that the average costs per institution in year 1 would be $11,600 and approximately $3,900 per institution in year 2.[17]

The NCUA estimates that there are 2,981 small federally insured credit unions, of which 1,876 held mortgages.[18] NCUA used the FDIC's estimate that 10% of small institutions use AVMs and

---

[8] 88 Fed. Reg. 40638, 40657.
[9] *Id.*
[10] *Id.*
[11] *Id.* at 40,658.
[12] *Id.*
[13] *Id.*
[14] *Id.* at 40,659.
[15] *Id.*
[16] *Id.*
[17] *Id.*
[18] *Id.* at 40,663.

concluded that the proposed rule could apply to 188 small credit unions.[19] NCUA estimates that the costs would be approximately $1,074 per credit union annually.[20]

The CFPB estimates that the proposed rule will impact a maximum of 3,672 real estate credit small entities, 134 secondary financing small entities, and 716 small entities in other activities related to credit intermediation.[21] The CFPB lacks data on the number of small entities that use AVMs. It used the FDIC's estimate of 10% for a lower bound and 100% for an upper bound.[22] The CFPB concluded that the proposal could impact a range of 452 to 4521 small entities. The CFPB estimates total costs of $23,000 for the first year and $7,667 for subsequent years.[23]

FHFA regulates Fannie Mae and Freddie Mac, which are not small entities.[24]

III. Small Entities Should Not Be Responsible for the Activities of the AVMs

A. Definition of an AVM

Section 1125 of the Financial Institutions Reform, Recovery, and Enforcement Act defines AVMs as computerized models used by mortgage originators and secondary market issuers to determine the collateral worth of certain mortgages. AVMs are being used with increasing frequency because of advances in database and modeling technology and the availability of larger property datasets. AVM technology and data availability have the potential to contribute to lower costs and shorter turnaround times in the performance of property valuations. However, there may be data integrity and accuracy risks associated with AVMs.

B. Small Entities Do Not Control the Activities of the AVMs

Because an AVM may produce a less expensive appraisal quicker than a traditional appraisal, AVMs may be beneficial to consumers. Some small entities use AVMs, while others use traditional appraisals. AVMs may be used less in rural areas because of the availability of data.

Although some small entities use AVMs, they do not control the AVM. AVM providers offer their services to a variety of clients, including real estate agents and brokers, mortgage lenders, and major financial institutions. AVMs are software-based pricing models used in the real estate market to value properties. AVM reports are technology based and include algorithms. Small entities do not control the data that is used in the AVM and, therefore, do not have the ability to quality control the data or the algorithms used by AVM vendors. Moreover, small businesses do not have the bargaining power that a large company may have to demand certain things from an AVM vendor.

---

[19] *Id.*
[20] *Id.*
[21] *Id.* at 40,665.
[22] *Id.* at 40,665-66.
[23] *Id.* at 40,666.
[24] *Id.* at 40,668.

C. Developing a Rule That Is Less Burdensome to Small Entities Benefits Consumers

The SBREFA panel recommended that the CFPB 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.[25] Additional costs and delays due to the usage of traditional appraisals rather than AVMs will be costly for consumers. Because of the potential harm to small entities and consumers, the agencies should adopt less costly alternatives.

As noted above, small entities do not have the bargaining power to compel AVMs to perform in a particular manner. They also do not have the resources to assess the algorithms that are used by AVMs. As such, it is unreasonable to hold them responsible for the actions of AVMs. Advocacy recommends that small entities be exempt from the rulemaking.

If exemption is not possible, the agencies should consider some type of certification program where a third party reviews the AVM and provides an approval. The approval would assure small entities that the AVM complies with the regulatory requirements. It could be similar to standard setting organizations found in other fields.

The agencies should also consider a safe harbor. The SBREFA panel recommended that the CFPB provide clear and simple instructions for complying with the rule and allow for some form of safe harbor.[26] A safe harbor would assist small entities with compliance and decrease the regulatory burden. Advocacy recommends that the agencies develop a safe harbor for small entities if the agencies decide not to exempt small entities from the rulemaking.

D. The Agencies' Should Not Include the Nondiscriminatory Quality Control Requirement in the Final Rule

As noted above, the proposed rule would require institutions that engage in certain credit decisions or securitization determinations to comply with applicable nondiscrimination laws. However, 12 USC § 3354 does not specifically state that quality control standards for AVMs must address the issue of discrimination. It states:

> **(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.

---

[25] Panel Report, *supra* note 7, at 37.
[26] *Id.* at 42.

The agencies are proposing the nondiscrimination requirement pursuant to section(a)(5). Advocacy asserts that including the nondiscrimination requirement is problematic. At the SBREFA panel outreach meeting, the SERs uniformly raised concerns regarding how they could assess fair lending issues in AVMs or know that they are violating the law.[27] They asserted that they are unable to validate the algorithms that AVM providers use and lack the staff to assess the AVM models results.[28] Lenders also do not have access to an AVM's data or methodology.[29]

In addition, there are other mechanisms to address the issue of discrimination. As noted in the NPRM, small entities are already required to comply with nondiscrimination and fair lending laws. Making them responsible for assessing fair lending issues in AVMs adds an extra layer of burden to this rulemaking. Advocacy recommends that the agencies exclude this requirement from the regulation.

IV. The Agencies Should Provide Clear Guidance to Assist Small Entities with Compliance

Given the requirements of the proposed rulemaking, providing clear guidance for complying with the agencies' rulemaking will be helpful to small entities and eliminate confusion. This proposal may impact small depository and non-depository institutions. The entities may lack resources to assist them in understanding regulatory requirements and performing the necessary actions to achieve compliance. Advocacy encourages the agencies to provide guidance to assist small entities in complying with the requirements of the rulemaking.

V. Conclusion

Thank you for the opportunity to comment on this important proposal. If you have any questions or require additional information, please contact me or Assistant Chief Counsel Jennifer A. Smith at (202) 205-6943 or by email at Jennifer.Smith@sba.gov.

Sincerely,

/s/

Major L. Clark, III
Deputy Chief Counsel
Office of Advocacy
U.S. Small Business Administration

[27] *Id.* at 30.
[28] *Id.*
[29] *Id.*

/s/

Jennifer A. Smith
Assistant Chief Counsel
Office of Advocacy
U.S. Small Business Administration

Copy to: Richard L. Revesz
Administrator Office of Information and Regulatory Affairs
Office of Management and Budget