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December 27, 2010

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
Washington, DC 20551

Re: Docket No. R-1394: RIN AD 7100-56
Interim Final Rule Amending Regulation Z: Rules Regarding Appraisal Independence (75 F.R. 66554-66587)

Dear Ms. Johnson:

American Bankers Association[1] (ABA) appreciates this opportunity to comment on the Federal Reserve Board's Interim Final Rule amending Regulation Z, which implements the appraisal independence provisions that were added to the Truth In Lending Act through Section 1472 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

ABA appreciates and supports the Board's methodical drafting of this difficult regulatory provision. We believe the interim final rules represent a thoughtful implementation of Section 1472 of the Dodd-Frank Act, and we think the Board achieves effective balances in augmenting consumer protections and avoiding unnecessary costs. There are, however, a few aspects of the interim final rule where some enhancement would be useful, and we ask for further consideration of these additional items.

Conflict of Interest: "Safe Harbor" (Section 226.42(d)(1(i))—Portfolio Loans

ABA appreciates the inclusion of a safe harbor, under Section 226.42(d), to protect lenders that utilize in-house appraisers from the restrictions against "conflict of interest." 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. ABA 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 many smaller community banks are predominately portfolio lenders. These institutions generally are managed to local interests, whether they are organized as public companies, are closely held, or are mutual banks. 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, creditors exercise extraordinary attention and care in make the lending decision, which would extend to any valuation activity that is performed by that

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its 2 million employees. The majority of ABA's members are banks with less than $165 million in assets. Learn more at www.aba.com.

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 alignment of interests between the creditor and the borrower concerning 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 the standards to which portfolio lenders adhere with respect underwriting and credit decisions, such loans should be deemed safe vis-à-vis prohibited interests, and therefore subject to their own safe harbor consideration.

ABA requests that the Board consider adding a safe harbor 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; (2) the creditor is a bank or other lending institution with a demonstrated a history of making mortgage loans predominately for the purpose of portfolio investment; and (3) the creditor was assets of $1 billion or less.

Conflict of Interest: "Safe Harbor" (Section 226.42(d)(1(i))—Loan Production Function

ABA requests clarifications with respect to the safe harbor provisions under Section 226.42(d), 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 level 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 must approve or authorize loans of larger size or volume. In such instances, these directors, 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 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 whose functions are not principally focused on loan generation or approval. In such instances, the director'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.

ABA 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.

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.

ABA requests additional clarification to this provision, as it is not at all clear how a creditor that negotiates a better price for the benefit of a consumer can be safe from violations under paragraph 42(f)(1). We note that where lenders negotiate a "better" price with an appraiser, that price could be deemed to be outside of the norm in the relevant area or locality. In other words, the negotiated price could render the payment to be lower than the customary or reasonable rate. 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.

ABA 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).

Conclusion

ABA concurs with the objectives of ensuring that appraisers use sound independent judgment in their valuations, and that they do so free of improper influence and pressure. ABA thanks the Board for these comprehensive regulations and we look forward to assisting with any implementation issues that may arise in the future.

Sincerely,

Rod Alba

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