American Financial Services Association
Consumer Mortgage Coalition
Housing Policy Council / Financial Services Roundtable

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Re: Interim Final Regulation on Appraiser Independence

Dear Ms. Braunstein and Ms. Ryan:

The undersigned financial services trade associations very much appreciate the efforts by the Board of Governors of the Federal Reserve System (Board) to collect information about appraisals in connection with consumer mortgage loans as the Board writes its interim final rule on appraiser independence pursuant to section 1472 of the Dodd-Frank Act.[1] In response to the Board's outreach efforts, we submit the following written comments to assist the Board in this important rulemaking.

Background

Congress enacted a new section 129E in the Truth in Lending Act (TILA) to promote independence in appraisals used in making consumer mortgage loans. One paragraph of the new section 129E requires the Board to write an interim final regulation "prescribing with specificity acts or practices that violate appraisal independence in the provision of mortgage lending services for a consumer credit transaction secured by the principal dwelling of the consumer or mortgage brokerage services for such a transaction and

[1] Dodd-Frank Act, Pub. L. No. 111-203, § 1472 (2010) (to be codified as § 129E of the Truth in Lending Act) (cited hereafter as § 129E).

defining any terms in this section or such regulations."[2] When that interim final regulation is promulgated, the Home Valuation Code of Conduct (HVCC) sunsets.[3]

The interim final regulation is due within 90 days of enactment of the Dodd Frank Act,[4] which, by any measure, is a very short time for writing a regulation.

The Dodd-Frank Act Does Not Require, and Congress Did Not Intend, the Interim Final Rule to Cover Customary and Reasonable Fees

The Statute Does Not Require the Interim Final Rule to Cover Customary and Reasonable Fees

The Dodd-Frank Act nowhere directs the Board to include customary and reasonable fees within its interim final rule under § 129E. The statute requires an interim final rule as follows:

> The Board shall, for purposes of this section, prescribe interim final regulations no later than 90 days after the date of enactment of this section defining with specificity acts or practices that violate appraisal independence in the provision of mortgage lending services for a consumer credit transaction secured by the principal dwelling of the consumer or mortgage brokerage services for such a transaction and defining any terms in this section or such regulations.[5]

The Board's interim final rule is not required to cover fees at all. It must define at least some acts or practices that violate appraisal independence, but is not required to include every possible act that might violate appraisal independence. There is no language in the Dodd-Frank Act requiring the interim final rule to mention, let alone define, customary and reasonable appraisal fees.

Rather, the Dodd-Frank Act authorizes several agencies acting *jointly* to define customary and reasonable fees. In addition to the Board's interim final regulation, several agencies may "jointly issue rules, interpretive guidelines, and general statements of policy with respect to acts or practices that violate appraisal independence in the provision of mortgage lending services . . . within the meaning of subsections (a), (b), (c), (d), (e), (f), (h), and (i)."[6] The reference here to subsection (i) is important because subsection (i) is the subsection that requires appraisal fees to be customary and reasonable. That is, Congress specifically authorized several agencies to conduct rulemakings on customary and reasonable appraisal fees, not just the Board.

It would be an unreasonable for the Board's interim final rule to require certain fee levels,

[2] Section 129E(g)(2).
[3] Section 129E(j). The HVCC is available here: http://www.fhfa.gov/webfiles/2302/HVCCFinalCODE122308.pdf
[4] Section 129E(g)(2).
[5] Section 129E(g)(2).
[6] Section 129E(g)(1).

only to have a joint regulation later reconfigure those fees and require a new implementation process. A rule followed by a different rule, on the same subject, would promote market disruption and regulatory burden, not appraisal independence.

The fact that Congress did not require customary and reasonable fees to be part of the Board's interim final rule, and the fact that Congress authorized several agencies acting jointly to define customary and reasonable fees, both indicate that Congress intended the agencies to consult with each other before defining those fees. It would not be realistic to expect several agencies to consult and agree on a topic as contentious as permissible fees, and conclude a rulewriting, all within 90 days. This means that Congress must have intended customary and reasonable fees to be defined separately from the Board's interim final rule.

Congress Intended That Customary and Reasonable Fees Be Set According To Appropriate Studies To Be Conducted After The Interim Final Rule is in Place

Congress instructed the regulators how to set customary and reasonable fees:

> Evidence for such fees may be established by objective third-party information, such as government agency fee schedules, academic studies, and independent private sector surveys. Fee studies shall exclude assignments ordered by known appraisal management companies.[7]

Today there simply are no studies of appraisal fees sufficient to define customary and reasonable fees. Further, Congress intends customary and reasonable fees to accommodate complex appraisals for which the ordinary customary and reasonable fees may be inappropriately low:

> In the case of an appraisal involving a complex assignment, the customary and reasonable fee may reflect the increased time, difficulty, and scope of the work required for such an appraisal and include an amount over and above the customary and reasonable fee for non-complex assignments.[8]

Again, there simply are no studies in existence establishing customary and reasonable fees on complex appraisals. It would be inappropriate to impute to Congress an intent to rely on or require the use of studies that do not exist.

