December 27, 2010

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R-1394 and RIN No. AD-7100-56

Thank you for the opportunity to comment on the Interim Final Rule (IFR) amending Regulation Z (Truth in Lending) and the matters of appraiser independence and customary and reasonable fees to appraisers. In reviewing the rule it is clear that the Federal Reserve spent considerable time in preparation of the IFR. The agency is to be commended for its hard work, especially for meeting a very strict and difficult deadline and given other agency resource constraints.

Our comments are divided into three sections – an executive summary, comments specifically to the customary and reasonable fee provisions, and an Addendum that answers to requests for comments from the Federal Reserve.

Executive Summary

We strongly urge the Federal Reserve to remove language that allows for the consideration of fees paid by AMCs when adhering to the first presumption of compliance with the customary and reasonable fee regulations. We also urge the Board to adopt certain safe harbors for lenders and agents who use the second presumption of compliance when relying on objective, third-part fee studies and surveys which comport with generally accepted survey methodologies. Additionally, we recommend that the Board, in subsequent rulemakings, use their authority under RESPA to require the separate disclosure of fees paid to appraisers and fees paid to AMCs on the HUD-1 form.

We also provide the following responses to the questions put forward by the Board:

- We believe that the conflicts of interest prohibitions that are applied to appraisals and BPOs should also extend to AVMs as a matter of fundamental consumer protection, and in conjunction with similar actions required under the Act;
- We do not believe that the Board should apply different standards for compliance with appraiser independence requirements for financial institutions based on total assets, as there are sufficient technology platforms available to ease compliance burdens for smaller banks;
- We do not believe the Board should permit appraiser compensation to be based on any subsequent event, such as the closing of a transaction, as this directly conflicts with the Uniform Standards of Professional Appraisal Practice (USPAP) and greatly undermines appraiser independence;
- We believe the Board should not specify the types of contractual obligations that, if breached, are appropriate reasons for withholding timely payments of appraisal fees by creditors or their agents;
- We believe that volume-based discounts should be permitted, so long as they are *bona fide* agreements which include a substantial volume of assignments and provide reasonable discounts;
- The Board should help identify technology vendors who track and report appraisal fees paid by non-AMCs for purposes of complying with customary and reasonable fee regulations;

- We strongly believe that professional appraisal designations should be considered as one of the factors when determining a reasonable and customary fee under the first presumption of compliance;
- If the Board allows work quality to be a factor considered in shaping appraiser compensation, then the review of work should be done by highly trained professional appraisers, and not by non-appraisers;
- We believe that refusal to disclose appraisal fees and AMC fees separately is an anti-competitive act, and allows AMCs to pay similar appraiser fees while controlling market share;
- Fee studies and fee surveys should be treated similarly, and should comply with generally accepted research and survey methodologies;
- We believe that the definition of "appraisal management company" should be amended to specifically exclude entities who meet the definition of "fee appraiser" as defined for TILA purposes;
- Mandatory reporting of material failures to comply with USPAP or these regulations should not be tied solely to misstatements of value; and, we do not believe the final rule should establish a percentage variance test relating to an appraiser's opinion of value for mandatory reporting purposes;
- Mandatory reporting of material failures to comply with USPAP or these regulations should occur no later than one year from the closing of the transaction in which the valuation was relied upon in extending credit; and,
- We believe no settlement service provider should be exempt from compliance with the appraisal independence requirements, and concur that those entities least likely to violate the requirements also have the smallest regulatory burden and, very likely, none at all;

<u>Customary and Reasonable Fees</u>
We believe that the Federal Reserve has incorrectly interpreted Congress' plain language, intent, and public policy purposes by allowing the consideration of fees paid by AMCs under the first presumption of compliance with customary and reasonable fee requirements imposed by the Dodd-Frank Act and these regulations. Our groups strongly urge the Board to amend the first presumption to explicitly exclude fees paid by AMCs from consideration under the first presumption, so that it comports with the statute and the second presumption of compliance, which the Board correctly interpreted and implemented in the proposed interim final rule. We also suggest the Federal Reserve provide an explicit safe harbor to lenders and agents who adhere to the second presumption.

Two Presumptions of Compliance
Under the Interim Final Rule, lenders and their agents are provided with two presumptions of compliance. The first option states that lenders will be presumed to comply if the amount of compensation is reasonably related with recent rates (last 12 months) for appraisal services performed in the geographic market of the property. The creditor or its agent must identify recent rates and make any adjustments necessary to account for specific factors, such as the type of property, the scope of work, and the fee appraiser's qualifications; and the creditor and its agent do not engage in any anticompetitive actions in violation of state or federal law that affect the rate of compensation paid to fee appraisers, such as price-fixing or restricting others from entering the market. The Fed's commentary on the first presumption states that AMC fees are an acceptable component of the factors used by creditors and their agents to establish compliance with the statute's customary and reasonable mandate. As stated above, our organizations strongly object to this feature of the IFR and urge its removal from the final rule.

Under the second presumption of compliance, a lender or agent is presumed to comply if it establishes a fee by relying on rates in the geographic market of the property being appraised established by objective third-party information, including fee schedules, studies, and surveys prepared by independent third parties such as government agencies, academic institutions, and private research firms. The interim final rule follows the statute in requiring that fee schedules, studies, and surveys, or information derived from them, used to qualify for this presumption of compliance must exclude compensation paid to fee appraisers for appraisals ordered by appraisal management companies.

