Federal Financial Institutions Examination Council

3501 Fairfax Drive • E-2035-C • Arlington, VA 22226-3550 • (703) 516-5588 • www.ffiec.gov

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

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Introduction

The Federal Financial Institutions Examination Council (FFIEC),[1] on behalf of its member entities, is issuing this statement to communicate principles for the examination of supervised institutions' (institutions) residential property appraisal and evaluation (valuation) practices to: (i) mitigate risks that may arise due to potential discrimination[2] or bias[3] in those practices, and (ii) promote credible valuations.[4] Real estate valuations are a critical underwriting component in residential real estate lending, both from a consumer compliance and safety and soundness perspective. Therefore, as part of their examination processes, examiners assess institutions' compliance management systems and risk management practices for identifying and mitigating potential discrimination or bias in residential property valuation practices.

Institutions are required to comply with laws and regulations, including anti-discrimination laws. When examiners identify instances or patterns or practices of discrimination in valuation practices, these findings should be reflected in the ratings assigned to an institution pursuant to the FFIEC's Uniform Interagency Consumer Compliance Rating System.[5] From a safety and soundness perspective, each of the federal prudential regulators has appraisal regulations that address appraisal practices at institutions. Evidence of valuation discrimination or bias that negatively affects an institution's safety and soundness

[1] The FFIEC member entities are the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Consumer Financial Protection Bureau (CFPB), the National Credit Union Administration (NCUA), and the State Liaison Committee. The FFIEC was established in March 1979 to prescribe uniform principles, standards, and report forms and to make recommendations to promote uniformity in supervisory matters. Issuance of this statement aligns with the FFIEC's mission of promoting consistency in supervisory matters.

[2] In the context of consumer compliance, "discrimination" is used to refer to prohibited discrimination based on protected characteristics in the residential property valuation process. Distinctions based on protected characteristics as a result of bias that result in a consumer being treated less favorably constitute discrimination.

[3] The Uniform Standards of Professional Appraisal Practice (USPAP) has defined "bias" as a preference or inclination that precludes an appraiser or other preparer of the valuation from reporting with impartiality, independence, or objectivity in an assignment. USPAP Standards 1-4. The safety and soundness of the credit underwriting process and portfolio management may be affected as a result of deficient valuations.

[4] For an overview of issues related to bias in residential real estate transactions, see the Property Appraisal and Valuation Equity (PAVE) Task Force's March 2022 Action Plan to Advance Property Appraisal and Valuation Equity.

[5] Refer to 81 Fed. Reg. 79473 (November 14, 2016); the NCUA, as a member entity, has incorporated the principles of the Uniform Interagency Consumer Compliance Rating System into its Compliance Risk Indicators. The supervisory evaluation of consumer compliance is ordinarily conducted as part of the NCUA's risk-focused examinations of credit unions, not as a separate examination.

should be reflected in an institution's ratings assigned under the Uniform Financial Institutions Rating System (UFIRS).[6]

Risks From Valuation Discrimination and Bias

Institutions rely on real estate valuations when assessing the level of collateral support in residential credit decisions. Deficiencies in real estate valuations, including those due to valuation discrimination or bias, can lead to increased safety and soundness risks, as well as consumer harm and have an adverse impact on borrowers and their communities. Examples of such harm are consumers being denied access to credit for which they may be otherwise qualified, offered credit at less favorable terms, or steered to a narrower class of loan products.

For an institution, the failure of internal controls to identify, monitor, and control valuation discrimination or bias could negatively affect credit decisions, potentially exposing an institution to legal and compliance risks or affecting an institution's financial condition and operations. Furthermore, material findings and concerns related to noncompliance with laws and regulations generally negatively affect the supervisory assessment of an institution's management in a safety and soundness examination.

Applicable Statutes, Regulations, and Guidance

Compliance and Consumer Financial Protection

The Equal Credit Opportunity Act (ECOA) and its implementing regulation, Regulation B, prohibit discrimination in any aspect of a credit transaction based on race, color, religion, national origin, sex (including sexual orientation and gender identity), marital status, age, whether all or part of the applicant's income derives from any public assistance program, or the applicant's good faith exercise of any right under the Consumer Credit Protection Act.[7] The Fair Housing Act (FHA) prohibits discrimination in all aspects of residential real estate-related transactions based on race, color, religion, sex (including sexual orientation and gender identity), national origin, disability, and familial status.[8] Both ECOA and the FHA prohibit discrimination in all aspects of residential real estate-related credit transactions, including in residential property valuations.

