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FFIEC Issues Statement on Examination Principles Related to Valuation Discrimination and Bias in Residential Lending

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On February 12, 2024, the Federal Financial Institutions Examination Council (FFIEC) issued a statement of principles that relate to valuation discrimination and bias for its member entities to consider in preparation for their consumer compliance and safety and soundness examinations. The FFIEC specifically states that this statement should neither be interpreted as new guidance, nor signal an increased focus on appraisal practices. Instead, the FFIEC frames this statement as providing transparency into the examination process. The statement comes in the wake of a rule proposed in June 2023 by the six federal agencies aimed at implementing quality control standards for use of automated valuation models (AVMs).

What is the FFIEC?

Founded in 1979, the FFIEC is a formal interagency body that is empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions. The FFIEC member agencies include: the Board of Governors for the Federal Reserve System (Board), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), the Consumer Financial Protection Bureau (CFPB), and the State Liaison Committee. The State Liaison Committee is comprised of representatives from the Conference of State Bank Supervisors, the American Council of State Savings Supervisors, and the National Association of State Credit Union Supervisors.

The FFIEC statement

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In the statement, the FFIEC communicates principles for examination of supervised institutions that will "(i) mitigate risks that may arise due to potential discrimination or bias in those practices, and (ii) promote credible valuations" with regards to residential property appraisal and evaluation practices. The statement reiterates that real estate valuations are an important aspect in underwriting for residential real estate lending, and that as part of the supervision process, examiners assess institutions' compliance management systems and risk management practices for identifying and mitigating potential discrimination or bias in residential property valuations.

The statement identifies how deficiencies in real estate valuations, including those resulting from discrimination or bias, can lead to increased safety and soundness risks, as well as consumer harm. For instance, consumers could be denied access to credit for which they would otherwise be qualified, offered credit at less favorable terms, or steered to a narrower class of loan products. Further, if an institution fails to maintain internal controls to identify valuation discrimination or bias, the institution could be exposed to legal and compliance risks.

The statement articulates principles that relate to both consumer compliance and safety and soundness examinations. The consumer compliance principles provide that the examination process should consider whether the institution's risk management practices for residential real estate valuations are appropriate to identify and address valuation discrimination. One stated principle is that examiners should consider board and senior management oversight. This includes evaluating whether senior management ensures that the institution implements and maintains compliance management systems (including third-party oversight). The other principle is that the examiners should assess the institution's policies and procedures, training, monitoring, and/or audit practices; the institution's consumer complaint response system; and the institution's ability to identify and resolve incidences of potential valuation discrimination.

The statement also sets forth principles related to real estate valuation programs in safety and soundness examinations. The statement specifies that examination processes should include consideration of whether institutions' risk management practices for valuations are appropriate to identify and address valuation discrimination or bias and promote credit valuations. Specifically, the statement communicates that the following principles should guide supervisory assessments of the risks arising from potential valuation discrimination or bias: consumer protection issues, risk assessment, governance, collateral valuation program, third party risk management, valuation review function, credit risk review function, and training program.

The FFIEC statement's relation to interagency automated valuation model rulemaking

This statement comes on the heels of a June 2023 rule proposal issued by the OCC, FRB, FDIC, NCUA, CFPB, and Federal Housing Finance Agency that would implement amendments by the Consumer Financial Protection Act (CFPA) to the Financial Institutions Reform, Recovery, and

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Enforcement Act of 1989 concerning AVMs. The proposed rule would implement quality control standards for use of AVMs by mortgage loan originators in determining the collateral value of a mortgage secured by a consumer's principal dwelling. In particular, institutions that engage in certain credit decisions or securitization determinations would be required to adopt policies, practices, procedures, and control systems to, among other things, ensure that AVMs adhere to quality control standards designed to ensure a high level of confidence in the AVMs' estimates; protect against data manipulation; and comply with applicable nondiscrimination laws. The semi-annual Unified Regulatory Agenda published by the Office of Management and Budget estimates a June 2024 date for a final Interagency AVM rule.

While the statement does not expressly refer to the AVM proposal, it is notable that the five federal financial regulators that issued the statement are participating in the AVM rulemaking. The FFIEC Appraisal Subcommittee also has held a series of public hearings to address appraisal bias issues; the most recent hearing was held the same week as the statement issuance. These actions collectively indicate that the key financial regulators at both the federal and state level are closely scrutinizing financial institutions to ensure that they maintain proper policies and procedures to identify any valuation discrimination or bias and make any required corrections.

How this development may affect your business

This statement provides principles that examiners will implement in both consumer compliance and safety and soundness examinations. Financial institutions should carefully review these principles to determine whether their current policies and procedures conform to them. Further, institutions should consider adopting the statement's principles to enhance the likelihood that they will receive favorable outcomes in their consumer compliance and safety and soundness examinations and to lay the foundation for implementing the AVM interagency final rule.

Contact us

If you have questions about appraisal valuation models, the FFIEC statement, or other matters related to consumer finance compliance, please contact Chris Friedman, Mike Silver, Leslie Sowers, Daniel Wilkinson, or your Husch Blackwell attorney.

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