Our organizations also believe that the two presumptions of compliance are inconsistent with one another. While the second presumption specifically excludes assignments ordered by known appraisal management companies, the first presumption specifically "does not require that a creditor use third-party information that excludes appraisals ordered by AMCs." While this statement could be read to clarify the previous comment found in that paragraph that stipulates "use of a fee survey or study is not required," a literal interpretation of this statement would create a significant departure from the intent of the legislation – defining customary and reasonable fees as appraisal assignments absent the involvement of AMCs.

As such, we are not surprised to hear that the first presumption of compliance has been initially interpreted by some large banks and AMCs to mean the current business model employed by many banks and AMCs today is thought to be satisfactory. Unfortunately, all available evidence suggests this arrangement is totally inconsistent with the second presumption of compliance, as explained below.

The Federal Reserve should avoid establishing a revised IFR or Final Rule that is inconsistent, or alternatively, weak, ineffective and contrary to the spirit of the Dodd-Frank Act. The very existence of the customary and reasonable fee provisions of Dodd-Frank, together with the mandated exclusion of AMC fees in calculating what's customary and reasonable, results from Congressional recognition of the influences of AMCs on fee appraisers and their harmful impact on appraiser independence and the integrity of valuations in our mortgage lending markets. For Congress, the debate is over. The law is the law. It is now incumbent upon the Federal Reserve to implement the regulation consistent with this law.

Further, we believe the IFR's definition of "appraisal services" is also at odds with the first presumption of compliance. Section 226.42(f)(4)(ii) states that, for purposes of § 226.42(f), "appraisal services" include:

> *only the services required to perform the appraisal, such as defining the scope of work, inspecting the property, reviewing necessary and appropriate public and private data sources (for example, multiple listing services, tax assessment records and public land records), developing and rendering an opinion of value, and preparing and submitting the appraisal report. The Board understands that agents of the creditor such as AMCs split the total appraisal fee between the AMC (for appraisal management functions) and the appraiser (for the appraisal). The interim final rule is thus intended to clarify that the customary and reasonable rate applies to compensation for tasks that the fee appraiser performs, not the entire cost of the appraisal (including management functions).*

If left as is, the first presumption of compliance, in effect, establishes customary and reasonable fees for "appraisal services and appraisal management functions," not customary and reasonable fees for "appraisal services." Again, we do not believe this is consistent with the intent of Dodd-Frank.

The IFR Will Perpetuate Fee Dictates from AMCs

We believe that the first presumption of compliance, if retained or left unaltered significantly, will perpetuate the current climate for appraisal fees, where fee appraisers are largely forced to pay for appraisal management services provided to banks by accepting fees well below what is customary and reasonable in the market area. Today, the residential appraisal market is burdened by the influences of AMCs, to the point where two appraisal fee markets exist. One market, which we would consider the customary and reasonable rate, is represented well by fees paid directly to appraisers by lenders. These rates compare well with private surveys that exclude assignments from known appraisal management companies. However, a second market, hovers dangerously below this rate and is influenced by the market power and business model of AMCs, which seeks out reduced fees to enhance its own profit margins. In appraisal terms, these rates reflect prices taken in duress, or a "liquidation value" for appraisal fees.

We attribute this to the incentives to compress fees on appraisers and the large market size that is controlled by AMCs. Creditors are contracting with AMCs, as their agents, to manage their valuation responsibilities. Traditional customary and reasonable total fees, previously paid to appraisers, remains

the basis for the amount passed through to the borrower. At the same time, these fees are being divided up with a more than substantial portion going to the AMC for their management fee on behalf of the creditor and the remaining portion to the actual Fee Appraiser. We clearly see that the use of the first presumption keeps open the loophole for AMC's to parse a "customary and reasonable fee" for a stated geographic area into "administrative fees" to themselves and "appraisers fees" to the appraiser, thus negating the intent of Congress. These factors applied in mass throughout the country, result in appraisal assignments taken in duress, and exclusion of more well-qualified appraisers from the AMC market altogether.

According to our research, fees to appraisers paid by AMCs are significantly lower than fees paid directly by lenders or through other objective sources such as the VA Fee Schedule. In October, the Appraisal Institute conducted a survey of appraisers regarding the VA Fee Schedule, and the results demonstrate slight to strong majorities of respondents said VA appraisal and inspection fees are "Reasonable" or "Very reasonable.[1]" Further, this research illustrates VA appraisal fees are on par with fees for similar non-VA appraisal and inspection assignments and that when VA appraisal fees are not on par, the fees apparently tend be below par more often than above par.

The Federal Reserve should also be cognizant of the distinction between "Customary" and "Reasonable". The customary fees do not adequately reflect the recent and significant increase in Scope of Work. Still working in the shadow of the housing and mortgage crisis, Lenders and their AMC Agents have dramatically expanded the amount of data and analysis expected within a "standard" residential appraisal report. While this may be appropriate, this expanded Scope of Work coupled with compressed fees has further exasperated the ability to attract and retain high caliber valuation professionals. An unsustainable business model will eventually prove very detrimental to the mortgage industry and public trust.