We can infer that Congress was aware of the absence of reliable studies because Congress required the Government Accountability Office (GAO) to conduct such studies. Congress required the GAO to study several matters relating to appraisals and appraisal fees. The subjects GAO must study include:

- The prevalence of certain appraisal approaches, models, and channels, and their accuracy.

[7] Section 129E(i)(1).
[8] Section 129E(i)(3).

- The costs to consumers of these approaches, models, and channels.

- The disclosure of fees to consumers in the appraisal process.

- The mechanism by which the lender compensates the appraiser.

- How the HVCC affects the cost of appraisals.[9]

The GAO's study is not required to be final until a year after enactment of the Dodd-Frank Act.[10] GAO must provide a status report to Congress within 90 days of enactment,[11] the same date the Board's interim final rule is due. Not only is the GAO study not required to be final before the interim final rule is due, Congress does not expect the GAO to have anything more that possible, preliminary, findings by then.[12]

It would be inappropriate to impute to Congress an intention to require GAO findings to inform a rulemaking only after that very rulemaking is completed.

For these reasons, the only reasonable inference is that Congress intended the rulemaking that sets customary and reasonable fees to be conducted after the GAO studies on appraisals are complete and only after there is a suitably robust basis on which to set customary and reasonable fees.

Creditors Will Avoid Appraisals When The Permissible Fee is Uncertain

Section 129E sets penalties for violations of the customary and reasonable fee restrictions. The penalties are very substantial – up to $10,000 per day for a first violation, and $20,000 for subsequent violations.[13]

These are not the only potential penalties. For appraisals in connection with a bank or thrift, the Federal Deposit Insurance Act (FDIA) sets penalties as well. For appraisals in connection with Fannie Mae, Freddie Mac, or a Federal Home Loan Bank, there are also additional potential penalties.

The Board, Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (the Federal banking agencies) have authority to take enforcement actions, including civil money penalty actions, against "institution-affiliated parties." These include:

> (3) any shareholder (other than a bank holding company), consultant, joint

[9] Dodd-Frank § 1476(c)(1) and (2).
[10] Dodd-Frank § 1476(b)(1).
[11] Dodd-Frank § 1476(b)(2).
[12] Within 90 days of enactment, GAO must report to Congress "on the status of the study and any preliminary findings[.]" Dodd-Frank § 1476(b)(2).
[13] Section 129E(k).

> venture partner, and any other person as determined by the appropriate Federal banking agency (by regulation or case-by-case) who participates in the conduct of the affairs of an insured depository institution; and
> (4) any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in—
> (A) any violation of any law or regulation;
> (B) any breach of fiduciary duty; or
> (C) any unsafe or unsound practice,
> which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution.[14]

This definition is very broad. It authorizes the Federal banking agencies to bring enforcement actions against creditors that are banks or thrifts, and against appraisers and appraisal management companies who work with banks or thrifts.

The types of actions the Federal banking agencies may bring include, but are not limited to, civil money penalty actions against institution-affiliated parties. If an institution-affiliated party violates "any law or regulation", the agency may assess civil money penalties of up to $7,500 per day.[15] Section 129E is a law, so violations of the customary and reasonable fees requirements could expose creditors and appraisal management companies to these penalties. Further, if the violation involves, among other things, recklessness, an unsafe or unsound practice, or "pecuniary gain or other benefit" to the institution-affiliated party, the penalty can be up to $37,500 per day.[16]

The Federal Housing Finance Agency (FHFA) has similar power to assess civil money penalties against an "entity-affiliated party," defined almost the same as an institution-affiliated party.[17] FHFA may assess civil money penalties under many of the same circumstances as the banking agencies,[18] in addition to the other types of actions FHFA may bring against entity-affiliated parties.

Penalties that the Federal banking agencies can assess under the FDIA or that FHFA can assess are *in addition* to penalties under § 129E. There is no question that a violation of § 129E(i) exposes "lenders and their agents" to potentially crippling penalties. The penalties can be so high that lenders and appraisal management companies will not arrange appraisals unless they are certain, ahead of time, that the appraisal fee is permissible, neither too high nor too low. It is important that the Board take this into consideration as it considers customary and reasonable fees, because it means that if the fees are unclear, credit may be inadvertently curtailed.

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[14] 12 U.S.C. § 1813(u).
[15] 12 U.S.C. § 1818(i)(2)(A). The amount of the penalties adjusts for inflation periodically without Congressional action. The Board's current penalty amounts are set out in 12 C.F.R. § 263.65(b)(2)(i).
[16] 12 U.S.C. § 1818(i)(2)(B) and 12 C.F.R. § 263.65(b)(2)(ii).
[17] 12 U.S.C. § 4502(11).
[18] 12 U.S.C. § 4636(b).

