CADWALADER

Cabinet News and Views

Informed analysis for the financial services industry

Rooting Out Discrimination In Real Estate Valuation and Appraisal

By Mercedes Kelley Tunstall
Partner | Financial Regulation

The Federal Financial Institutions Examination Council ("FFIEC") published a statement on February 12, 2024 regarding "principles for the examination of supervised [institutions'] residential property appraisal and [valuation] practices to: (i) mitigate risks that may arise due to potential discrimination or bias in those practices, and (ii) promote credible valuations." The FFIEC made the statement because "[d]eficiencies 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" and such deficiencies have been acknowledged by the FFIEC's member entities, including the Federal Reserve, the Office of the Comptroller of the Currency ("OCC") and the National Credit Union Association ("NCUA"). In fact, on February 13, 2024, acting Comptroller Michael Hsu remarked to a fourth hearing by the FFIEC's Appraisal Subcommittee on appraisal bias that, "Thanks to a housing shortage and soaring home prices, Americans who own their homes have seen a nearly $12 trillion increase in housing wealth since 2020. While these homeowners may rejoice, many minority homebuyers still face daunting hurdles and endure a widening racial wealth gap . . . [And a]ppraisals are integral to underwriting residential real estate lending: they are the 'value' part of the 'loan-to-value' measure. By rooting out bias in the appraisal system, we can expand homeownership and wealth creation opportunities to all Americans."

Accordingly, the FFIEC has encouraged examiners charged with supervisory financial institutions to evaluate appraisal practices and trends on the basis of both consumer protection grounds and safety and soundness grounds. Specifically on the consumer protection front, the statement reminds examiners that several laws are in place to address patterns and practices of discrimination and bias in real estate appraisals, including the Equal Credit Opportunity Act and Regulation B, the Truth In Lending Act and Regulation Z, the Federal Trade Commission's Section 5 prohibitions against unfair or deceptive acts or practices, and the Consumer

Financial Protection Bureau's own prohibitions against unfair, abusive or deceptive acts or practices under the Consumer Financial Protection Act. Examiners focused on the consumer protection aspects of appraisal bias and discrimination should therefore pay particular attention to board and senior management oversight of the compliance management systems ("CMS") as well as to third-party risk management, as well as to ensure that the CMS consists of robust policies and procedures, training, monitoring, auditing and review of consumer complaints.

On the safety and soundness front, examiners are reminded that in addition to the consumer protection laws, "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." Thus, the risks attendant to potential valuation discrimination and bias should take into account consumer protection concerns, appropriate training protocols and third-party risk management, but also all of the following: 1) consideration of the materiality of residential real estate lending and related credit risks in relation to the institution's overall lending activities, size, complexity, and risk profile; 2) 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; 3) 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; and 4) assessment of the institution's valuation review function for identifying potentially discriminatory or biased valuation results.

Of particular note is the statement's encouragement that institutions establish a formal valuation review program designed to minimize findings regarding potential valuation discrimination or bias, consistent with the Interagency Appraisal and Evaluation Guidelines.
