FNC®

By Federal Express

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Chairman Ben S. Bernanke
Board of Governors of the Federal Reserve System
Federal Reserve Board
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Interim Final Regulations to be Promulgated under Section 1472 of Dodd-Frank Act (New Section 129E of Truth in Lending Act)

Dear Chairman Bernanke:

FNC would like to provide some comments that may be helpful in the development of the Interim Final Regulations required under §1472 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, HR 4173 (Dodd-Frank Act) related to Appraisal Independence.

Background

FNC, Inc. is a mortgage technology company headquartered in Oxford, Mississippi. FNC provides large residential mortgage lenders, servicers and investors with automation services that allow them to order, track, receive, analyze and store the residential real estate appraisals and other valuation services they use to support or evaluate residential mortgages. The service we provide to our clients is called the Collateral Management System® or (CMS®). Each individual CMS, in turn, connects electronically to FNC's AppraisalPort® where appraisers receive, process and return orders for appraisals. On an annual basis, FNC assists in the processing of several million residential appraisals.

As the major mortgage lenders, servicers and investors are typically federally regulated financial institutions, a major component of these automation services is directed to providing these clients with the tools they need to assure compliance with the various regulations that govern their activities and the activities of the real estate appraisers who provide appraisal services.

The passage of the Dodd-Frank Act has added many new regulatory provisions to those that already govern our clients. Since FNC will be called upon to develop the systems that will assist our clients in complying with these new regulations, we have a keen interest in assuring that any regulations issued under the Dodd-Frank Act are reasonable, clear and understandable. The need for regulations that are reasonable, clear and understandable is reinforced by recognition that the potential penalties that may arise under Truth in Lending §130 can be quite substantial (especially when augmented by those enumerated in the new §129E(k)).

To that end we would like to provide these comments on the provisions of §1472 to be covered by the Interim Final Regulations (IFR).

Reach of the Regulation

The basis for the Interim Final Regulations is §129E (g)(2). There has been a fair amount of discussion concerning the reach of the Interim Final Regulations. Our reading is that the IFR are intended to be a mirror of the provisions in §129E (g)(1),

> "with respect to 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 and mortgage brokerage services for such a transaction, within the meaning of subsections (a), (b), (c), (d), (e), (f), (h), and (i)".

This indicates that the IFR will be directed to subsections (a), (b), (c), (d), (e), (f), (h), and (i) and limited to appraisal independence issues arising with respect to consumer credit transactions secured by the principal dwelling of the consumer. By definition, consumer credit transactions are less inclusive that those transactions encompassed by the term "federally related transaction" as defined in Title XI §1121(4) of the Financial Institutions Reform Recovery and Enforcement Act of 1989 (FIRREA), PL 101-73.

For example, a "non-owner occupied" residential mortgage transaction would be a federally related transaction, but not a consumer credit transaction[1].

Since the basis for much appraisal regulation to date has been Title XI of FIRREA governing federally related transactions, this suggests that the IFR will need to be careful to make the distinction with respect to the loans and transactions to which these regulations apply, and those transactions to which it does not.

Direct or Indirect Interest

Subsection (d) provides that an appraiser (or appraisal management company) may not have "a direct or indirect interest, financial or otherwise, in the property or transaction involved in the appraisal".

Currently the Uniform Standards of Professional Appraisal Practice (USPAP) Standards Rule 2-3 requires that the appraiser must include a certification in every appraisal that includes, among other certifications:

> I have no (or the specified) present or prospective interest in the property that is the subject of this report and no (or the specified) personal interest with respect to the parties involved.

That is, the appraiser is not forbidden from having a present or prospective interest, only that if the appraiser does, that that interest be disclosed.

[1] See,, for example, Federal Reserve Board Official Staff Commentary, Regulation Z, § 226.3 Exempt transactions.

Subsection (d) prohibits the appraiser (and appraisal management company) from having such an interest.

The more important issue that it would be helpful for the FRB to address would be how it sees "direct or indirect interest" and "financial or otherwise". Commonly the view of a direct or indirect interest is that the appraiser has a direct or indirect interest if the appraiser has an ownership interest in the property itself (or a member of the appraiser's immediate family or someone with whom the appraiser has a business relationship where the property is involved). It is not generally considered an interest where the appraiser is to earn a fee for his or her services appraising the property, or if the appraiser works for a financial institution and the financial institution may profit by the granting of the loan for which the appraisal is sought.

In addition, it would be helpful to know what would be considered a "direct or indirect interest" which is "otherwise" than a financial interest, since this is a slightly different issue than lenders and appraisers have faced to date.

