June 8, 2012

Office of the Comptroller of the Currency, Treasury
Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation

Re: Leveraged Lending Proposed Guidance

Dear Sir or Madam:

The American Society of Appraisers (ASA) and the U.S. region of the Royal Institution of Chartered Surveyors (RICS Americas), representing thousands of professional appraisers credentialed in business valuation and commercial real estate appraisal practice, appreciate the opportunity to comment on the "Proposed Guidance on Leveraged Lending." [1] Although our comments focus on the sections of the Guidance involving "Valuation Standards," we endorse the need for and the public policy purposes of the proposal in its entirety.

I. Executive Summary

(1)**The Appraisal Portion of the Leveraged Lending Guidance Lacks Provisions Relating To Appraiser Qualifications, Appraiser Independence and Appraiser Adherence to Generally-Accepted Appraisal Standards. These Missing Elements Undermine the Reliability of Enterprise Valuations and Their Usefulness in Helping to Ensure Safe and Sound Leveraged Loans:**

While our organizations strongly support the important purposes of the proposal's valuation provisions, those provisions are missing crucial elements without which their effectiveness as an aid to ensure safe and sound leveraged lending are fundamentally undermined. Those missing elements and our recommendations on how the omissions can be easily remedied are described below:

First, the valuation provisions do not address the crucial issues of appraiser qualifications and appraiser independence for those providing enterprise valuations in connection with leveraged loans. Requirements relative to the qualifications and independence of appraisers are essential to ensure that appraisers are competent and that their conclusions of value are objective and free from any conflicts of interest;

Second, the valuation provisions do not address the imperative of appraiser adherence to generally-accepted appraisal standards. Adherence to such standards is necessary to ensure

[1] ASA and RICS Americas are professional appraisal organizations which teach, test and credential their members for professional appraisal practice in business valuation and in commercial and residential real estate. Both organizations require their members to adhere to a strict and enforceable Code of Ethics. In addition, ASA awards a credential in personal property appraising, including the valuation of machinery, equipment and technical specialties. ASA is widely regarded as the leading business valuation professional appraisal organization in the U.S.

uniformity in the valuation approaches, methods and procedures utilized for business enterprise appraisals in leveraged lending situations. We believe that requiring adherence to generally-accepted appraisal standards is an essential safeguard against advocacy appraisals.

While the omissions cited above seriously undermine the purpose and effectiveness of the Guidance's valuation provisions (and the potential usefulness of the Guidance itself), there are ready-made, virtually off-the-shelf solutions available that are easily includible in the Leveraged Lending Guidance. Those solutions can be found in the provisions of the federal banking agencies Interagency Appraisal Guidelines and in IRS guidance governing "Qualified Appraisers" and "Qualified Appraisals". Both documents contain provisions which establish appraiser qualifications and independence requirements and ensure adherence to generally-accepted appraisal standards. These provisions are directly relevant to and needed in the Appraisal Standards portion of the Leveraged Lending Guidance; and, they can be readily incorporated into it.

(2)The Credit Review Capabilities of Lenders Should Include Appraisal Expertise:

Given the inherent riskiness of leveraged loans, the Leveraged Lending Guidance properly emphasizes the importance of the credit review capabilities of lenders, including the ability to effectively review the "valuation methodologies" relied on during the loan underwriting process. While the Guidance, as proposed, appropriately states that lenders should "staff their internal credit review function appropriately," it does not address the particulars of staff expertise necessary to review appraisals. When the Guidance is issued in final form, we believe it should encourage lenders to include, as members of their audit team (including third parties hired by the lender), individuals who are competent to review appraisals, particularly going concern appraisal reports which typically contain complex analyses involving the value of an operating business, the business ownership interests and the intangible assets.

In this regard, we recommend that the Guidance ensure that members of a lender's audit team responsible for reviewing enterprise appraisals possess valuation qualifications comparable to those required of appraisers who perform valuations during the loan underwriting process; and, that these individuals be independent of the lender's loan production function. The Interagency Appraisal Guidelines include such provisions that are specifically directed at lenders; and, they provide an ideal template for inclusion in the Leveraged Lending Guidance. We believe it is self-evident that individuals working for the lender in an appraisal review or audit capacity should have the credentials and independence necessary to perform that job responsibly.

