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National Association of Federally-Insured Credit Unions

August 21, 2023

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

RE: Quality Control Standards for Automated Valuation Models (Docket No. NCUA-2023-0019)

Dear Ms. Conyers-Ausbrooks:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the joint notice of proposed rulemaking (NPRM) to implement the quality control standards mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) for the use of automated valuation models (AVMs) by mortgage originators and secondary market issuers in determining the collateral worth of a mortgage secured by a consumer's principal dwelling. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 137 million consumers with personal and small business financial service products. NAFCU and its member credit unions appreciate the opportunity to comment on this proposed rule and urge the agencies to support the integration of dependable technology into the appraisal process in order to streamline procedures, enhance efficiency, and reduce bias, while avoiding regulation that stifles the use of innovative algorithmic valuation models.

Specifically, NAFCU urges the agencies to adopt a principles-based approach to the first four quality control factors. The agencies should also exclude the fifth factor on compliance with nondiscrimination laws, as it would be duplicative and burdensome to put into practice. AVM providers should be tasked with ensuring their models comply with nondiscrimination laws and the providers as well as lenders and other industry stakeholders should participate in a Standards Setting Organization (SSO) to develop standards for the creation and use of fair, equitable, and reliable AVMs.

General Comments

NAFCU is strongly supportive of all efforts to eliminate bias and ensure equity in the home appraisal process, while simultaneously fostering an environment that supports modernizing and streamlining the process, especially for historically disenfranchised communities and demographics. These dual priorities, which might at times appear to conflict, are linked, and have the potential to be jointly remediated through a nuanced, principles-based approach to regulation. Discrimination in the appraisal process is real, as highlighted by the report issued by the interagency task force on Property Appraisal and Valuation Equity (PAVE).[1] This report found an evident market value gap between majority-Black and majority-White neighborhoods for several decades, noting that undervaluation often results in a negative impact on both the seller and buyer, sometimes leading to higher required down payments that can cause the sale to fall through. Undervaluation can also result in a downward price renegotiation, ultimately reducing the seller's financial gains. Additionally, the impact of a lower home valuation can even impact the home values of entire neighborhoods and communities due to the use of comparable sales in future valuations. Mirroring the market value gap, the homeownership gap has significantly increased. While the U.S. homeownership rate increased to 65.5 percent in 2021, the rate among Black Americans lagged significantly at 44 percent, had only increased 0.4 percent in the last 10 years, and was nearly 29 percentage points less than White Americans homeownership rate of 72.7 percent.[2] This disparity represents the largest Black-White homeownership rate gap in a decade.

At the same time, as a result, in part, of the pandemic, NAFCU's member credit unions have seen an increase in the price of appraisals, especially in rural areas. There is a lack of standardization between appraisers and throughout the appraisal process, and the effects of this are carried over to the borrower in increased costs. NAFCU's member credit unions strive to provide their full range of products and services, including mortgage loans, to members in the rural communities, but face challenges in doing so. Often, credit unions are the only financial institutions in a rural community, increasing the need for a more streamlined appraisal process so that these communities have easy access to safe, affordable mortgage credit. In rural communities, the appraisal process is less efficient than anywhere else. Moreover, credit unions have been faced with severe difficulties in securing an appraiser to complete traditional appraisals in these rural areas and sometimes even in urban areas. Just as undervaluation can lead to a discriminatory effect, a lack of access to appraisals and increased costs of appraisals can have a serious impact on rural and underserved areas and similarly harm historically disenfranchised communities.

In order to combat these challenges, NAFCU has recommended that the agencies promote efficiency and cost savings in the mortgage process by streamlining and modernizing the appraisal process.[3] NAFCU supports alternative appraisal processes such as appraisal bifurcation, desktop appraisals, and exterior-only appraisals.[4] There is a need for consistent, reliable technology to simplify the appraisal process and make it more efficient. NAFCU has suggested

