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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

Dear Ms. Johnson:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions (FCUs), I am responding to the Federal Reserve Board's (the Board) request for comment regarding its interim final rule on appraiser independence. NAFCU opposes the rule as it would impose new requirements on credit unions and others to report certain activity if the credit union has a "reasonable basis" to believe there has been some sort of inappropriate action on the part of independent third parties. Further, the rule would, seemingly, require credit unions to become experts in rules, laws and standards regarding appraisers. In addition, NAFCU has some specific concerns regarding the duty to report, whether the rule should include any exemptions and the fee compensation mechanism.

As a preliminary matter, I would like to address two non-substantive issues. First, NAFCU requests that the Board consider a compliance date beyond April 1, 2011 for provisions in the rule that are different than what is required under the Home Valuation Code of Conduct (HVCC). Second, this rule is unnecessarily complex and seeks to alleviate a problem that already has been, in large part, corrected by the market, to the extent it existed at all.

Generally, NAFCU supports the intent of the rule: to prevent inappropriate or fraudulent valuation of home values. However, NAFCU does not believe it is appropriate to *require* any party involved in a home mortgage transaction to report the activity targeted by this proposal. NAFCU believes that the additional policing of appraisal activity creates an undue burden on our members. Because of the not-for-profit structure of credit unions, there is less incentive for credit union lending officers to approve questionable loans; a fact born out by credit unions' low mortgage default rate, relative to the rest of the lending industry. Further, while credit union management has varying degrees of familiarity with the Uniform Standards of Appraisal Practice (USPAP) and other ethical standards, there are many credit union employees involved in the lending process who have little or no familiarity with the applicable standards.

Closely related to this first issue, NAFCU opposes the reasonable person standard used in the rule to delineate when a covered person must report a failure to comply. The rule states that a covered person,

> "has a reasonable basis to believe that an appraiser has materially failed to comply with USPAP or ethical or professional requirements if the person has actual knowledge or information that would lead a reasonable person to believe that the appraiser has materially failed to comply with USPAP or such requirements." 74 Fed. Reg. 66554, 66576 (proposed Oct. 28, 2010) (to be codified at 12 C.F.R. pt. 226).

This requirement could be construed as requiring all covered persons to have some working knowledge of the ethical standards for appraisers. As discussed above, it would be a serious burden to require all staff involved with the mortgage process to become familiar with appraisal guidelines. Further, institutions that make mortgage loans in multiple states may be construed to have a responsibility to understand the ethical requirements in each state.

NAFCU has two suggestions to alleviate both of these concerns. First, NAFCU recommends that the reporting requirements be reconsidered and instead offered only as a best practice for covered parties. Lenders, title inspectors, mortgage insurers and other parties involved in the mortgage process should not be required to act in a regulatory capacity, reporting appraisal violations that may or may not have actually occurred. Alternatively, NAFCU requests that the Board consider an exemption within the definition of "covered persons" for administrative or support staff who may have a very minor role in the process but who are unlikely to have any knowledge regarding potential problems with the valuation.

If the Board is determined to move forward with the proposal, at the very least, the Board should not use a reasonable person standard. Given that a number of covered parties may have little understanding of the duties of appraisers, the reasonable person standards should be replaced in favor of an actual knowledge standard. An actual knowledge requirement would clarify, as a general matter, that each covered party in a mortgage transaction is not required to have any special knowledge of applicable appraisal standards. Absent such a standard, the regulation could be construed to require covered parties to become familiar with applicable standards in several different states, which is a considerable regulatory burden.

<u>The Duty to Report</u>

If the Board determines to move forward with the rule more or less as proposed, NAFCU supports requiring reports in any instance where a covered person has a reasonable basis to believe a material failure affecting the value of the home has occurred. The Board sought comment on whether reporting a material failure should be required only if the failure causes the valuation to exceed a certain tolerance over "the value that would have been assigned had the material failure to comply not occurred…." <u>Id</u>. NAFCU appreciates that the tolerance would, in essence, define exactly what constitutes the sort of "significant" failure to comply that triggers the reporting requirement. A bright line rule would provide certainty and serve as a filter for less significant problems. Allowing certain tolerances, however, would do little to relieve the regulatory burden this rule creates. Further, permitting tolerances would be highly subjective and thus difficult to administer in any consistent fashion.

First, if institutions are required to report material failures that significantly affect the value of the home, it is likely easier to simply report all such failures. Once a covered party has a reasonable basis to believe such a failure has occurred, the report can be filed without further analysis. If, however, the Board permits certain tolerances, covered parties would then be put in the position of trying to determine whether the failure was so significant that it exceeded the permitted tolerance. Thus, a measure presumably intended to limit the scope of the rule would actually create more work in the event a covered party believes a violation occurred. Simply put, covered parties should be permitted to report any violation that it reasonably believes significantly affected the valuation.