While we expect representatives of AMCs and banks will try to convince the Federal Reserve that AMCs are providing services to appraisers in an attempt to justify the forced fee reductions, we firmly disagree. Here, it is worth noting again, that AMCs have a client relationship with lenders, not appraisers. Further, claims that AMCs are providing marketing and invoicing services, our members report that AMCs themselves are some of the worst offenders of failure to pay appraisers. Further, appraisers with clientele beyond one AMC still have overhead expenses relating to marketing and accounts payable, so any purported benefit to appraisers is an overstatement, at a minimum.

Recommendation
As the Federal Reserve moves to complete the Final Rule, we urge it to study the preponderance of evidence that illustrates appraiser fees involving AMCs are taken in duress, and that fees not involving AMCs are considered customary and reasonable by appraisers. We urge the Federal Reserve to put appraisal quality and appraisal independence first by revising the first presumption of compliance to require consideration of direct lender fees to appraisers or fees absent the involvement of AMCs.

The Federal Reserve should specify that creditors are required to evaluate appraisal fees that involve non-AMC orders when undertaking the first presumption, even though the use of a third party survey is not necessarily required. Such information that segregates appraisal fees paid directly by lenders is readily available in the marketplace – we are aware of at least three private sector sources widely used by lenders that identify fees paid to appraisers absent the involvement of AMCs. The Department of Veterans Affairs fee schedules that are established for various geographic markets is another reliable source. This, when factored into other considerations such as scope of work, qualifications, etc., would help alleviate the inconsistencies between the first presumption and second presumption.

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[1] Appraiser Opinions on Department of Veterans Affairs Appraisal and Inspection Fees. Appraisal Institute. October 5, 2010. Available at http://www.appraisalinstitute.org/newsadvocacy/downloads/key_documents/AI_VA_AppraisalFeeSurvey Oct52010.pdf

Safe Harbor for Second Presumption of Compliance

The Board is soliciting comments on whether and on what basis the final rule should give creditors or their agents a safe harbor for relying on a fee study or similar source of compiled appraisal fee information. The Board also requests comment on what additional guidance may be needed regarding third-party rate information on which a creditor and its agents may appropriately rely to qualify for the presumption of compliance.

The Federal Reserve should be explicit in its recognition of federal agency fee schedules, such as the VA Fee Schedule. We also believe that privately developed fee surveys should be granted a safe harbor so long as they exclude assignments from known appraisal management companies and adhere to generally accepted research standards. To this end, we strongly believe any privately developed surveys should meet the standards set forth by the Marketing Research Association Code of Research Standards and the best practices procedures of the American Association for Public Opinion Research[2]. Such standards will enhance confidence and provide a mechanism for adjudication should there be complaints.

Impact of Fee Comingling and the Failure to Disclose Fees Separately to Consumers

An alternative approach that we urge the Federal Reserve to facilitate through this rule and forthcoming changes to the Real Estate Settlement Procedures Act (RESPA) is a system where creditors pay for appraisal management services separately from payment for the actual appraisal. One large national lender describes this as a "cost-plus" system. Under current business models and interpretations of RESPA, fees for appraisal management services and the appraisal itself are allowed to comingle[3]. When a lender utilizes an AMC, HUD requires the comingled fee be disclosed to the consumer on Truth and Lending disclosures and listed on the HUD-1 settlement statement. As a result, a perverse incentive exists for AMCs to seek reductions in appraisal fees to carve out larger profit margins, as the national appraisal fee data illustrate by the existence of a bifurcated appraiser fee market.

What is particularly troubling to our organizations about the current interpretation of RESPA is that it enables AMCs to operate in the dark. Consumers are led to believe the "Appraisal Fee" being paid to a creditor is for a property appraisal, when in fact it is for the appraisal as well as appraisal management services. In talking with chief appraisers of banks and financial institutions about this situation, we understand most AMCs actually refuse to disclose the portion of the appraisal fee they take for themselves even to the lender-clients. This is not solely the fault of the AMCs but also creditors who seek to outsource their valuation needs to AMCs and demonstrate little interest in what portion of the appraisal services fee the AMC actually pays to the appraiser.

We believe the RESPA policy that compels consumers to pay for both the appraisal fee and the AMC fee as a bundled fee is in dire need of reexamination. Specifically, we are not aware of any value to the consumer in a bank using the services of an AMC. The benefit of AMC services is clearly and solely to the bank, which is passing through a traditional overhead or origination expense onto the backs of consumers and appraisers. Further, an additional argument can be made that banks are already being compensated for the procurement *and* review of the appraisal as a component of the origination fee. As such, a requirement that **the consumer shall only pay for the services of the appraiser** would likely result in the payment to appraisers of customary and reasonable fees as a result of market forces.

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[2] An example is found at. http://www.aapor.org/Best_Practices/1480.htm

[3] "**Q:** If an appraisal is ordered through XYZ appraisal vendor management company and the appraisal is subcontracted to ABC Appraisal Company, what name is identified in Line 804 on the HUD-1?
A: XYZ appraisal management company must be identified on Line 804." From "New RESPA Rule FAQs," April 2, 2010. Available at http://www.hud.gov/offices/hsg/rmra/res/resparulefaqs422010.pdf

Further, an alternative arrangement that recognizes and establishes two markets – one for appraisers, and one from AMCs – would deleverage the AMCs from the fee process and enable each market to act on their own. Further, requiring the creditor to pay each separately would allow AMCs to compete for the management services provided to lenders based on *service*, and not nearly exclusively on *price*, such as the case today. Lastly, we believe this arrangement would be consistent with the spirit of the Federal Housing Administration's Mortgagee Letter on this subject (ML 09-28), which requires FHA Roster appraisers be compensated at a rate that is customary and reasonable for appraisal services performed in the market area and AMC fees not to exceed what is customary and reasonable for such services provided in the market area of the property being appraised[4].