We believe a safe harbor will be necessary to prevent inadvertently interrupting credit. We suggest a certain and practical method would be for the lender or appraisal management company to be able to rely on a certification from an appraiser that the appraiser believes the proposed fee is customary and reasonable for an appraisal assignment in the market area.

Pricewaterhouse Coopers, LLP is Conducting a Comprehensive Study of Appraisal Fees to Inform a Rulemaking

In response to the absence of data on which to base a regulation that sets customary and reasonable appraisal fees, the Consumer Mortgage Coalition (CMC) has engaged Pricewaterhouse Coopers (PWC), an independent and respected accounting firm with the capacity to conduct a thorough and reliable study of appraisal fees nationwide. This study will be the first broad study of appraisal fees across geographic areas that will identify the factors that affect appraisal fees. This study and GAO's study will be the only suitable, reasonable measures of customary and reasonable fees.

The PWC study is moving quickly but is not yet complete. We believe it would be advisable for the Board to consider all the reasonable information available before promulgating a final regulation, even if it means not completing a final rule on customary and reasonable appraisal fees as soon as the Board may prefer. Basing a rulemaking only on a sound basis would prevent the Board from promulgating an interim final rule, only to have to start over again with another rulemaking after the PWC and GAO studies collect the information that, for the first time, demonstrates where customary and reasonable fees fall.

We do not believe two rulemakings back-to-back setting, then resetting, appraisal fees is a sound use of the Board's resources, or of the industry's implementation resources.

The Veterans Affairs Appraisal Fee Schedule Sets Maximum Permissible, not Customary and Reasonable, Fees

The Veterans Affairs Schedule Sets Fee Caps, Not Fees

The Department of Veterans Affairs (VA) has its unique schedule of appraisal fees for VA-insured mortgage loans. While this schedule has the advantage of being available, it does not attempt to measure or reflect customary or reasonable fees for VA appraisals. Rather, it sets the maximum permissible fee, and often requires a *lower* fee. As the VA instructs:

> Regardless of the amount of the maximum fee, appraisers and inspectors must not charge veterans more than they charge other clients for similar services.[19]

[19] Veterans Administration Lender's Handbook VA Pamphlet 26-7, Revised (Including Change 1), § 10.12, p. 10-29, available here: http://www.vba.va.gov/ro/roanoke/rlc/forms/VA%20Pamphlet%2026-7.PDF

That is, the VA fee schedule is not designed to measure or even indicate what Dodd-Frank requires. The VA schedule only defines what fee is so high as to be impermissible. Dodd-Frank requires, not a cap, but a customary and reasonable fee.

VA Fees Must Be Measured Differently Than Dodd-Frank Fees

VA fees must be set at the market rates that *individual* appraisers or inspectors charge their "other clients for similar services." The Dodd-Frank Act requires that the "market area" be the basis for the § 129E rule:

> Lenders and their agents shall compensate fee appraisers at a rate that is customary and reasonable for appraisal services performed *in the market area* of the property being appraised.[20]

Fees in a "market area" is a broader measure than fees an individual appraiser charges "other clients." Even if actual VA fees were known, they still would be an inappropriate benchmark for a § 129E rule because VA fees are set by reference to individual appraiser's fees, not market area fees charged by multiple appraisers in the area as § 129E requires.

VA Appraisals Fees Are Not Customary or Reasonable For Non-VA Loans

VA appraisals must meet unique VA standards, and are therefore often higher than non-VA appraisal costs. VA appraisals are done with a more in-depth scope of work than a typical conventional residential appraisal, and this additional work is reflected in the VA fee schedule.

Congress requires the appraisal fees under § 129E to be customary and reasonable. Customary means usual or common. VA loans are less than 5 percent of the market. VA appraisal fees do not represent the cost of appraisal fees in the other 95 percent of the market. VA fees are simply not customary for the other 95 percent of the market.

Nor, for non-VA loans, are they reasonable. They are unreasonably high in a great many cases. VA does not attempt to measure specific fees for specific types of appraisals. The VA sets its fee caps by blending fees for multiple states and jurisdictions that often have a wide range of appraisal fees, reflecting supply and demand for appraisals, and the uniqueness of each market.

More importantly, VA does not allow for tiered pricing based on complexity of the property or for mileage or travel allowances. The result is that in many markets, veterans located in urban and densely populated areas, or whose appraisal is straightforward, are charged more than they would otherwise pay, and in effect subsidize appraisal fees for

[20] Section 129E(i)(1) (emphasis added).

veterans located in rural or non-dense markets or in complex properties.

The Dodd-Frank Act rejects this type of blended approach. It specifically encourages higher fees for complex appraisals, rather than averaging complex appraisals with straightforward appraisals.[21] Again, the VA fee schedule uses a different measure than Dodd-Frank does in § 129E.