(3)The Appraisal Standards Portion of the Guidance Should Include Commentary Addressing the Fact that Under Certain Circumstances A Going Concern Valuation By A Business Appraiser May Require the Services of an Appraiser Credentialed to Value the Firm's Tangible Assets, Such as Real Estate, Machinery and Equipment and, Possibly, The Non-Fixed Assets (e.g., Furnishings) In Buildings Owned or Leased by the Firm Being Valued.

The issue of whether the tangible assets of an operating business should be separately valued as part of a going concern appraisal – or whether an asset-based approach to value is warranted –

depends on the judgment of the business appraiser and is further dependent on the applicable standard of value, the purpose and intended use of the valuation and all other relevant factors. As a general matter, for example, the asset-based approach should be considered in valuations conducted at the enterprise level when they involve an investment or real estate holding company or a business appraised on a basis other than as a going concern.[2] We understand that the Leveraged Lending Guidance is not an appropriate vehicle for detailed commentary on when and how the tangible assets of a firm should be separately valued in the context of a going enterprise appraisal (the business valuation standards and professional journals of the American Society of Appraisers and other professional organizations which credential business appraisers) include appropriate discussion and guidance on this issue. Nevertheless, we believe that those most affected by the "Valuation Standards" portion of the Guidance (i.e., appraisers and lenders who use their services) would benefit from a recognition, in Guidance commentary, that enterprise appraisals performed in connection with underwriting a leverage loan to an operating business may well require the services of a real estate or machinery and equipment appraiser to value the firm's tangible assets. That decision is and should continue to be made by the business appraiser performing the going concern valuation and who is ultimately responsible for its integrity.[3]

II. Discussion

A. Competent Business Enterprise Appraisals Can Greatly Assist Lenders In Measuring Leveraged Loan Risk:

Our organizations agree with a central premise of the Leveraged Lending Guidance that a competent and independent business enterprise appraisal will provide financial institutions engaged in leveraged lending with important information necessary to underwrite such loans in a safe and sound manner. Our business appraisers recognize that the appraisal reports typically prepared for and about the value of going concerns, including their tangible and intangible assets, contain conclusions, analyses and data that can be invaluable to a lender's (as well as a regulator's) understanding of leveraged loan risk. The proposal correctly recites the several categories of information and analysis that an appraisal of enterprise value will provide leveraged lenders (e.g., evaluating the feasibility of a loan request; determining the debt reduction potential of planned asset sales; assessing a borrowing firm's ability to repay a loan and access the capital markets). The Guidance also accurately describes the general approaches for valuing closely held businesses.

The "Credit Review" portion of the proposed Guidance states that due to the elevated risk inherent in leveraged financing, financial institutions should "have a strong and independent credit review function" and that reviews should include the evaluation of "valuation

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[2] The "Business Valuation Standards" of the American Society of Appraisers describes the asset-based approach as "a general way of determining a value indication of a business…using one or more methods based on the value of the assets net of liabilities." It further states that "The asset based approach should be considered in valuation conducted at the enterprise level and involving (a) An investment or real estate holding company [and] (b) A business appraised on a basis other than as a going concern."

[3] To the extent that there are any unresolved issues regarding the facts and circumstances under which a going concern appraisal should draw on the services of another appraisal discipline to value the tangible assets of the firm being valued, they should be addressed by the appraisal profession in conjunction with The Appraisal Foundation's boards.

methodologies." We concur and point out that in order for a leveraged lender's credit review staff or third party contractors to properly evaluate enterprise or other appraisals performed during the underwriting process, they should possess the qualifications and independence of the appraisers performing loan origination appraisals. Given the fact that lenders often rely on enterprise value, including the value of the tangible and intangibles assets of the borrowing firm to determine risk, we believe that the appraiser qualifications and independence provisions included in the final Leveraged Lending Guidance, should be applied, as well, to the appropriate members of the lender's credit review team.