Second, reporting only if a certain tolerance is exceeded would likely be no less subjective than requiring reporting anytime a covered person has reason to believe a violation occurred that affected the appraisal. How would an individual determine whether the appraisal exceeded the ten percent threshold? Certainly the lender could order another appraisal if it believes the first appraisal is inaccurate. Appraisals, however, are inherently subjective. Consequently, there will be very incongruent results at the margin in terms of which failures are reported and which are not. Further, even if misconduct is suspected, it will be a rare case where any covered party involved, other than the lender, has an incentive to order a new appraisal. Other covered parties would have no sound way in which to gauge whether the tolerance had been exceeded. Given the subjective nature of the home valuation process and the fact that many covered persons will have incomplete information, the tolerance would, in reality, provide little clarity. NAFCU does understand that permitting a tolerance would function as a filtering mechanism to capture the most egregious problems. However, leaving the decision in the hands of the parties involved in the transaction to determine which failures are so significant as to require reporting, would catch those same transactions and would prove no less subjective.

Exemptions from Coverage

The Board also requested comment on two different potential exemptions. First, the Board sought comment on whether any "covered persons" under the rule should be exempt from the anti-coercion provisions or the reporting requirements. Second, the Board asked for input as to whether there should be exemptions to allow for individuals, other than the appraiser, to make changes to the appraisal. NAFCU opposes an exemption in both cases. While NAFCU does not support the proposed rule, the discussion that follows assumes the Board will finalize a rule that fairly closely reflects the interim final rule.

Any "covered party" as defined in the proposed rule should be subject to both the anti-coercion and the reporting requirements. As the Board stated in the section-by-section analysis of the proposal, some parties may have little reason to improperly inflate the price of the dwelling. Similarly, other parties may have little familiarity with the ethical obligations involved in the appraisal process. Nonetheless, assuming the Board does not make any of the changes suggested above, NAFCU supports including settlement service providers under the rule's coverage, along with creditors. All parties involved in the real estate transaction should be held to the same standard regarding the anti-coercion rules and the reporting requirements. Further, as the Board indicated in its discussion of the proposal, there is little reason not to include all parties as those who have no incentive to inflate or deflate valuations and little familiarity with the ethical obligations involved will have very little, if any, burden under the rule.

The final rule should not permit changes in the valuation by anyone other than the appraiser. Changes in the valuation are customarily made by the individual responsible for the appraisal and permitting others to make changes will likely only lead to problems in the event that there is a dispute over the accuracy of an appraisal. Even in cases where there the correction is simple, such as a typo or any other obvious mistake, the duty to correct it should lie with the individual who conducted the appraisal.

Reasonable and Customary Compensation

NAFCU is also somewhat concerned with the mechanism the Board proposed to determine compensation. The Board proposed two different ways in which appraisal fees could be set, which would be presumptively reasonable. NAFCU does not have any concern with the two methods the Board proposed to determine what is "reasonable and customary." Instead, our concern is that such a requirement exists in the first place. As a general matter, NAFCU opposes attempts by the government to regulate prices for goods or services that are negotiated between private parties. While the rule sets up two ways to presumptively prove a fee is reasonable, institutions that choose not to use one method or the other are put in the awkward position of, effectively, proving their innocence. This matter is particularly troubling for credit unions as credit union home mortgage portfolios have generally outperformed the market and our industry has seen, relatively speaking, lower mortgage default rates. NAFCU believes these fees are best left to the market and that the other provisions addressing appraiser independence should be sufficient to alleviate much of the problem regarding improper valuations.

In conclusion, NAFCU does not support the final interim rule. The parties involved in the mortgage process should not be required to act as reporting agents in this manner. Further, the Board should make clear that covered persons do not have any duty to become familiar with USPAPS or other applicable standards simply by virtue of being involved in the mortgage process. While NAFCU does not support the rule, the burdens it would create would be dramatically reduced if the Board replaced the reasonable person standard with an actual knowledge standard for reporting. Should the Board decide to move forward with the rule, more or less as written, it should not include tolerances for the reporting requirement. Additionally, the rule should not provide exemptions from its coverage for settlement service providers. Likewise, no exemptions should be permitted to allow minor changes in the valuation by anyone other than the individual who conducted the appraisal. Finally, NAFCU questions the need to dictate prices for good or services negotiated between private parties. NAFCU appreciates this opportunity to share its comments on the interim final rule. Should you have any questions or require additional information please call me at (703) 842-2212.

Sincerely,

Dillon Shea

Dillon Shea
Associate Director of Regulatory Affairs