The Truth in Lending Act (TILA) and its implementing regulation, Regulation Z, govern the way credit terms are disclosed to consumers and include several provisions that address valuation independence in transactions when a consumer's home is securing the loan.[9]

In addition, section 5 of the Federal Trade Commission Act (FTC Act) prohibits unfair or deceptive acts or practices,[10] and the Dodd-Frank Wall Street Reform and Consumer Protection Act prohibits covered persons (e.g., financial institutions) or service providers of covered persons from engaging in unfair, deceptive, or abusive acts or practices.[11]

Safety and Soundness

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[6] The UFIRS, also known as the CAMELS rating system, is an internal rating system used by the prudential federal supervisory agencies and state supervisory agencies. Refer to 61 Fed. Reg. 67021 (December 19, 1996).

[7] The Equal Credit Opportunity Act is codified at 15 USC 1691 – 1691f et seq.; see also 12 CFR 1002; and the Consumer Protection Financial Bureau's "Equal Credit Opportunity (Regulation B); Discrimination on the Bases of Sexual Orientation and Gender Identity." While this Statement focuses on residential valuations, ECOA covers all lending, including commercial lending.

[8] The Fair Housing Act is codified at 42 USC 3601 – 3619 et seq.

[9] The Truth in Lending Act is codified at 15 USC 1601 – 1667f et seq.

[10] Refer to 15 USC 45(a)(1).

[11] Refer to 12 USC 5531 and 5536.

Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) and the implementing federal appraisal regulations include several requirements to promote the reliability of appraisals in federally related transactions. The provisions of FIRREA mandate that the federal prudential regulatory agencies issue regulations to promote safety and soundness in certain federally regulated institutions' appraisal practices, addressing both appraisal standards and appraiser qualifications.[12]

Under such appraisal regulations, appraisals in federally related transactions are required to conform to USPAP[13] as promulgated by the Appraisal Standards Board of the Appraisal Foundation and are subject to appropriate review for USPAP compliance. In addition, the appraisal regulations include appraiser independence requirements and competency standards for appraisals, among other requirements. Furthermore, the appraisal regulations require evaluations[14] for certain transactions where an appraisal is neither required nor obtained by an institution.

To promote compliance with statutory and regulatory requirements, institutions may establish a formal valuation review program. Effective review programs can enable institutions to identify noncompliance with appraisal regulations or USPAP, inaccuracies, or poorly supported valuations. These review programs can also provide the opportunity for institutions to address deficiencies due to potential valuation discrimination or bias before making a credit decision. The *Interagency Appraisal and Evaluation Guidelines*[15] provide additional information on the valuation review process and identify elements of an effective real estate valuation program.

Valuation practices must also comply with other applicable federal and state laws and regulations. For instance, state licensed and certified appraisers are subject to state laws governing the activities of appraisers.

Examination Principles

Examiners routinely assess risk management processes of institutions' residential lending activity during both consumer compliance and safety and soundness examinations, as applicable. Consumer compliance examinations focus on compliance with consumer protection laws and regulations prohibiting discrimination and other illegal practices, while safety and soundness examinations focus on an institution's financial condition and operations. Because both examination disciplines review an institution's credit functions, including valuation practices, the member entities are providing examination principles tailored for each discipline. These principles focus on the review and assessment of institutions' practices for identifying, monitoring, and controlling the risk of valuation discrimination or bias. The principles for consumer compliance examinations are in Attachment A, and those for safety and soundness examinations are in Attachment B.

Conclusion and Implementation of the Principles

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[12] Refer to 12 CFR 34 (OCC); 12 CFR 225 (FRB); 12 CFR 323 (FDIC); and 12 CFR 722 (NCUA).
[13] Refer to USPAP Standards 1-4 on the Appraisal Foundation's website.
[14] The NCUA uses the term "written estimate of market value" in place of the term "evaluation." See 12 CFR 722.3.
[15] Refer to 75 Fed. Reg. 77449 (December 10, 2010).

