

A Review of the Regulatory Framework Impacting Automated Valuation Models

Lee Kennedy
President/CEO
AVMetrics, LLC

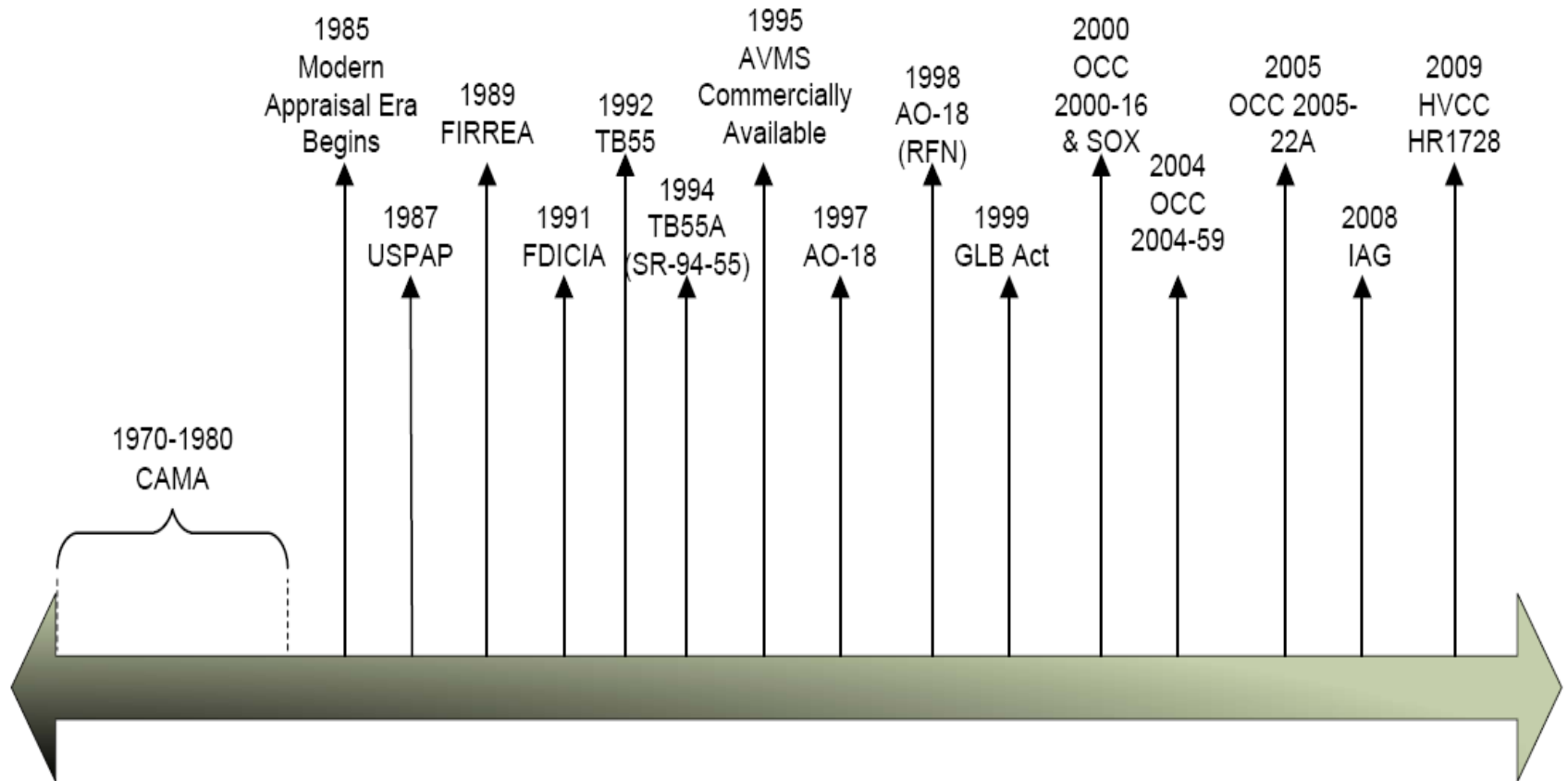


Learning from the Past, Preparing for the Future

Key Regulatory Documents

- What are the critical documents, past and present?
- How are these guidelines evolving?
- What can your lending institution do to comply with the examiners' concerns without negatively impacting your current or future lending practices?

AVM Regulatory Timeline



TB 55a (SR 94-55)

Oldest and most comprehensive Bulletin

(Issued by the Interagency appraisal workgroup)

- Defines what an evaluation is and when it can be used in place of the more traditional “appraisal” process.
- Provides guidance to lending institutions and examiners concerning prudent appraisal and evaluation policies, procedures, practices and standards.
- Supersedes Thrift Bulletin 55 and references clarifications to Title XI (FIRREA) and USPAP.

OCC 2000-16

Crafted to address risk modeling and model validation issues

- Provides guidance to financial institutions on mitigating potential risks arising from reliance on computer-based financial models that are improperly validated or tested.
- Outlines key model validation principles and expectations for a sound model validation process.
- Defines “model risk” as risk that can be derived from “an overly broad interpretation of model results” or “the incorrect use of a model”.