[1] PAVE, "Action Plan to Advance Property Appraisal and Valuation Equity" (March, 2022) *available at* https://pave.hud.gov/sites/pave.hud.gov/files/documents/PAVEActionPlan.pdf.
[2] National Association of Realtors, "2023 Snapshot of Race and Home Buying in America" (March 2, 2023) *available at* https://www.nar.realtor/research-and-statistics/research-reports/a-snapshot-of-race-and-home-buying-in-america.
[3] NAFCU, "Letter to Senate Banking Committee on Strengthening Oversight and Equity in the Appraisal Process" (March 23, 2022) *available at* https://www.nafcu.org/letter-senate-banking-committee-appraisals-hearing-File.
[4] NAFCU, "Letter on RFI on Appraisal-Related Policies, Practices, and Processes" (February 25, 2021) *available at* https://www.nafcu.org/comment-letter-fhfa-rfi-appraisal-related-policies-practices-and-processes-File.

that the FHFA continue to permit the use of technology developed to modernize the appraisal process, as well as new and emerging technology, as an alternative to traditional appraisals. Desktop appraisals proved to be much easier and just as accurate for NAFCU's member credit unions to utilize to facilitate mortgage lending.

The ability to use AVMS as well as desktop appraisals or other alternatives and appraisal waivers in rural and underserved areas will decrease the strain placed on NAFCU's member credit unions and their member-borrowers when financing the purchase of a home through the mortgage loan process. The appraisal process would greatly benefit from the integration of consistent reliable technology that streamlines procedures, boosts efficiency, and mitigates bias and discrimination. Furthermore, as is noted by the agencies, through utilizing AVMs, it's possible to decrease the potential for bias and discrimination in the home appraisal process, ensuring a more fair and equitable system. Simultaneously, it is imperative for regulatory bodies, tasked with safeguarding the reliability of algorithmic valuation models, to exercise caution while formulating regulations. These rules should not dampen the spirit of innovation or act as a deterrent for smaller community financial institutions from adopting cutting-edge technology because of prohibitive compliance costs.

First Four Quality Control Factors

In regard to compliance with the first four AVM quality control factors, NAFCU supports a principles-based approach wherein regulated institutions 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. The agencies should avoid a prescriptive rule with overly detailed and specific requirements for the quality control factors. This will allow credit unions to formulate quality control standards that are commensurate in complexity to the size and risk of their mortgage lending practices and ensure that unnecessarily expansive requirements are not required where they are not needed.

This perspective is shared by many financial institutions, particularly those smaller financial institutions for whom the cost of compliance with prescriptive requirements would be more burdensome. This is borne out in the responses elicited from small entity representatives (SER) during the Consumer Financial Protection Bureau's (Bureau) Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) review panel:

> "[O]ne SER explained that their institution focuses on the risk assessed, especially the dollar amount of the loan, and the [principles-based] option would allow them to maintain that focus. That SER further stated that a more prescribed approach would increase their costs and affect their ability to offer services that utilize AVMs, and that the CFPB should allow AVM use to evolve rather than shut down useful innovation with specific controls. Another SER said 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. One 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."[5]

While overly prescriptive requirements should be avoided, the agencies should consider providing additional clarity 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 Bureau should establish guidance to aid small financial institutions such as through clear instruction on how a small entity can monitor compliance regarding use of third-party AVM vendors. NAFCU strongly opposes granting the National Credit Union Administration (NCUA) examination authority over third parties because it would provide no clear benefit to credit unions and their members but instead would result in duplicative regulation as other federal agencies already compile and can share this information with the NCUA. Despite this, NAFCU feels that the NCUA has a role to play in working with the Bureau to develop guidance on compliance monitoring and using existing structures to aid credit unions in enhancing their due diligence and third-party management policies and practices.

Compliance with Applicable Nondiscrimination Laws

History demonstrates that credit unions have served as sources of affordable credit in communities neglected by other lenders, and this tradition informs our industry's longstanding commitment to fair lending principles. Credit unions strongly support laws and regulations aimed at detecting and preventing discrimination, as well as the legal mechanisms used to protect fundamental consumer interests. As cooperatives that are directly accountable to their member-owners, credit unions are focused on developing long-lasting, trusted relationships with their communities—an interest that is best served by adhering to core principles of equality and fairness.