We do not believe it would be reasonable or appropriate for one of the first Board rulemakings under the Dodd-Frank Act to result in substantial and unnecessary increases in the appraisal cost that consumers will pay. It is not reasonable to believe Congress intended unnecessary price increases simply because the Board cannot immediately find other fee information.

For these reasons, we believe it would be inappropriate for fees under § 129E(i) to be based on or to reflect the VA appraisal fee caps.

The HVCC Halted the Race to the Bottom of Underwriting Standards

FHFA announced the HVCC on December 23, 2008. It replaced a March 2008 agreement between Fannie Mae, Freddie Mac, the New York Attorney General, and FHFA's predecessor the Office of Federal Housing Enterprise Oversight.

One of the most important improvements that the HVCC has brought to consumer mortgage lending is its prohibition on the use of "any appraisal report completed by an appraiser selected, retained, or compensated in any manner by any other third party (including mortgage brokers and real estate agents)."[22] It is critical that the Board's interim final regulation include this prohibition.

The problem with third parties selecting, retaining, or compensating appraisers is that the third parties are compensated contingent on a loan closing, not contingent on a loan performing. Third parties, no matter how well intentioned, have an incentive to close loans regardless of the soundness of the loan.

It is true that lenders can protect themselves from faulty appraisals by refusing to accept an appraisal ordered by a third party. However, this moves, but does not stop, the problem. In this case, the real estate agent or mortgage broker can simply shop the faulty appraisal at another lender, and another and another, until one lender finally accepts it. When a lender rejects the appraisal, the lender knows that the third party can take the business to the lender's competitor, something lenders have an incentive to avoid.

When one lender rejects a third party appraisal, or even when several lenders do so, the appraisal can still be the basis for a loan to the consumer who wants to finance the particular property. A lender refusing a third party appraisal does not prevent the consumer from getting a loan based on a flawed appraisal. It merely affects which lender

[21] Section 129E(i)(3).
[22] HVCC § III.A.

makes the loan. That is, lenders' refusal to accept third party appraisals *does not prevent consumers from obtaining inappropriate loans*.

As the subprime mortgage crisis has made painfully clear, permitting a race to the bottom of underwriting standards is absolutely inappropriate policy. It hurts consumers, it hurts lenders, and it hurts the mortgage markets. Permitting a third party to shop an appraisal from lender to lender until the lender with the lowest underwriting standards accepts the appraisal is a process of methodically selecting the weakest standards. The HVCC was a major contributor to stopping the race to the bottom of underwriting standards because it empowers and requires lenders – all lenders subject to the HVCC – to reject third party appraisals.

Some have suggested that the SAFE Act,[23] which requires registration and licensure of loan originators, is sufficient to halt the race to the bottom. We respectfully disagree. The race to the bottom resulted from misaligned incentives. The SAFE Act does many things, but does not affect incentives. It therefore cannot prevent a race to the bottom.

For these reasons, it will be *critical* that lenders continue to be required to reject third party appraisals when the HVCC sunsets.

Appraisal Management Companies Contribute to Appraisal Quality

In weighing appraisal independence issues, it is important to understand the several ways in which appraisal management companies (AMCs) promote independence and appraisal quality.

AMCs are companies that maintain panels of preselected appraisers over a wide geographic area. The AMC selects an appraiser for each assignment, provides valuable support services to the appraiser, tracks the process, provides quality control both before and after the appraisal is delivered, sends a final appraisal report to the lender, and warrants the quality of the appraisal.

AMCs provide additional layers of isolation between loan originators and appraisers, and thereby promote independent appraisals.

- Lenders that use AMCs order appraisals from the AMC, not from the appraiser. Further, lenders order appraisals electronically rather than by direct contact between a lender and an AMC. Lenders do not request particular appraisers through an AMC, rather, the AMC selects the appraiser.

- AMCs select the appraiser for each assignment by an automated process that is specifically designed to select a qualified appraiser, independently. Technology

[23] The Safe and Fair Enforcement for Mortgage Licensing Act of 2008, enacted as §§ 1501 – 1517 of the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, codified at 12 U.S.C. §§ 5101 note – 5116.

> advancements enable AMCs to methodically and impartially select qualified, unbiased, appraisers.

Further, AMCs use automated processes to continually rate individual appraisers for appraisal quality. Only appraisers who maintain acceptable standards can be placed on or retained on an AMC's panel of appraisers. Individual appraisers, by contrast, typically rely on their customers or investors to detect and correct their errors, a much less effective method.

AMCs develop and use technology-assisted quality-control programs. AMCs routinely and rapidly subject appraisals to checks for thousands of indicators of a flawed appraisal. This would not be possible without the AMCs' technology, and it is not possible for fee appraisers to conduct so many checks.

Appraisers retained by AMCs have an incentive to deliver unbiased appraisals because they know the AMC measures their accuracy, and they know that inflated appraisals can cost them their employment.