The CFPB, which will soon assume the responsibility of the IFR and RESPA, is well positioned to prohibit consumer payment of appraisal management services under the system described above. We note the CFPB has been granted authority over RESPA and that the Dodd-Frank Act authorizes separation of appraisal management and appraisal services on the HUD-1 settlement statement. At a very minimum, there should be a requirement for a clear and transparent disclosure to the consumers of the fees paid to the appraiser and, separately, the fees paid to the AMC.

Addendum

Specific comments relating to questions solicited by the Federal Reserve are found below.

1. ***The Board requests comment on whether AVMs should be excluded from the independence and anti-conflict of interest provisions of the IFR; and whether and whether creditors or other persons exercise or attempt to exercise improper influence over persons that develop an automated model or system for estimating the value of the consumer's principal dwelling.***

Comment: Yes, it is our understanding that AVM orders can be conducted by loan officers or those involved with loan production. We believe it is appropriate for the Federal Reserve to extend prohibitions of loan production involvement in collateral valuation processes to AVM orders in loan decisions.

AVM's are developed and generated by persons who make decisions relating to the factual information what will be included in the AVM for the property and the data that will be used to produce the value estimate. These persons could be subject to coercion like that prohibited under 42(c) (1) this reality was recognized in separate sections of the Dodd-Frank Act. As part of the amendments to FIRREA, Dodd-Frank requires that AVMs:

> adhere to quality control standards designed to—
> (1) **ensure a high level of confidence in the estimates produced by automated valuation models**;
> (2) protect against the manipulation of data;
> (3) **seek to avoid conflicts of interest**;
> (4) require random sample testing and reviews; and
> (5) account for any other such factor that the agencies listed in subsection (b) determine to be appropriate.[5] (Emphases added)

Dodd-Frank goes on to include AVMs under a separate definition of valuation for ECOA consumer disclosure purposes:

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[4] From Mortgagee Letter 09-28, issued September 18, 2009. Available at http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/09-28ml.pdf

[5] *See* Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub.L. 111-203, H.R. 4173, Title XIV, p. 836.

(6) VALUATION DEFINED.—For purposes of this subsection, the term 'valuation' shall include any estimate of the value of a dwelling developed in connection with a creditor's decision to provide credit, including those values developed pursuant to a policy of a government sponsored enterprise ***or by an automated valuation model****, a broker price opinion, or other methodology or mechanism."*[6]

There is no compelling reason why the definition of "valuation", as used in the broadest context of consumer protection, should exclude AVMs where the enabling legislation speaks to a contrary result in comparable (and, arguably, narrower) areas of law. For these reasons, the Board should extend appraisal independence and conflict of interest prohibition requirements AVMs

2. ***The Interim Final Rule Creates Two Safe Harbors for Compliance With The Conflict-of-Interest Prohibitions for Persons Who Prepare Valuations Or Perform Valuation Management Functions And Who Are Also Employees Or Affiliates Of The Creditor. One Safe Harbor Applies To Creditors With Assets of $250 Million Or Less And The Other To Creditors With Assets of More Than $250 Million. The Rule Seeks Comment On Whether The Asset Size Distinctions Are Appropriate And Whether The Safe Harbor Requirements For Smaller Institutions Are Adequate.***

Comment: The Interim Rule addresses situations in which mortgage lenders or other creditors have in-house appraisal or appraisal review services or where these services are performed by an affiliate of the lender. In this regard, the Rule establishes safeguards to ensure that the valuation function is "walled off" from loan production functions. The safeguards for larger financial institutions are more rigorous than those that apply to smaller institutions (i.e., loan production staff of smaller institutions, but not larger ones, is permitted to select the appraiser or AMC to value the principal dwelling collateralizing the loan).

We are unconvinced of the merit or necessity of exempting creditors with assets of $250 million or less from the full range of appraiser independence and conflict of interest requirements of the Dodd-Frank statute. Today, for example, a variety of technologies have been created specifically to enable smaller financial institutions to manage their valuation functions independently from their loan production functions. enable appraisal management internally. We urge the Fed to proceed cautiously on this issue and to require, at a minimum, evidence that smaller creditors are unable to meet the safe harbor requirements established for larger ones.

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3. ***The Fed Seeks Comment On The Adequacy Of The Standards Established In Its Rule To Wall-Off The Valuation And Valuation Review Functions From The Loan Production Function In Larger Financial Institutions.***

Comment: The Interim Final Rule establishes three basic requirements for ensuring that the valuation functions are independent from the loan production functions. Essentially, they require, <u>first</u>, that the compensation of the person preparing the valuation not be based on the value arrived at in any transaction; <u>second</u>, that the person preparing the valuation not report to anyone who is part of the loan production function or whose compensation relates to loan production; and, <u>third</u>, that a creditor's loan production staff not be involved, directly or indirectly, in the selection of the person (or a list of persons) to perform the valuation. The Fed solicits comments on the adequacy of these three criteria.