Mandatory Reporting

Subsection (e) calls for what is commonly called mandatory reporting of various violations of laws or requirements, or unethical or unprofessional behavior to the relevant state appraiser certifying and licensing agency.

The first challenge is that list of covered individuals and organizations is quite broad

> Any mortgage lender, mortgage broker, mortgage banker, real estate broker, appraisal management company, employee of an appraisal management company, or any other person involved in a real estate transaction involving an appraisal in connection with a consumer credit transaction secured by the principal dwelling of a consumer

Within that group there are varying degrees of sophistication and knowledge about appraisals and appraisal practices. Moreover, there are some who will remain more or less ignorant of this statute and the regulations.

Taking the varying degrees of sophistication and knowledge, the challenge here has to do with ""who has a reasonable basis to believe...". While many of the other covered individuals may have only a casual understanding of this issue, our clients engage millions of appraisal and other valuation services every year, often dealing with tens of thousands of appraisers. In order to comply with this provision, they will need to establish institution wide policies and practices that can be applied uniformly across that volume of activity. It would be helpful to receive guidance on what a reasonable basis might be that would lend itself to neither "underreporting" nor "over-reporting".

Appraisal Report Portability

While subsection (h), Appraisal Report Portability, is one of the listed subsections to which the Interim Final Regulations might apply if the Interim Final Regulations are to mirror the general regulatory authority in subsection (g)(1), the language of subsection (h) seems to cast that in some doubt. Subsection (h) is an invitation to the enumerated regulatory agencies to jointly issue regulations, which may suggest that this specific sub-section might be left out from the list of issues that the IFR should address.

The issue of appraisal report portability has been with us for a long time. The challenge with "portability" is that the appraisals are not performed for the world at large but for specific clients. And each client is obligated to assure that the quality of the appraisal it receives is of sufficient quality and reliability to use to support a mortgage transaction.

USPAP prevents an appraiser from simply changing the name of the client on the appraisal and handing it (or having someone else hand it—pre Home Valuation Code of Conduct, typically a mortgage broker) to a new client. If another client is to receive the appraisal, that new client needs to engage the appraiser and have the appraisal directed to that new client[2]. In addition, the appraiser needs to be aware of any confidential information which may be incorporated in the appraisal to avoid compromising that information by revealing the appraisal to a third party, even if that third party is a new client.

If the FRB intends to address this issue, it would be very helpful to the lending/appraisal community at large if it could provide some practical guidance on how an appraisal might be made portable (setting aside issues of quality, which we will address shortly) and on what basis. Within the regulatory constraints, how can the parties effectuate the transfer of an appraisal from one lender (who may not wish to make the loan, or may only wish to make the loan on unfavorable terms) to another lender (who is presumed to be more likely to grant the loan on acceptable terms)?

With respect to the quality issues, a subsequent client/lender who receives an appraisal is not immune from its obligation to review the appraisal and assure that it is fully compliant and "contain[s] sufficient information and analysis to support the institution's decision to engage in the transaction"[3]. It would appear very difficult to provide any simple means for a subsequent lender/client to ascertain the suitability of the appraisal transferred without applying its normal due diligence. The FRB may wish to provide some guidance on this issue as well (especially on the issue of the level of due diligence it believes is appropriate in this circumstance).

Customary and reasonable

There has been a fair amount of discussion about this specific section, often focusing on the issue of price surveys. In fact, this issue is undoubtedly the most controversial of all of the provisions in §1472/§129E.

The issue of appraisal fees is a challenging one and has had a major effect on the appraisal community at large. The total income appraisers receive from residential appraisal services has certainly declined in the past few years. Some of this is the direct result of the decline in the demand for appraisal services with the substantial decline in residential mortgage originations. This is paired with a substantial run-up in the number

[2] See, for example, Uniform Standards of Professional Appraisal Practice, Advisory Opinions 26 and 27.

[3] See, e.g., 12 CFR 34.44

of licensed or certified appraisers in the past decade (the number of appraisers on the national registry increased by 38.5% between 2001 and 2007)[4].

The other reason appraisal fees have changed is that the nature of process by which appraisal services are procured has changed. Up until the implementation of the Home Valuation Code of Conduct (HVCC) by Fannie Mae and Freddie Mac in May 2009, a substantial (but declining) portion of residential appraisal services were procured by mortgage brokers with whom the appraiser was likely to have a direct relationship. Since the HVCC did not permit mortgage brokers to engage appraisers, the appraisers who had established relationships with one or more mortgage brokers no longer had a source of work, and needed to find other avenues. For various reasons the work that was previously procured by mortgage brokers in many cases shifted to appraisal management companies. Since appraisal management companies (as do appraisal companies) work on a fee split basis, the net effect of this shift was that an appraiser who had worked directly with a mortgage broker received what the appraiser believed was a full fee (taking into account that the appraiser was taking the marketing risk) now received a lesser fee. Hence, this shift is other reason (besides the dramatic decline in mortgage volume) that many appraisers have suffered a decline in their total income.

