IOWA BANKERS ASSOCIATION

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Via Electronic Delivery to:

December 27, 2010

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Docket No. R-1394
75 FR 66554

Ms. Johnson and Board:

Iowa Bankers Association (IBA) is a trade association representing over 350 banks and savings and loan associations operating in the state of Iowa. Our membership is predominantly comprised of banks and savings associations deemed to be “small” for purposes of the Community Reinvestment Act (CRA) with a handful of “intermediate small” and large banks. Our member banks offer a limited variety of residential mortgage loan products including in-house portfolio adjustable rate mortgage loans, balloon loans, fixed rate loans, secondary mortgage products and a whole range of home equity loans - both closed end and open end lines of credit.

The IBA appreciates the opportunity to comment on the Federal Reserve Board’s Interim Final Rule amending Regulation Z, implementing the appraisal independence provisions added to the Truth-in-Lending Act through Section 1472 of the Dodd/Frank Wall Street Reform and Consumer Protection Act. We believe that although the interim final rules represent a substantial portion of the current Home Valuation Code of Conduct, there are a few parts of the final rule where some changes would be helpful to IBA members.

Conflict of Interest - Safe Harbor - Independence with Loan Production Function

The IBA appreciates the inclusion of a safe harbor within Section 226.42(d), to protect lenders utilizing in-house appraisers from the restrictions against a “conflict of interest.” The IBA would request clarification, however, with respect to those safe harbor provisions applicable to creditors with assets of more than $250 million. Under § 226.42(d)(2), compensation to persons preparing the valuation must not be based on the value in any valuation; the appraiser must report to a person who is not part of the creditor’s loan production function and whose compensation is not based on the closing of the transaction to which the valuation relates; and finally, no employee, officer or director in the creditor’s loan production function is directly or indirectly involved in selecting, retaining, recommending or influencing the selection of the person to prepare a valuation, or to be included in or excluded from a list of approved appraisers.

With regard to the second condition, a creditor’s “loan production function” is defined as an employee, officer or director with responsibility for generating covered transactions, approving covered transactions, or both. See Paragraph 42(d)(5)(i). This very broad definition raises difficulty for many banks that are just over the $250 million threshold, where it is often the case that one or more directors or officers must approve or authorize loans of larger size or volume. In such instances, these directors or officers, generally high in bank hierarchy, will not be able to escape being included within the "loan production" function's line of reporting.

We request that the definition in Paragraph 42(d)(5)(i) be amended to exclude directors or officers that have a secondary or ancillary function relating to generating or approving covered transactions. We believe that the definition, as proposed, makes sense only with respect to those directors that are directly and fully in charge of loan approval functions. The definition does not make full sense, however, when it is applied to directors or officers whose functions are not principally focused on loan generation or approval. In such instances, the director or officer's ancillary approval functions occur only after the loan originator has completed all of the origination procedures required by the bank, and has decided based on the qualifications of the applicant, the characteristics and value of the property, and the results of the underwriting analysis, that the loan should be made.

The IBA believes that slight adjustment to the definition would not lessen the protections of this provision, and would go a long way in accommodating smaller institutions.

Conflict of Interest: "Safe Harbor" (Section 226.42(d)(1(i))–Portfolio Loans/Home Equity Loans

There is an additional safe harbor that would greatly assist lenders to comply with Section 226.42(d)(1)(i), while still ensuring that there is no prohibited interest in the transaction. The IBA believes that where creditors originate loans with the intention of retaining such loans in their investment portfolios, there is an inherent protection against the conflicts of interest that may exist when creditors originate a loan to sell to an investor.

We note that in today's market, portfolio lenders are more likely to be smaller community banks. These institutions are often privately held depositories and often have more discretion in terms of lending criteria and loan products than larger, stockholder-driven institutions. Such banks often make lending decisions based on long-term relationships and experience in their communities, and based upon both, tangible and intangible elements of a transaction. For example, a community banker that has had a sustained banking relationship with a customer might well understand the specific circumstances that have caused the positive and negative elements of the customer's credit score over time. In such situations, the creditor would use extraordinary attention and care to make the lending decision, and such extraordinary care includes valuation activity that is performed by that creditor.