NAFCU urges the agencies to exclude a separate fifth factor for the quality control standards—compliance with applicable nondiscrimination laws. To be clear, NAFCU supports holding AVM providers and developers accountable for compliance with nondiscrimination laws, and credit unions are responsible for conducting due diligence to ensure these providers have a culture of compliance, but to place the burden on credit unions to verify whether an AVM complies with nondiscrimination laws is inappropriate. Compliance with nondiscrimination laws with respect to AVMs is already encompassed by the statutory quality control factors requiring a high level of confidence in the estimates produced by covered AVMs, protection against the manipulation of data, and random sampling and reviews. Furthermore, there is sufficient fair lending regulatory infrastructure already in place under the Equal Credit Opportunity Act (ECOA) and the Fair

[5] 88 FR 40638.

Housing Act (FHA)[6] and adding a fair lending requirement to the quality control standards for AVMs would be duplicative and, therefore, unnecessary.

Moreover, the fifth quality control factor is not specified in the Dodd-Frank Act. The agencies added the factor based on their authority under the Act to account for any other factor that the agencies determine to be appropriate. Addressing the potential for bias in AVMs, the agencies state in the preamble that the increased use of AVMs in property estimation raises concerns about the potential for these models to reflect discriminatory bias. The agencies note that this could occur if the AVMs replicate systemic inaccuracies and historical patterns of discrimination due to the data used or various aspects of their development, design, implementation, or use. The proposed rule seeks to ensure that the data feeding these models does not incorporate any biases that could create discrimination risks. Despite these concerns, the agencies acknowledge that AVMs could potentially reduce human biases because they involve less human discretion than traditional appraisals.

The potential for discrimination resulting from the use of artificial intelligence (AI) in the real estate appraisal process is a valid concern, given that AI systems often learn from historical data which can incorporate past discriminatory practices. However, it is crucial to recognize that documented instances of such bias are not prevalent. While the industry must be alert to the risks, it is counterproductive to stifle innovation and modernization based on unsubstantiated fears. AI has the power to transform the real estate appraisal process by making it faster, more efficient, and potentially even more fair by removing human bias from the equation. It is worth noting that the AI models themselves are not inherently biased or discriminatory, they merely reflect the data from which they learn. AI has the potential to significantly reduce bias in the real estate appraisal process. In essence, while we must remain vigilant to ensure that AI systems are used ethically and responsibly, we should not allow the fear of potential problems halt the progress and benefits that these systems can bring.

The inclusion of a separate quality control factor dealing with nondiscrimination would unnecessarily export the requirements of already existing fair lending regulations, including ECOA and the FHA, to these quality control standards. The FHA prohibits discrimination in the sale, rental and financing of dwellings based on race, color, religion, sex or national origin. The FHA also makes it unlawful "[t]o discriminate against any person in the terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection therewith," because of those same protected characteristics. Furthermore, the Department of Housing and Urban Development's recently reinstated 2013 discriminatory effects rule[7] requires covered entities, such as financial institution lenders, to assess whether adverse fair housing consequences result from any business practice, even if the practice has no explicit discriminatory features.

[6] 42 U.S.C. § 3601 et seq.
[7] 88 FR 19450.

The agencies have failed to recognize the limits on lender discretion in using proprietary underwriting models (e.g., the automated underwriting systems used by Fannie Mae and Freddie Mac), as well as challenges that are likely to arise as AI and machine learning technologies gain acceptance. Specifically, this proposed rule ignores the difficulty an individual lender might face when having to defend third-party, industry standard underwriting software that it has no power to modify. Credit union lenders are well-suited to identify discriminatory outcomes within their own policies, as those policies are under credit union control and within their expertise. However, when they are required to delve into the complexities of an AVM algorithm, or to explore the historical context of the data sets used by the AVM, especially a third-party AVM, this moves beyond core competencies.

Regulatory bodies have yet to provide a clear performance indicator by which a lender could discern any inherent bias within a data set. If the agencies have specific aspects of discriminatory data sets that they seek to identify and prohibit, lenders could certainly avoid using those data sets with concerning traits. However, expecting lenders to demarcate what data sets are unacceptable goes beyond their role of ensuring vendor quality. It instead places them in the role of the regulator, without the protection of qualified immunity that a regulatory body would have. NAFCU urges the joint agencies not to finalize the proposed rule with the fifth factor on nondiscrimination, but rather to provide clear guidance on discriminatory red flags in AVMs so that the AVM developers are put on notice and credit unions have the tools necessary to develop strong vendor quality control standards.