That shift in the source and amount of income is one of the sources of the interest in customary and reasonable fees.

It would be helpful to look at the statute and see how it might be interpreted and applied.

> "(i) CUSTOMARY AND REASONABLE FEE.—
> "(1) IN GENERAL.—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. 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.
>
> "(3) EXCEPTION FOR COMPLEX ASSIGNMENTS.—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[5].
>
> 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. Evidence for such fees **<u>may be established</u>** by objective third-party information, such as government agency fee schedules, academic studies, and independent private sector surveys.

[4]See, e.g., ASC 2009 Annual Report
https://www.asc.gov/Documents/AnnualReports/2009%20ASC%20Annual%20Report.pdf

[5] Query: is this a one way exception, that is, it is possible to reflect increased time, difficulty and scope of work, but not <u>decreased</u> time, difficulty and scope of work? It would seem as if both circumstances should apply.

While a lender (and for our discussions we will assume that lender's agent is included) may find evidence of what may be a customary and reasonable fee in schedules, studies or surveys, they are not required to--they may also find evidence in other places. Typically and traditionally the lender will find evidence of what might be customary and reasonable fees in its own experience as an actor in that marketplace, which is the most common approach to pricing (in the world at large) and the model used by lenders and appraisers today[6].

In establishing the fees paid, one lender may focus on price (perhaps by negotiating for volume discounts) and as a result pay lower fees than another lender in the same market who may emphasize some other aspect of the lender-appraiser relationship.

Let's look at an example. This example is very much simplified, and ignores the fact that fees may vary based on issues of location, scope of work and so on.

Lender	Appraisal fee range
A	$ 7.00 – 9.00
B	8.00 – 10.00
C	7.00 – 8.00

As we might expect, the market will vary simply by the actions, motivations and requirements of the players. In this marketplace, an appraiser working for Lender B may be paid more for what is more or less the same assignment as when that same appraiser works for Lender C (the most aggressive on price).

That would be expected, and it would be hard to argue that in each case the appraiser did not receive the customary and reasonable fee.

Let's add an appraisal fee price survey --"government agency fee schedules, academic studies, and independent private sector surveys"—("price survey"). Our chart now says

Lender	Appraisal fee range
A	$ 7.00 – 9.00
B	8.00 – 10.00
C	7.00 – 8.00
Survey	8.50 – 10.00

Should the introduction of the price survey information change the result?

If the price survey were to overrule the marketplace experience of the lenders, then it would have the effect of price fixing, which is clearly anti-competitive. Since we have to assume that it was not Congress' intention to condone price fixing, we believe that a price survey cannot overrule another means by which a lender arrives at its

[6] As a matter of course, FNC's clients all store their own individual fee schedules (typically accounting for geographic location and scope of work—esp. type of service and form type required) inside their own Collateral Management System for use and reference in the engaging of individual appraisal services. Each of these fee schedules is independently developed and maintained by the individual clients without reference to other fee schedules.

understanding of customary and reasonable (and in our view helps explain why the use of a price survey is not mandatory).

Resilience in the Marketplace

To understand how resilient this marketplace might be let's take a look at a different example. Suppose there is only one appraiser is a market area and this appraiser routinely charges $11.00 since there is no competition. Is that customary and reasonable? How would the measure of customary and reasonable fees change if a second appraiser came into the marketplace and only charged $9.00? It seems reasonable the lender and appraiser could agree on that price (and the fact that it also was customary and reasonable).

Any other result would argue that the market will become ossified at the first price and the second appraiser (who is representing the competitive market) would not be able to compete against the first appraiser based on fees. More important, the ultimate party to pay, the consumer (and this is part of a consumer protection act) would end up paying more for the service than would otherwise appear necessary.

Let's take another example. Suppose that what we have is a market where the lender has determined that $8.00 - $10.00 is customary and reasonable, but then that lender receives an offer from an appraiser which says the appraiser will perform those appraisals for $7.50 each provided the appraiser receives a guaranteed volume of work.

Would the lender be able to accept that offer as customary and reasonable or not? It would seem that a price for one appraisal is not the same as the price for a quantity of appraisals. How should the lender handle this circumstance?