Although, as a general matter, these three conditions seem to be appropriate for ensuring that the valuation function is independent from the loan production business side of banking, our organizations are perplexed – and potentially very troubled – by one element of the standard relating to compensation. The Fed commentary states that while its Interim Rule "prohibits basing an appraiser's compensation on the conclusion of value," it "does not expressly prohibit basing the appraiser's compensation on whether the transaction closes." We are unclear as to what circumstances the Fed has in mind with respect to this commentary; and, we are having great difficulty understanding a scenario under which it would be appropriate – in the context of a consumer protection and appraiser independence statute – to deny

[6] *Id.* at 838.

compensation to an appraiser or to withhold some portion of that compensation because a loan fails to close. Indeed, we believe such a carve-out is completely contrary to the essential purposes of the new law. Moreover, any professional appraiser accepting an assignment subject to the loan closing proviso would be in direct violation of Standards Rule 2-3 of the Uniform Standards of Professional Appraisal Practice (USPAP) which requires appraisers to certify that "my compensation for completing this assignment is not contingent on…the occurrence of a subsequent event directly related to the intended use of this appraisal." Accordingly, our organizations strongly oppose any Rule which ties the appraiser's compensation to any results-oriented outcome involving the appraisal or the transaction for which the appraisal is being provided including, specifically, whether the loan does or does not close.

4. ***The Fed Seeks Comment On The Appropriateness of the Conditions Established By the Interim Rule Under Which Firms Preparing Valuations or Performing AMC Functions Also Can Provide Other Settlement Services Without Violating The Conflict-of-Interest Prohibitions of Dodd-Frank***

Comment: The Interim Rule permits firms that provide valuation and/or AMC functions to also provide other settlement services for the same transaction; but, it establishes certain safeguards and fire-wall type requirements for these "one stop shopping" entities so that appraiser/appraisal independence is maintained. The Fed opines that to prohibit valuation firms or AMCs from performing other settlement services or from affiliating with firms performing such other services could be detrimental to the smooth functioning of the mortgage markets. The established safeguards for multi-function settlement services providers parallel the safeguards established for creditors when they have in-house appraisal or appraisal review functions or when those services are performed by affiliated entities: First, they prohibit the compensation of the appraiser or persons performing AMC functions being tied to the value arrived at in any valuation; Second, they prohibit persons preparing valuations or performing AMC functions from reporting to loan production people or to anyone whose compensation is dependent on the closing of the transaction to which the valuation relates; and, third, they prohibit anyone involved in loan production from selecting the appraiser or the AMC. However, even if these "safe harbor" conditions are met, a conflict still exists if the person performing the valuation or the AMC functions or its affiliate, has a financial or other interest in the property.

Although the safeguards established to preserve appraiser independence and the avoidance of conflicts of interest with respect to multi-function settlement services providers seem reasonable on their face, we find it very difficult to determine from the Interim Rule and its accompanying commentary whether or how these safeguards would work in the real world. Stakeholders, including appraisal organizations, would be in a far better position to comment if the Interim Final Rule had included several factual scenarios as examples of what would or would not be acceptable under this proposal. Additionally, some commentary on how RESPA impacts the provision of multi-function settlement services by firms which are affiliates of lenders also would have been helpful. Accordingly, because of this uncertainty we have some discomfort regarding the adequacy of the conditions established by the Interim Rule for preserving the independence of the appraisal function for valuation firms or AMCs operating inside or in association with a multifunction settlement service firm

5. ***The Board requests comment on whether the final rule should define "agent" to exclude fee appraisers or any other parties.***

Comment: The Federal Reserve makes clear that where the term "creditor" appears in Regulation Z (Truth-In-Lending) – including in the Interim Rule – it includes agents of the creditor, as determined by applicable state law. The Fed states its belief that Congress was especially concerned that AMCs, serving as agents of creditors, be covered by the requirement to pay customary and reasonable fees to appraisers. In this regard, however, the Fed adopts the position that a fee appraiser hired by a creditor or by an AMC is NOT himself or herself considered an agent of the creditor. Nor is a valuation company that is not itself an AMC regarded as an agent of the creditor. The Fed reasons that without these exclusions, a fee appraiser who hires another fee appraiser or a non-AMC valuation company that hires fee

appraisers would be bound by the "customary and reasonable" fee requirement. The Fed asks for comment on whether these exclusions should be maintained in the final rule.

For the reasons set forth in the commentary to the Interim Rule, we believe it is appropriate and necessary to exclude fee appraisers and non-AMC valuation companies from the definition of the term "agent of the creditor" with respect to the customary and reasonable fee requirements.