AMCs back their appraisals with significant capital as well as errors and omissions insurance, both of which most individual appraisers lack. This is an important protection that enhances the safety and soundness of mortgage lenders, while it benefits private investors.

The AMCs are subject to review and examination by the Federal banking agencies as third-party vendors to insured institutions. AMCs are also required by their highly regulated lender clients to comply with the various laws and regulations that apply to lenders, including GLBA, RESPA, FIRREA, USPAP, federal agency guidance on appraisal operations, Regulation Z, and now § 129E.

It is interesting to note a report by the Auditor of the State of Hawaii on a proposal to regulate AMCs. The Auditor found that additional regulation of AMCs would be harmful rather than helpful:

> Specifically, the purpose to protect consumers is not clearly articulated; instead, the bill is primarily designed to protect appraisers. The risk of harm to consumers and evidence of abuses by AMCs in Hawai‘i are lacking. The cost that lenders typically pass on to consumers may rise because of regulation; and the high regulatory fees that are anticipated will more than likely discourage small AMCs from registering, thus disproportionately precluding such businesses from entering the market in Hawai‘i. [24]

[24] The Auditor, State of Hawai'i, *Sunrise Analysis: Real Estate Appraisal Management Companies*, *A Report to the Governor and the Legislature of the State of Hawai'i*, Rep. No. 10-07 (September 2010). The report is available here: http://www.state.hi.us/auditor/Reports/2010/10-07.pdf

AMC's have developed and taken advantage of technology to improve and standardize the appraisal process, and to reduce the time required for an appraisal, all while lowering costs to consumers. This is why AMCs have grown to a market share approaching 70%.

HVCC Restrictions on Affiliations Should Be Maintained

The HVCC contains restrictions on affiliations between lenders and appraisers or appraisal management companies that should be maintained because they ensure appraiser independence. Restrictions on affiliations between lenders and appraisers are longstanding safety and soundness practices, and they have improved over the years, most notably with the HVCC.

The Federal banking agencies have had the following restriction on appraisers with an interest in the transaction since 1990:

> (a) *Staff appraisers*. If an appraisal is prepared by a staff appraiser, that appraiser must be independent of the lending, investment, and collection functions and not involved, except as an appraiser, in the federally related transaction, and have no direct or indirect interest, financial or otherwise, in the property. If the only qualified persons available to perform an appraisal are involved in the lending, investment, or collection functions of the regulated institution, the regulated institution shall take appropriate steps to ensure that the appraisers exercise independent judgment. Such steps include, but are not limited to, prohibiting an individual from performing an appraisal in connection with federally related transactions in which the appraiser is otherwise involved and prohibiting directors and officers from participating in any vote or approval involving assets on which they performed an appraisal.[25]

The Federal banking agencies reiterated this need for appraiser independence in interagency guidelines in 1994:

> Because the appraisal and evaluation process is an integral component of the credit underwriting process, it should be isolated from influence by the institution's loan production process. An appraiser and an individual providing evaluation services should be independent of the loan and collection functions of the institution and have no interest, financial or otherwise, in the property or the transaction.[26]

The Federal banking agencies reiterated the need for appraiser independence yet again in 2005 in frequently asked questions, and recognized that an affiliation between a lender and an appraiser requires controls, independence, separate responsibilities, and separate lines of reporting:

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[25] 12 C.F.R. § 34.45(a) (OCC); 12 C.F.R. § 225.65(a) (Board); 12 C.F.R. § 323.5(a) (FDIC); and 12 C.F.R. § 564.5(a) (OTS).
[26] *Interagency Appraisal and Evaluation Guidelines*, October 27, 1994, available here: http://files.ots.treas.gov/84042.pdf

> **Question:**
> Can the regulated institution accept an appraisal prepared by an appraiser who is engaged by a financial services institution with whom the appraiser has an affiliated business relationship?
>
> **Answer:** The business relationship between the financial services institution and the appraiser may not necessarily violate the independence requirement of the agencies' appraisal regulations. However, the agencies' appraisal regulations do not permit a regulated institution to accept an appraisal in which the appraiser has a direct or indirect interest, financial or otherwise, in the property or the transaction. The regulated institution should evaluate the financial services institution's controls to ensure independence and that there is appropriate separation of responsibilities and reporting lines between the appraiser and the financial services institution's lending function.[27]

In 2006, the USPAP also recognized that affiliations between a lender and an appraisal firm require independence:

> **Question**:
> The principals of a local mortgage company propose to acquire an appraisal firm and have the appraisal firm complete assignments for the mortgage company. Is this a conflict of interest for the appraisers completing assignments for the mortgage company?
>
> **Response**:
> An appraiser should review the ETHICS RULE and Standards Rule 2-3 when completing appraisal assignments in situations where the appraisal company that engages (by employment or contract) the appraiser is owned by the client.
> It is important to note that USPAP does not prohibit the acceptance of an assignment in this specific situation. In an appraisal assignment developed under STANDARD 1 and reported under STANDARD 2, an appraiser must specify the particulars in a situation where he or she has any present or prospective interest with respect to the parties involved in the property that is the subject of the report. The engagement of an appraiser by an appraisal company that is owned by the client or by owners of the client does not, in and of itself, mean that the appraiser has an interest or bias with respect to the property or properties involved. If the appraiser has an interest but could provide the service in an ethical, unbiased manner then the appraiser could accept the assignment as long as the appraiser was competent and properly disclosed the interest in accordance with Standards Rule 2-3.
> If the appraiser's interest in the property or the parties involved in the assignment prevented the appraiser from providing an unbiased service, then the appraiser

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[27] *Frequently Asked Questions on the Appraisal Regulations and the Interagency Statement on Independent Appraisal and Evaluation Functions*, no. 17 (March 22, 2005), available here: http://www.occ.treas.gov/ftp/bulletin/2005-6a.pdf

> should not accept the assignment for it would be in violation of the ETHICS RULE and parts of the appraiser's certification in Standards Rule 2-3.[28]

The HVCC improved on all of these. It sets out detailed and specific independence requirements. It also requires written policies and procedures, adequate training, disciplinary rules, and mechanisms to report and discipline anyone who violates the written policies and procedures, among other things:

> [T]he lender and any appraisal company or any appraisal management company providing the appraisal to the lender has [ ] written policies and procedures implementing this Code of Conduct, including, but not limited to, adequate training and disciplinary rules on appraiser independence (including the principles detailed in Part I of this Code of Conduct) and has mechanisms in place to report and discipline anyone who violates these policies and procedures[.][29]

These requirements help ensure that lenders and appraisers are independent of each other. These protections are tough but necessary to ensure independence without having to disrupt longstanding business relationships. We believe the Board should include these restrictions in its interim final rule.

On a related note, with the addition of the words "no appraisal management company," new TILA Section 129E(d), entitled "Prohibitions on Conflict of Interest," appears to modify the existing and accepted conflict of interest standard, which could be too broadly construed to prohibit an affiliated relationship between an appraisal management company and its lender affiliate – something that is currently permitted provided the HVCC restrictions on affiliations are followed.

New Section 129E(d), within Section 1472, specifically provides:

> No certified or licensed appraiser conducting, <u>and no appraisal management company</u> procuring or facilitating, an appraisal in connection with a consumer credit transaction secured by the principal dwelling of a consumer may have a direct or indirect interest, financial or otherwise, in the property or transaction involving the appraisal." (Emphasis added.)

While it does not seem likely that Congress intended to modify the accepted appraiser conflict of interest standard or the related HVCC restrictions on affiliations, we request that the Board confirm in its interim final rules on appraiser independence that the above prohibition on "indirect interest" would not prevent lender-owned or affiliated AMCs and their staff and fee appraisers from performing appraisals for their affiliated lenders. More specifically, the industry respectfully requests confirmation that an AMC affiliate of a national bank lender does not have a direct or indirect interest in the property or credit transaction merely as a result of its common ownership.

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[28] *USPAP Q&A*, no. 16 (December 2006), available here: http://www.affiliatedappraisersworkshop.com/QA%20December%202006.pdf

[29] HVCC § IV.B(6). *See* all of § IV.B.

Types of Property Valuations

Appraisals are just one method of valuing property. Appraisals are performed by people, and therefore raise independence issues.

Another valuation method uses automated valuation models (AVMs). AVMs amass data on property sale prices, and are able to estimate property values by mining and analyzing the data. AVMs do not raise appraisal independence questions in the same way as appraisals because AVMs are produced by entering a property address into an automated system. There is no ability for a party with an interest in the transaction to influence the resulting valuation, unlike with an appraisal where a person who has an interest in the appraised value may be able to communicate inappropriately with the appraiser.

The Dodd-Frank Act requires AVMs to adhere to quality standards, and requires six agencies, in consultation with the with the staff of the Appraisal Subcommittee and the Appraisal Standards Board of the Appraisal Foundation, to promulgate regulations to implement these quality control standards.[30] Congress appears to have intended that rulemaking, rather than the Board's present interim final rulemaking, to weigh any concerns about the quality of AVMs.

Broker price opinions (BPOs) are another type of property valuation. The Dodd-Frank Act provides that, "[i]n conjunction with the purchase of a consumer's principal dwelling, broker price opinions may not be used as the primary basis to determine the value of a piece of property for the purpose of a loan origination of a residential mortgage loan secured by such piece of property."[31] There is no prohibition on the use of BPOs outside of the origination of purchase-money loans.

Loan servicers commonly use AVMs and BPOs in default cases, or cases where a loan is current but under water and a consumer needs relief. It is important to continue to permit the use of AVMs and BPOs in these cases because the loan agreements require borrowers to cover the lender's or servicer's costs resulting from default, such as the cost of a property valuation. AVMs and BPOs are less expensive than an appraisal. AVMs and BPOs may not always be as accurate as full appraisals, but often are sufficient in evaluating foreclosure alternatives, such as modifications, short sales, or deeds in lieu of foreclosure.