Ensuring compliance with non-discrimination laws in the use of AVMs can pose a considerable challenge for credit unions, especially smaller ones. Smaller credit unions struggle with the inherent lack of bargaining power that they possess in comparison to larger financial institutions. Given their limited resources and market influence, these small credit unions may find it difficult to negotiate favorable terms with third-party AVM providers or demand detailed insights into the operations of their proprietary algorithms. This situation is further exacerbated by the fact that AVM providers are often hesitant to divulge the inner workings of their algorithms, citing the need to protect their proprietary technology and maintain a competitive advantage in the market. While credit unions are willing and able to switch AVM providers and seek out more transparent vendors, to the extent that the AVM industry standard represents opacity in algorithms, credit unions have little recourse.

Credit unions, in line with NCUA regulation, have comprehensive risk-based vendor management programs; however, even the most sophisticated credit union and the most transparent AVM provider may be unable to ascertain which data and inputs to eschew in seeking to avoid discrimination, particularly in terms of disparate impact. This dilemma underscores the need for clearer guidance and potentially, industry standards for transparency and compliance for third-party AVM providers. However, despite these concerns it must once again be noted that the increased use of AVMs in the home appraisal process holds great promise in curtailing instances of bias and discrimination, leading to more unbiased outcomes. Furthermore, the simplicity and accuracy of AVMs makes it an attractive tool to simplify the mortgage lending process and get borrowers into homes and sellers into their next homes faster and with less hassle, potentially shrinking the skyrocketing homeownership gap that our country faces today.

NAFCU supports strong and effective fair lending rules for credit unions that are responsive to technological change. Compliance with fair lending laws, such as the FHA, constitutes an essential part of financial institution supervision and NAFCU supports agency efforts to detect and eliminate discrimination in all forms. As credit unions explore the use of new technology to expand access to credit in communities across America, whether they be rural or urban, we ask that the agencies avoid actions that would chill adoption of this new technology that would ultimately benefit underserved and historically disenfranchised communities. Specifically, NAFCU urges the agencies to exclude the fifth factor for the quality control standards—compliance with applicable nondiscrimination laws.

Standards Setting Organization

NAFCU strongly recommends that the agencies support the creation of a SSO composed of stakeholders involved in the appraisal process. Such a consortium would be in an excellent position to establish robust and informed standards for AVM providers, incorporating diverse perspectives and expertise to address the complexities of these technologies. The SSO could involve representatives from credit unions, other lending institutions, data scientists, and consumer protection groups, among others, ensuring that all relevant interests are considered in the development of these standards.

NAFCU recommends that, rather than requiring financial institutions to validate the compliance of AVM providers with applicable nondiscrimination laws, the SSO is tasked with setting guidelines to ensure compliance. This recommendation aligns with our belief that it is crucial for financial technologies, including AVMs, to adhere to principles of fairness and equality. By outlining clear standards of compliance, the SSO could help prevent the replication of discriminatory biases within AVMs. This approach would be more practical for financial institutions than the alternative of a separate fifth factor for the quality control standards. With clear guidelines set by a SSO, institutions would be able to confidently utilize AVM technologies without needing to delve into the complexities of AVM algorithms or the historical context of the data sets they employ.

Furthermore, we propose that financial institutions that utilize AVMs certified by the SSO be presumed to have complied with the quality control standards and be granted a "safe harbor." This arrangement would allow credit unions and other lenders to focus on their primary mission of serving their members, rather than being burdened with excessive compliance concerns. This safe harbor would provide a reasonable degree of legal protection, recognizing good faith efforts to employ technologies that meet industry-approved standards of fairness, accuracy, and transparency, and it would bolster the adoption of AVMs, thereby reducing the prevalence of human bias. By creating an SSO, the industry can better ensure fair and non-discriminatory lending practices, supporting the progress and adoption of AVMs. Such an organization would strike the right balance between embracing modern technological tools and adhering to critical consumer protections, offering a practical and forward-thinking solution to this complex issue.

Conclusion

NAFCU appreciates the opportunity to comment on the proposed quality control standards. If you have any questions, please do not hesitate to contact me at 703-842-2268 or jakin@nafcu.org.

Sincerely,

James C. Akin
Senior Regulatory Affairs Counsel