We believe this section can be clarified further. Specifically, Section 226.42(f)(1) of Regulation Z clarifies that "agents" of the creditor do not include any fee appraiser as defined in paragraph (f)(4)(i) of Section 226.42. The Board clearly excluded fee appraisal companies ("FACs") from the requirement of paying customary and reasonable compensation for a logical and compelling reason, namely that FACs pay their employee staff appraisers a form of salary and may provide them with other benefits such as office services, health insurance, travel or transportation reimbursement and other such benefits. The Board notes this fact regarding FACs and their employee staff appraisers in the Section-by-Section Analysis of the Rule. Thus, if TILA required FACs to pay their employee staff appraisers customary and reasonable fees for each appraisal assignment, those companies would be unduly financially burdened, and such a requirement may undermine their viability as a provider of appraisal services - which the Board believes would ultimately harm consumers by reducing competition in the market. The Board also notes this rationale regarding competition in the market in the Section-by-Section Analysis of the Rule.

However, in order to ensure that only FACs, and not appraisal management companies ("AMCs") or other hybrid appraisal companies that function primarily like AMCs, are excluded from the requirement to provide customary and reasonable fees, we believe the definition of "fee appraiser" should be further clarified. We respectfully suggest that the definition of "fee appraiser" in Section 226.42(f)(4)(i) of Regulation Z should be amended to clarify that the defined term includes *only* companies or individuals who establish an appraiser-client agreement with the creditor or its agent to perform appraisal services in compliance with USPAP. Only the prime contractor fee appraiser or FAC shall be subject to the rule for payment of reasonable and customary fees. Other employees working under the prime contractor shall not be subject to the rule.

6. ***The Board requests comment on whether the Board should specify particular types of contractual obligations that, if breached, would warrant withholding compensation without violating § 226.42(f).***

Comment: We do not believe the Board needs to be more specific regarding the types of contractual obligations that, if breached, would warrant withholding payment. Rather the final rule should reiterate that creditors and their agents may never condition or withhold payment based on the amount of the value opinion, the attainment of a stipulated result, or the occurrence of a subsequent event.

7. ***The Board requests comment on whether further guidance is needed concerning the permissibility of volume-based discounts under § 226.42(f)(1).***

Comment: We believe that volume-based discounts should be permitted, as they provide appraiser with a guaranteed number of assignments while affording creditors or their agents, discounts on customary and reasonable appraisal fees. However, we caution that volume-based discount agreements must provide for an actual exchange of consideration between the parties; that is, the volume of assignments given under the agreement must be sufficient to justify the fee discount being extended by the appraiser. An agreement where only a few assignments are offered in exchange for a steep discount in fees is more likely an effort to circumvent customary and reasonable fee requirements; these types of agreements should be policed by the Board and offending creditors appropriately sanctioned.

8. ***The Board requests comment on whether additional guidance regarding how creditors may identify recent rates is needed, and solicits views on what guidance in particular may be helpful.***

Comment: The Interim Final Rule contains guidance on how the "customary and reasonable" compensation requirements of Dodd-Frank can be met, specifically the two presumptions of compliance. The Fed seeks comment on whether additional guidance is required.

We do not believe there is a need for further guidance relative to compliance by creditors and their agents with the customary and reasonable fee mandate of the Dodd-Frank Act. However, we reiterate here our earlier point that the use of AMC fees as part of the requirements necessary to meet the first presumption of compliance is in direct conflict with the clear language and public policy purpose of the customary and reasonable fee provisions of the law; and, should be omitted from the final rule.

9. ***The Board requests comment on whether the final rule should expressly prohibit basing an appraiser's compensation on an appraiser's membership or lack of membership in particular appraisal organization.***

Comment: We strongly oppose such a prohibition and believe it would be inconsistent with the provisions and intent of the Dodd-Frank Act which specifically calls for consideration of an appraiser's overall qualifications in connection with establishing customary and reasonable fees. Further, we are not aware of any such prohibition in any of the 45 state appraiser independence statutes enacted by state legislatures in recent years. Lastly, we are unaware of any situation in which a lender or agent has based compensation on membership or lack of membership in particular appraisal organizations.

We note that the Dodd-Frank Act amends Title XI of FIRREA to clarify that a professional designation <u>can be considered</u> in the appraiser hiring process, as well as education achieved, experience, referrals from clients. Further, if a higher State licensing category can be considered in determining a customary and reasonable fee then membership in a professional organization should also be permitted. We believe the Federal Reserve should specify as such; that professional designations can also be considered in determining the customary and reasonable fees.

10. ***The Interim Final Rule Lists Six Factors Related To The Appraisal Assignment And The Qualifications of The Appraiser That Should Be Considered In Connection With the "Customary and Reasonable" Fee Issue; And, It Asks Whether Those Factors Are Appropriate Or Should Be Changed***

Comment: The IFR proposes the following factors to be considered in establishing the "customary and reasonable" appraisal fee: The property type (e.g., complex or non-complex); scope of work; time for completing the appraisal; professional qualifications of the appraiser; professional record and experience of the appraiser; and, appraiser's work quality. The Fed asks whether these criteria are appropriate and whether any additional factors should be listed in order to reach a fee that is customary and reasonable.