Unlike with appraisals during loan origination, in the event of default or imminent default there is no issue of appraiser independence with a BPO, because the broker is paid a fee that is not contingent on, or in any way related to, the dollar amount in the price opinion itself.

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[30] Dodd-Frank Act § 1125(b).
[31] Dodd-Frank Act § 1126(a).

The Treasury Department's Making Home Affordable program specifically and appropriately authorizes the use of AVMs and BPOs.[32] It is important that the Board's interim final rule not inadvertently interfere with the Treasury Department's important program.

For these reasons, we recommend that the Board's interim final rule on appraisal independence cover independence of appraisals during loan origination only, and not cover AVMs and BPOs in any case. It is important that use of AVMs and BPOs continue to be permitted in appropriate circumstances.

Extension of Credit After Discovery of Appraisal Flaws Requires Reasonable Flexibility

Section 129(f) addresses the circumstances in which a creditor may extend credit based on an appraisal after the creditor discovers problems with the appraiser's independence:

> [A] creditor who knows, at or before loan consummation, of a violation of the appraisal independence standards established in subsections (b) or (d) shall not extend credit based on such appraisal unless the creditor documents that the creditor has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of such dwelling.

We suggest that flexibility be permissible in defining "reasonable diligence" because the appropriate diligence will vary depending on the degree of the problem. We suggest the Board provide examples of reasonable diligence to include:

- Obtaining an AVM to substantiate the property value;
- An appraiser documenting the lack of effect of the breach of independence on the appraiser's opinion of the property value;
- Requesting the appraiser to correct any errors or omissions in the appraisal, or to substantiate the appraised value.

Mandatory USPAP Reporting; "Safe Harbor"/Confidentiality Privilege

Section 129E(e) requires reporting of violations of law and USPAP or "otherwise engaging in unethical or unprofessional conduct." However, in addition to TILA liability exposure for not reporting, the reporting entity may be exposed to liability for defamation, especially if the unethical or unprofessional conduct reported is "borderline" and requires a judgment call. A safe harbor/confidentiality privilege (and protection from

[32] "Servicers must obtain an assessment of the current value of the property securing the mortgage loan being evaluated for HAMP. Servicers may use either an automated valuation model (AVM), provided that the AVM renders a reliable confidence score, a broker's price opinion (BPO) or an appraisal." *Making Home Affordable Handbook*, v1.0, § 6.8, p. 42, available here: https://www.hmpadmin.com/portal/docs/hamp_servicer/mhahandbook.pdf

discovery under the State's Freedom of Information Act) might facilitate responsible reporting and reduce liability for defamation claims. The safe harbor available for suspicious activity reporting may be somewhat analogous.

Definitions of § 129E Terms

Definitions of Prohibited Conduct Would Benefit From a Reasonableness Standard

Congress gave the Board authority to define the terms in § 129E. There are some § 129E terms, directly related to appraiser independence, for which clarification would be helpful. Section 129E(b)(1) makes it illegal acts or practices in which a person with an interest in a transaction "compensates," "instructs," "intimidates," certain persons, or attempts to do so. The words "instruct" and "intimidate" are subjective and lacking clear meaning. The word compensate requires clarification because appraisers must be paid.

What intimidates one person may be unthreatening to another. It would be helpful if the Board were to make clear that a reasonableness standard applies. If a reasonable, professional, and licensed or registered, trained appraiser would not be intimidated by conduct, that conduct should not be impermissible under § 129E regardless of the state of mind of the person engaging in the conduct.

What instructs one person may be simple noise to another. Again, a reasonableness standard is appropriate. If a reasonable, professional, and licensed or registered, trained appraiser would not feel compelled to comply with the instruction or attempted instruction, then there should be no § 129E violation, regardless of the state of mind of the person engaging in the conduct.

Definition of Permissible Practices Would Benefit From Clarity

Section 129E(c) lists some practices that are expressly permissible, including asking an appraiser to consider additional, appropriate property information, provide further detail, substantiation, or explanation for a value conclusion, or to correct errors.

It would be helpful for the Board to add to this list to include safe and sound practices. Drawing from the Board's Regulation Z, it should be clear that a creditor may obtain multiple appraisals on the same property in connection with origination of the same loan, as long as the creditor has a practice of selecting the appraisal that is the most reliable for underwriting the loan.

The Board should also make clear that lenders or appraisal management companies may withhold compensation from appraisers for breach of contract or for substandard performance. A regulatory requirement to pay appraisers for substandard appraisals would not encourage quality appraisals, and would defeat the purpose of § 129E.