OCC 2000-16 (cont.)

This bulletin defines Models as consisting of three components:

- 1. Informational input** (*delivers assumptions and data to model*)
- 2. Processing** (*theoretical, code driven, converts inputs into estimates*)
- 3. Reporting** (*translates mathematical estimates into business information*)

...and then states that “an effective model validation process must address all three components”.

OCC 2000-16 (cont.)

The bulletin outlines these general procedures for model validation

- “(an) independent review of the logical and conceptual soundness (of the model)”
- “(a) comparison against other (similar) models”
- “(a) comparison of (the) model predictions against subsequent real world events”

In order to satisfy these requirements a lender would need to develop an internal or outsourced testing and auditing program that encompassed the requisite statistical/modeling skills.

OCC 2004-59

First bulletin to address the use of AVMs

- 3 pages of text concerning AVMs in the 134 page document
- Example of text:

“If the bank uses such tools as Automated Valuation Models (AVMs) or Tax Assessment Values to meet evaluation requirements, determine the extent of usage (i.e. for portfolio management or to underwrite individual loan transactions). Also ascertain how management evaluates and ensures the accuracy and validity of these tools on an ongoing basis.”

OCC 2005-22

Credit risk management guidance for home equity lending

This bulletin cites the use of AVMs as a risk component in originating equity loans.

THE TEXT INCLUDES THE FOLLOWING AS AN AREA OF CONCERN:

Specific product, risk management, and underwriting risk factors and trends that have attracted scrutiny are:

- (One of six factors) *Greater use of automated valuation models (AVMs)* and other collateral evaluation tools for the development of appraisals and evaluations

OCC 2005-22 Cont..

- Financial institutions should have appropriate collateral valuation policies and procedures that ensure compliance with the agencies' appraisal regulations and the "Interagency Appraisal and Evaluation Guidelines" (guidelines) In addition, the institution should:
- Implement policies and controls to preclude "value shopping."
- When AVMs are used to support evaluations or appraisals, the financial institution should validate the models on a periodic basis to mitigate the potential valuation uncertainty in the model.
- Financial institutions that use AVMs should have an understanding of how the model works as well as what the confidence scores mean (and) should also establish the confidence levels that are appropriate for the risk in a given transaction or group of transactions.

The Political Climate

"Considerations of stability, safety and systemic risk have to loom larger in the planning, thinking, and strategizing of every financial institution going forward than they have in the past,"

- Lawrence Summers, White House National Economic Council Director – June 12, 2009

Proposed Interagency Guidelines

- Supersede 1994 guidelines
- Draft released 11/08
- Public comment period ended 1/09
- Adoption and implementation pending
- Appendix B provides a discussion of the use of AVMs as a valuation alternative
- Provides guidance on the process for selecting and validating a model

Additional Concerns

- HVCC
 - Private agreement between GSEs and NYAG
 - Sunsets in 2010
 - Mandates testing of “all” valuations used by the lender (Section VI)
- H.R. 1728
 - Passed house vote 2/09
 - Proposes AVM oversight by ASC

Summary

- Regulatory guidance seems to be gelling
- Opportunity to get ahead by adopting “Best Practices”
- Conformity in the application of guidance by the regulatory bodies
- What's next? BPO’s and other evaluation hybrids?
- Proposed “Super-Regulator” on the horizon?

Links

- All OCC Bulletins: www.occ.treas.gov/occ_current.htm
 - SR 94-55: www.federalreserve.gov/boarddocs/SRLETTERS/1994/
 - AO-18: www.appraisalfoundation.org/html/USPAP2004/ao18.htm
 - USPAP: www.appraisalfoundation.org/html/USPAP2003/toc.htm
 - GLB Act: www.ftc.gov/privacy/glbact/glbsub1.htm
 - HR 1728: [thomas.loc.gov/cgi-bin/query/z?c111:H.R.1728:](http://thomas.loc.gov/cgi-bin/query/z?c111:H.R.1728)
 - HVCC: www.efanniemae.com/sf/guides/ssg/relatedsellinginfo/appcode/
 - IAG: www.occ.treas.gov/ftp/release/2008-133a.pdf
 - AVMetrics: www.AVMetrics.net
- This presentation is available from our website

* Many of these documents refer to other bulletins for further clarification and support.

Next Steps

- Understand the guidance— examiners use this in the AVM Model Validation process (Testing & Auditing)
- Gain access to subject matter expertise - internal or outsource
- Document your Model Validation processes and “trend” your resulting analytics
- Testing and auditing results should be reflected in your collateral risk decision policy and procedures
- Contact AVMetrics

AVMetrics, LLC

- An independent AVM test and validation company
- Perform quarterly validations on all AVMs available – usually 18-20
- Delivered AVM test and validation training to OCC examiners
- Content of IAG Appendix B came largely from AVMetrics' input
- Quarterly test consists of 150,000 – 200,000 properties
- Perform a customized analysis to meet client's lending parameters and risk profile
- Engagement is the beginning of the relationship