The factors proposed by the Fed seem appropriate. As stated above, we believe considering the appraisers professional record and professional designations should also be listed as a factor of appraiser experience and qualifications. Professionally designated appraisers have spent considerable time and effort to obtain their credentials. Further, Dodd-Frank clearly states this factor can be considered as part of the appraiser's professional record. As such, we believe the Final Rule should read:

> *Fee appraiser qualifications. The fourth factor is the fee appraiser's professional qualifications. See§ 226.42(f)(2)(i)(D). Comment 42(f)(2)(i)(D)-1 clarifies that professional qualifications that appropriately affect the value of appraisal services include whether the appraiser is state-licensed or state-certified in accordance with the minimum criteria issued by the Appraisal Qualifications Board of the Appraisal Foundation. For example, a state-licensed appraiser could legitimately command a higher rate for appraisal services than an appraiser-in-training who has not yet received a license. Relevant qualifications may also include the appraiser's completion of continuing education courses on effective appraisal methods and related topics <u>or professional appraisal designations conferred by nationally recognized professional appraisal organizations</u>.*

Determining "work quality" can be a very subjective process, depending on who is doing the analysis. It is one thing if the analysis is conducted by another peer with professional appraisal credentials. However, if the review is completed by someone of lesser qualifications or by a non-appraiser, the results are likely to be highly subjective. Should the Federal Reserve explore the work quality factor, we urge explanation of the presumptions or requirements necessary for determining credible conclusions regarding work quality.

11. The Board requests comment on whether additional guidance is needed regarding anticompetitive acts that would disqualify a creditor or its agent from the presumption of compliance under § 226.42(f)(2).

Comment: As discussed above, the comingling of appraisal fees and appraisal management company fees in the HUD-1 and Truth in Lending disclosures allows AMCs to set appraisal fees far below what is customary and reasonable, and potentially to do so in a manner where each AMC's appraisal fees are similar to one another, all without fear of disclosure requirements or means of piercing the veil afforded by current reporting requirements. We urge the Board to use their RESPA rulemaking authority, in this or a subsequent rulemaking, to require separate disclosure of these fees as a matter of consumer protection and to prevent potential anticompetitive acts by AMCs.

12. The Board requests comment, however, on whether studies and surveys should be treated differently for the purposes of this rule.

See comments under Safe Harbor for Second Presumption above.

13. The Board requests comment on whether the interim final rule's definition of "appraisal management company" is appropriate for the final rule.

Comment: The Rule also creates Section 226.42(f)(3) of Regulation Z, which states that creditors and their agents will be presumed to comply with the requirement to compensate fee appraisers for performing appraisal services at a rate that is customary and reasonable if the creditor or its agent determines "the amount of compensation paid to the fee appraiser by relying on information about rates that:

1. Is based on objective third-party information, including fee schedules, studies, and surveys prepared by independent third parties such as government agencies, academic institutions, and private research firms;
2. Is based on recent rates paid to a representative sample of providers of appraisal services in the geographic market of the property being appraised or the fee schedules of those providers; ***and***
3. In the case of information based on fee schedules, studies, and surveys, such fee schedules, studies, or surveys, or the information derived there from, ***excludes compensation paid to fee appraisers for appraisals ordered by appraisal management companies as defined in paragraph (f)(4)(iii) of this section****."*

This concept is taken from Section 129E of TILA, as implemented by Dodd-Frank, which excluded from fee studies assignments ordered by AMCs. Section 226.42(f)(4)(iii) defines "appraisal management company" as any person authorized to perform one or more of the following actions on behalf of the creditor:

1. Recruit, select, and retain fee appraisers;
2. Contract with fee appraisers to perform appraisal services;
3. Manage the process of having an appraisal performed, including providing administrative services such as receiving appraisal orders and appraisal reports, submitting completed appraisal reports to creditors and underwriters, collecting fees from creditors and underwriters for services provided, and compensating fee appraisers for services performed; ***or***
4. Review and verify the work of fee appraisers.

The Board took the majority of this definition of "appraisal management company" verbatim from Section 1124 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), which was enacted by Dodd-Frank, and requires in pertinent part that AMCs register with state regulatory bodies. However, in order to clarify that the definition of "appraisal management company" exclude FACs from its meaning, we respectfully suggest that the definition in Section 226.42(f)(4)(iiii) of Regulation Z should be amended to specifically state that FACs are not covered within the meaning of "appraisal management company." Note that this will also ensure that that only AMC fee surveys and data are excluded from the pricing rate determinations. Specifically, we propose that a new clause ***"other than a person or organization that meets the definition of "fee appraiser" as that term is defined in paragraph (f)(4)(i)"*** be added to the existing definition of "appraisal management company" after the phrase "means any person." The proposed definition "appraisal management company" in Section 226.42(f)(4)(iiii), as revised with our amendment in bold italics, would read as follows:

> *(iii) Appraisal management company. The term ``appraisal management company'' means any person,* ***other than a person or organization that meets the definition of "fee appraiser" as that term is defined in paragraph (f)(4)(i)****, authorized to perform one or more of the following actions on behalf of the creditor--*
>
> *(A) Recruit, select, and retain fee appraisers;*
> *(B) Contract with fee appraisers to perform appraisal services;*
> *(C) Manage the process of having an appraisal performed, including providing administrative services such as receiving appraisal orders and appraisal reports, submitting completed appraisal reports to creditors and underwriters, collecting fees from creditors and underwriters for services provided, and compensating fee appraisers for services performed; or*
> *(D) Review and verify the work of fee appraisers.*

14. The Board solicits comment on whether reporting should be required only if a material failure to comply causes the value assigned to the consumer's principal dwelling to differ from the value that would have been assigned had the material failure to comply not occurred by more than a certain tolerance, for example, by 10 percent or more.