It would also be helpful if the Board were to consider the possibility that options (1) and (2) of the permissible practices may actually lead to appraisal independence concerns. Sections (1) and (2) of new Section 129E(c) are overbroad, and constitute a lesser standard than HVCC for lenders, which, without clarification, could possibly open the door to prohibited conduct (i.e., "interested parties," such as mortgage brokers, real estate brokers and builders, trying to influence appraiser's value conclusion by providing additional, unsolicited comparables). These exceptions could potentially swallow the rules of prohibited conduct. The exceptions may also conflict with one of USPAP's core tenets of "Confidentiality," which restricts appraisers in their communications regarding an appraisal <u>to the lender-client</u>.

Definition of "Appraiser" and "Appraisal Report"

The term "appraiser" would benefit from clarification. Section 129E(b)(2) prohibits "seeking to influence an appraiser" but does not define the word appraiser.

For purposes of a rule on appraiser independence, we believe the definition should relate to instances where appraiser independence is needed. These are cases where in individual appraiser could be inappropriately influenced to alter a property valuation.

Lenders and AMCs create and use AVMs to value property, and they do seek to cause, or "influence," the AVMs to produce reliable and accurate property valuations. They hire staff specifically for the purpose of producing accurate and reliable AVMs. This is not the area where an appraiser independence rule makes sense because there is not an incentive to produce inaccurate AVMs.

The definition of appraiser for § 129E(b) purposes should be an individual who is, or is required to be, registered or licensed as an appraiser and who is engaged in the valuation of individual properties.

The term "appraisal report" is broadly defined in the Board's Regulation B, implementing the Equal Credit Opportunity Act (ECOA). Regulation B requires creditors to deliver to consumers a copy of the "appraisal report," meaning the documents on which the creditor relied in valuing the property in a loan application, regardless of whether there was a traditional appraisal.

ECOA has a very different purpose than TILA. ECOA is designed to ensure equal treatment of similarly situated consumers, while TILA is designed to ensure that consumers understand their transactions. Appraisal independence, now included within TILA, is different than both of these. It is designed to promote safe and sound lending. It is instructive to look at the purposes of the different laws in defining their terms.

A broad definition of "appraisal report" within Regulation B ensures that consumers receive a copy of the property valuation the creditor used, regardless of its form. The form of valuation is a safety and soundness matter, not an equal treatment matter. The form of valuation is therefore irrelevant to Regulation B, and Regulation B appropriately ignores it and requires delivery of the valuation to consumers regardless of its form.

The form of valuation is very important to a safety and soundness requirement such as appraisal independence. The definition of appraisal report for this purpose should therefore not be ignored. Appraiser independence issues arise when a person conducts a property inspection and appraisal because, when individuals prepare the valuation, there exists the possibility of improper influence. With the use of an AVM to value a property, there is not this possibility. One cannot coerce, extort, or bribe a technology system. This is a significant reason for distinguishing, under § 129E, between appraisals and other types of valuations. We believe § 129E(b) should be limited to appraisals in the traditional sense, in which persons value a property for the purposes of loan origination.

Definition of Covered Transaction Should Not Prohibit Application of the Regulation to Noncovered Transactions

Section 129E applies to many consumer mortgage loans, but only if they are secured by the consumer's principal dwelling. What is a safe and sound appraisal will rarely vary based on whether the property is a consumer's principal dwelling, second home, or investment property. For many creditors, it will be easier to apply the § 129E regulations uniformly to all such transactions. We believe the Board should not prohibit this.

Training of Those Who Select Appraisers

We note one area in which the HVCC may inadvertently require an irrelevant type of training. It requires that those who select appraisers must be "appropriately trained and qualified in the area of real estate appraisals[.]"[33] We note that technology advances have changed the process of selecting appraisers, and that process is much more technology-driven that it was even a short time ago. Today, it is often important for those who are involved in designing and maintaining the technology systems to be trained in technology or appraisal management matters, rather than in the conduct of appraisals directly. We believe it is important not to require irrelevant training. We suggest that those who select appraisers be trained in appraisal management, not in appraisals directly.

Conclusion

For the reasons discussed above, we urge the Board to await the completion of the GAO and PWC studies of appraisal fees so that there is a reasonable basis for a rulemaking on reasonable and customary appraisal fees. The fact that a rule could inadvertently curtail credit makes the quality of the rule more important than its timing.

It is also important that the Board's rule not reintroduce into the consumer mortgage market the race to the bottom of underwriting standards, a lesson that the subprime crisis has made all too clear.

[33] HVCC § III.C.

Lenders have been improving the quality of appraisals over the years, such as through technology advances funded to a large extent by AMCs. The Board should not interfere with these advances, as they have proven themselves both effective in terms of improving quality, as well as cost-effective.

We would be very pleased to contribute what we can to assist the Board in the difficult task of writing an interim final appraisal independence rule in a very short amount of time.

Sincerely,

American Financial Services Association
Consumer Mortgage Coalition
Housing Policy Council /
Financial Services Roundtable