Real estate valuations are a critical component of residential real estate lending that support an institution's credit decisions. Valuation discrimination or bias can cause consumer harm, lead to violations of law, and have a detrimental impact on communities. In addition, valuation discrimination or bias could result in deficient and unreliable collateral valuations that undermine an institution's credit decisions and negatively impact its safety and soundness. Member entities will consider the attached examination principles in the context of consumer compliance and safety and soundness examination processes and procedures relative to assessing supervised institutions' residential real estate valuation programs, as applicable.

Attachment A: **Consumer Compliance Examination Principles**

Attachment B: **Safety and Soundness Examination Principles**

Attachment A: Consumer Compliance Examination Principles

The member entities' consumer compliance examination procedures include consideration of whether an institution's compliance management system is commensurate with the institution's risk profile. In assessing compliance management systems, examination processes should consider whether the institution's risk management practices for residential real estate valuations are appropriate to identify and address valuation discrimination. Consistent with the member entities' risk-focused consumer compliance examination approach, examiners should consider the following principles when assessing the risks arising from potential valuation discrimination:

- **Board and senior management oversight:** Evaluation of whether the board of directors and management, as appropriate for their respective roles and responsibilities, ensure that the institution implements and maintains compliance management systems (including third-party oversight) commensurate with the institution's residential real estate lending risk profile, including information provided to the board that communicates the strength of the consumer compliance program.

    Third-party risk management: Evaluation of the institution's oversight of residential real estate valuation third parties' consumer compliance-related policies, procedures, internal controls, and training. Evaluation of an institution's due diligence and ongoing monitoring of third parties, including persons or entities that prepare valuation reports, third-party appraisers, and appraisal management companies, to assess compliance with consumer protection laws and regulations, including anti-discrimination laws.

- **Consumer compliance program:** Assessment of the institution's policies and procedures, training, monitoring, and/or audit practices; the institution's consumer complaint response systems or processes; and the institution's ability to identify and resolve incidences of potential valuation discrimination.

    Policies and procedures: Assessment of the institution's collateral valuation review function for identifying potentially discriminatory valuation practices or results.

    Training program: Assessment of the institution's training programs to ensure that they appropriately address identification of potential discrimination in residential real estate lending and collateral valuation programs, whether internally identified or from consumer inquiries or complaints.

    Monitoring and/or audit: Assessment of the institution's adherence to its policies and procedures designed to identify and address potential discrimination.

    Consumer complaints: Evaluation of the institution's systems or processes for reviewing, documenting, tracking, addressing, monitoring, and handling collateral valuation complaints, including those that allege potential discrimination. This includes handling complaints from various channels and sources (such as letters, phone calls, in person, regulators, third-party service providers, emails, and social media).

Attachment B: Safety and Soundness Examination Principles

Examiners review institutions' residential real estate collateral valuation programs as a component of safety and soundness examinations. Therefore, 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 credible valuations. Consistent with a member entity's risk-focused examination approach, the following principles should guide supervisory assessments of the risks arising from potential valuation discrimination or bias:

- **Consumer protection issues:** Consideration of consumer compliance examination findings, including feedback through discussions with compliance examiners; and reviewing other examination planning information to identify consumer complaints, litigation, and other matters related to valuation discrimination or bias, as applicable.
- **Risk assessment:** Consideration of the materiality of residential real estate lending in relation to the institution's overall lending activities, size, complexity, and risk profile.
- **Governance:** Assessment of the institution's policies, processes, staff organization and resources, control systems, and management information systems for residential real estate collateral valuations, as well as the institution's ability to identify and resolve incidences of potential valuation discrimination or bias.
- **Collateral valuation program:** Evaluation of the institution's practices for selecting, retaining, and overseeing independent, qualified, and competent individuals (and applicable valuation models) that have the ability to render unbiased and credible opinions of collateral value.
- **Third-party risk management:** Evaluation of the institution's oversight of valuation-related third-parties and their review functions, including the institution's understanding of how these third parties identify, monitor, and manage the risks related to valuation discrimination or bias.
- **Valuation review function:** Assessment of the institution's valuation review function for identifying potentially discriminatory or biased valuation results.
- **Credit risk review function:** Assessment of the institution's credit risk review function for residential real estate loan portfolios for appropriate consideration of potentially discriminatory or biased valuations.
- **Training program:** Assessment of the institution's training program intended to provide staff with the knowledge and skills to identify and resolve valuation discrimination or bias.