Where the creditor intends to keep the loan in portfolio, and therefore assume the default and the interest rate risk, there is a built-in assurance that the creditor will not jeopardize its own long-term interests vis-à-vis the value of the collateral. Lenders often engage in portfolio lending to build strong long-term relationship with borrowers, and in all cases, they want ensure that the portfolio assets are able to realize the full value of the investment, with appropriate collateral behind it. Portfolio lenders cannot be reckless in any aspect of mortgage loan origination or they would not be in the business of lending for very long. In light of these assurances that portfolio lenders undertake with respect to portfolio products, such loans should be deemed safe vis-à-vis prohibited interests, and therefore subject to their own safe harbor consideration. Home equity loans are a good example of this type of lending, where lenders may have internal staff prepare evaluations from publically available data, such as comparable sale information and tax assessment valuations. These evaluations are prepared typically at little expense to the consumer, and still afford the bank collateral protection for its portfolio investments.

The IBA requests that the Board consider adding a safe harbor (for any sized institution) that would provide that a person preparing valuations who is employed by the creditor does not have a conflict of interest in violation of Section 226.42(d)(1)(i) if–(1) the compensation of the person preparing a valuation or performing a valuation management function is not based on the value arrived at in any valuation; and (2) the creditor is a bank or other lending institution that makes mortgage loans with the intention of holding the loans in their investment portfolios. Without this important safe harbor, many community banks will be forced to outsource evaluations for smaller first mortgage and home equity loans, which will significantly increase costs for consumers without providing any additional portfolio protection for the bank.

Section 226.42(f) –Customary and Reasonable Compensation

Section 226.42(f) implements TILA Section 129E(i), which requires creditors and their agents to compensate fee appraisers (appraisers who are not their employees) at a rate that is "customary and reasonable for appraisal services in the market area of the property being appraised." However, under Comment 42(f)(1)-5, the Board affirms that the interim final rule is not intended to prohibit a creditor and an appraiser from negotiating a rate for an assignment in good faith, nor is it intended to prohibit a creditor from communicating to a fee appraiser the rates that had been submitted by the other appraisers solicited for the assignment as part of this negotiation. In addition, the interim final rule is not intended to prevent appraisers and creditors from negotiating volume-based discounts for a creditor that provides multiple appraisal assignments to a fee appraiser.

The IBA requests additional clarification to this provision, as it is not clear how a creditor that negotiates a better price for the benefit of a consumer can be safe from paragraph 42(f)(1). We note that lenders may be able to negotiate a "better" price with an appraiser and then have that price be deemed to be outside of the norm in the relevant area or locality. This would render the payment to be lower than the customary or reasonable rate, as required by the statute. If the creditor is challenged on this payment, the creditor may not be able to rely on proof that the fee is a "negotiated" fee because Comment 42(f)(1)-4 states that a document signed by a fee appraiser indicating that the appraiser agrees that the fee paid to the appraiser is "customary and reasonable" does not by itself create a presumption of compliance with § 226.42(f) or otherwise satisfy the requirement to compensate a fee appraiser at a customary and reasonable rate. Also, under Comment 42(f)(2) - the Board notes that a presumption of compliance is not met by failure to meet one of the required elements of the safe harbor found in 42(f)(2)(i)(A-F). The challenges with documentation of scope of work, qualifications, experience, work quality and professional record of the appraiser will seemingly put community banks at a significant disadvantage as compared to larger volume based mortgage lenders when qualifying for this "presumption of compliance."

The IBA believes that the articulation of these provisions will generate useless judicial challenge and much confusion going forward. As written, the interim rule creates an inadvertent trap that misleads honest lenders into believing they can safely engage in "negotiations" with business partners without fear of running astray of the reasonableness restrictions. We would urge that the Board provide clear elements of proof that would be acceptable to establish that a particular price is a "negotiated price" and is compliant with the rule's strictures. The Board should, at minimum, revisit Comment 42(f)(1)-4, and state that a signed document that reflects a mutual agreement to a particular price should be deemed acceptable and sufficient for purposes of Section 226.42(f).

We appreciate the opportunity to comment on the Board's Interim Final Rule. Hopefully the comments as stated above will be helpful to the Board as it considers making adjustments to these new regulations effective April 1, 2011.

If you have questions about these comments, please contact the undersigned at 515-286-4211 or via e-mail, rhartwig@iowabankers.com. Thank you for your time and consideration.

Sincerely,

Robert L. Hartwig
Legal Counsel