Comment: While our organizations strongly support reasonable regulatory limits on the mandatory reporting provisions of Dodd-Frank (such as the requirement in the IFR that a violation be material) in order to discourage complaints that are frivolous or are designed to impede the independence of the appraiser), we generally do not favor having the Federal Reserve establish a percentage tolerance that would govern which opinions of value should be reported and which should not. When complaints are lodged against appraisers – whether in the normal course of business or as a result of the mandatory reporting provision – they are generally referred to the appropriate state appraiser licensing authority for investigation and enforcement. These agencies are accustomed to examining alleged violations of USPAP or state and federal laws (some of which involve the appraiser's opinion of value) and to respond appropriately. On occasion, challenges concerning an appraiser's opinion of value will involve the question of tolerances. We believe that with the additional financial resources that will become available to the state licensing agencies under Dodd-Frank, questions about tolerances are best left to the state licensing agencies which have experience dealing with them.

Moreover, the amount of the value estimate is not the only issue. There are other issues in appraisal reports (other than value) that are "material" and which could adversely affect the consumer. For instance, the appraiser could report the condition of the property or neighborhood market conditions inaccurately resulting in the creditor or its agent underwriting the loan differently. A material misrepresentation in the appraisal report could cause the consumer to be denied a loan, or be approved for a loan, that they otherwise should not, or should, have been, approved for regardless of the value conclusion. We also caution that it is one thing for allegations of infractions to be determined based on a review of the appraisal by another qualified appraiser having local market knowledge. It is another for this to be determined based on an AVM, the report of a reviewer not having local knowledge or an employee of a creditor or its agent having no real formal appraisal training.

15. The Board requests comment on what constitutes a reasonable period of time within which to report a material failure to comply under § 226.42(g).

Comment: In order for preserve consumer confidence in valuations and ensure the safety and soundness of these transactions, any material failure to comply must be reported to the appropriate state licensing board. As such, we recommend that mandatory reporting be based on a covered party's reasonable belief that a violation of USPAP or these regulations has occurred, and that such reporting take place no later than one year from the closing date of the transaction in which the appraisal was relied upon in the decision to extend credit to the consumer.

We would also recommend that the Board, in consultation with appraiser groups, state boards, and the Appraisal Subcommittee, work to develop a streamlined reporting mechanism that would help covered parties identify *bona fide* material failures to comply, while limiting frivolous or spurious claims based solely on dissatisfaction with the value conclusion reached by the appraiser.

16. The Board invites comments on the effect of the interim final rule on small entities.

See Comment #2 above.

17. The Board is soliciting comment on whether some settlement service providers should be exempt from some or all of the interim final rule's requirements.

Comment: The IFR applies to those who extend credit secured by a consumer's principal dwelling (e.g., mortgage lenders) and to any person that provides "settlement services" (as defined under RESPA). The Rule lists the following as examples of settlement services: credit reports, legal services, surveys of real estate and pest inspections. The Fed points out that some settlement service providers are unlikely to have any interest in improperly influencing the appraiser, such as a supplier of borrowers' credit reports or inspectors (but it acknowledges that in such cases these service providers will not have any compliance burden even if the rules cover them). The Fed solicits comments "on whether some settlement service providers should be exempt from some or all of the interim final rule's requirements."

Our organizations are opposed to the exemption of any settlement service providers from the requirements of the rule. Even if the Fed is correct that some providers are unlikely to have a reason to improperly influence the appraiser, the very act of exempting some categories of settlement service providers is likely to encourage other provider groups to argue that they too should be exempted. Given the fact, acknowledged by the Fed, that service provider who are less likely to impede the independence of appraisers also will not have any compliance burdens, establishing a list of exempted entities is an unnecessary and problematic slippery slope.

18. The Board also welcomes further information and comment on any costs, compliance requirements, or changes in operating procedures arising from the application of the interim final rule to small business.

See Comment #2 above relative to technology solutions available to lenders to manage the appraisal process internally with appropriate firewalls.

19. The Interim Final Rule Prohibits "Material Alterations" To An Appraisal Report By Anyone Other Than The Appraiser. The Fed Asks For Comment On Whether There Are Specific Types of Alterations That Other Persons May Make That Would Not Affect The Value And Would Not Constitute A Material Alteration Of The Report.

Comment: The Fed acknowledges that alterations to an appraisal report that would result in a mischaracterization of the value of collateral property are strictly prohibited. It asks whether there are elements of a report that could be altered by a person other than the appraiser, without resulting in a

mischaracterization of the appraiser's conclusion of value. As a general matter, we do not believe that the correction of "typos" or spelling errors would constitute a material alteration of the appraisal report. However, even in such cases our view is that the original "typo" or spelling error should remain visible and the source of the correction shown. Changing any information on an appraisal report is an alteration of that report; and, the final rule should so provide.

Should you have any questions, please contact Bill Garber, Director of Government and External Relations, Appraisal Institute , , Brian Rodgers, Manager of Federal Affairs, Appraisal Institute, Peter Barash, Government Relations Consultant, American Society of Appraisers, at or John Russell, ASA's Director of Government Relations at

Sincerely,

Appraisal Institute
American Society of Appraisers
American Society of Farm Managers and Rural Appraisers
National Association of Independent Fee Appraisers