Application to Non-Consumer Credit Transactions

As we have pointed out before, this new section of Truth in Lending governs consumer credit transactions secured by the principal dwelling of the consumer. If that is true, with respect to non-consumer credit transactions, would the issue of customary and reasonable fees even apply?

"Price Surveys"

The statute has indicated that a lender or lender's agent may use objective third party information in establishing what the lender considers customary and reasonable.

> 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.

While the statute does not address the question, the issue of ascertaining prices between competitors by survey or other action, is clearly governed by anti-trust considerations. There is some guidance available on the issue, found in the 1993 "Statement of Department of Justice and Federal Trade Commission Enforcement Policy on Providers' Collective Provision of Fee-Related Information to Purchasers of Health Care Services". http://www.ftc.gov/bc/healthcare/industryguide/policy/statement5.htm .

While this guidance is directed towards health care services, the federal regulators have often commented that the guidelines in the Statement have general applicability[7], and in the absence of other guidance, most have taken it to heart on the issue of price surveys (or for that matter, some see it governing academic studies).

As can be seen from the Statement, a price survey is subject to certain requirements that can influence not only who might be permitted to conduct the survey but also the results.

It should be noted that the statute itself makes the development of a reliable survey more challenging, since it has the effect of substantially reducing the number of samples (that is, the actual price paid for an appraisal) since the survey is to exclude any assignments ordered by known appraisal management companies (which some estimate is as much as 70% of the appraisals ordered today).

On a practical level, this provision is also somewhat challenging in that most lenders do not track whether the fee is for an appraisal ordered by an appraisal management company or not.

Within this context, it would be helpful if the IFR were to provide some guidance on the appropriate practical measures to alleviate the challenges that are presented by developing a price survey that complies with not only anti-trust considerations but the potential skewing of the results by excluding a substantial number of transactions.

Scope of Work, Location and Other Considerations

Up to this point, we have treated all appraisals as the same. In addition, we have taken the notion of an appraisal out of the question of appraisal services, which is more than the appraisal report. The payment for appraisal services is intended to cover all of the costs for the operation of a successful service based business, from marketing to accounting (including collections), rent, data and other fixed costs and the overall services that go into the production and delivery of an acceptable appraisal report to a client.

It would be helpful in approaching this issue to give some guidance on all of the factors that come together with respect to the economic value of an appraisal service, and which may create differences in the fees paid for those appraisal services, for example

- Quality and completeness of the appraisal. Does the appraisal need to be returned for correction of errors, faulty or unsupported analysis, or other reasons? Can a lender reward quality and completeness and penalize a lack of quality and completeness?
- Is the appraisal service timely? Can the client reward timely delivery, and penalize late delivery?

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[7] E.g., "We believe that the guidance offered with respect to hospitals on this issue has broader, general applicability. The analysis on which the safety zone is premised is applicable to all competitors engaged in exchanges of price and cost data." Anne K. Bingaman, Assistant Attorney General Antitrust Division U.S. Department of Justice, DC Bar Association Meeting, February 16, 1994 http://www.justice.gov/atr/public/speeches/0109.htm

- Where is the property located? Is there active competition among appraisers in the market area, or are there only a small number of practitioners? What happens if the degree of competition changes?
- Nature of the assignment. What is the work product required? Which of the residential appraisal forms is required?
- Responsiveness. How responsive is the appraiser to client questions and issues?

<u>When Should the Interim Final Regulations Go into Effect?</u>

From our viewpoint there are some challenging issues in many of the provisions of §1472/ Truth in Lending §129E. However the Interim Final Regulations treat these various issues, it is clear that all of the parties involved will need some lead time in which to digest the Interim Final Regulations and then develop the policies, procedures they intend to follow in order to comply. From there, FNC and others like FNC will need to develop the appropriate processes to automate those policies and procedures and put them into effect.

Lenders who may wish to use "government agency fee schedules, academic studies, and independent private sector surveys" in order to ascertain what they believe are customary and reasonable fees (the ground rules of which are not yet known) will need some time to develop or seek out the appropriate, compliant sources of this information and then obtain the necessary results.

No one will be able to comply with the Interim Final Regulations on the day they are issued. As a result, we actively recommend that there be a reasonable phase-in period (no less than 90 – 180 days) to allow all the parties enough time to understand the Interim Final Regulations and adopt appropriate compliance measures.

Thank you for this opportunity to provide comment on the various aspects of Dodd-Frank Act §1472/ Truth in Lending §129E. We hope that you find the comments helpful.

Feel free to contact me if you have any questions.

Sincerely,

Neil Olson
Chief Legal Officer