B. While Our Organizations Strongly Support the Thrust and Purposes of the Guidance's Valuation Standards, They Lack Elements Necessary to Ensure Their Reliability and Effectiveness

As proposed, The Valuation Provisions of the Leveraged Lending Guidance Fail To Address the Need For Appraiser Qualifications, Appraiser Independence and Appraiser Adherence To Generally-Accepted Appraisal Standards: Although the Guidance properly requires that enterprise valuations be "performed or validated by qualified persons independent of the origination function," it nowhere prescribes or even addresses the valuation skill-sets (including adherence to generally-accepted appraisal standards) necessary to ensure competent going concern appraisals. It also fails to establish appraiser "independence" requirements that would ensure that conclusions of value are objective.

Our organizations strongly believe that if the Guidance's valuation standards fail to include these elements, the reliability and effectiveness of going concern appraisals will be seriously compromised. While it is standard practice for private sector users of business appraisal services to only retain individuals with well-established professional appraiser credentials (indeed, this may have been contemplated by the drafters of the proposed Guidance), the Guidance should make this explicit and not leave it to chance.

RECOMMENDATION:

Our Organizations Strongly Recommend the Inclusion of Appraiser Qualifications, Appraisal Standards and Appraiser Independence Provisions In the Leveraged Lending Guidance. Well Known Templates for These Provisions Already Exist at Federal Agencies, Providing Off-the-Shelf Solutions to These Missing Elements –

The templates for each of the missing appraisal elements of the Leveraged Lending Guidance currently exist both in the **Interagency Appraisal Guidelines** promulgated by the federal financial institutions regulatory agencies in December 2010[4] and in **the Internal Revenue Service Appraisal Guidance** for valuing non-cash charitable contributions and for several other tax purposes.[5] Both documents establish appraiser qualification requirements. Both documents require that appraisers adhere to generally-accepted appraisal standards (i.e., the Uniform

[4] The Interagency Guidelines were published by the federal banking agencies in the Federal Register of December 10, 2010.

[5] IRS Notice 2006-96, "Guidance Regarding Appraisal Requirements For Non-Cash Charitable Contributions" and for other tax purposes.

Standards of Professional Appraisal Practice or, in the case of IRS, USPAP or other generally-accepted standards that are consistent with the substance and principles of USPAP). Both documents include independence provisions which require appraisers to be independent of any financial or other interests that could influence their conclusion of value.

The Interagency Appraisal Guidelines, which govern the performance of real estate appraisals by real estate appraisers in connection with real estate-collateralized lending by regulated financial institutions, establish **appraiser independence** and **appraisal standards** requirements that are fully relevant to and compatible with business enterprise appraisals of going concerns addressed in the Leveraged Lending Guidance. Clearly, the real estate appraiser qualifications provisions of the Interagency Appraisal Guidelines are not applicable to the valuation skill-sets needed by business appraisers to value going concerns and intangible property. However, they do become relevant in situations where a business enterprise appraiser, performing a going concern valuation, determines that the services of a real estate appraiser are required to value the real estate assets of the firm being valued.

The IRS Guidance, which specifies the valuation skill-sets necessary to be considered a "Qualified Appraiser" for tax-related valuations of going concerns and intangible property (as well as for other categories of property such as machinery and equipment), is directly relevant to the qualifications of business appraisers and other non-real property appraisers in connection with leveraged lending. IRS' definition of "Qualified Appraiser" specifically covers business appraisers (as well as other non-real estate appraiser disciplines) and is an appropriate template for inclusion in the Leveraged Lending Guidance.

As stated above, our organizations believe that the important missing elements in the valuation provisions of proposed Leveraged Lending Guidance are readily available from the appraisal provisions found in the Interagency Appraisal Guidelines and IRS' Appraisal Guidance. Our review of the two documents leads us to the following conclusions:

Adherence to generally-accepted appraisal standards and appraiser independence: With respect to the imperatives of the appraiser's adherence to generally-accepted appraisal standards and the appraiser's independence from conflicts-of-interest, we believe that the provisions of both the Interagency Appraisal Guidelines and IRS' Appraisal Guidance are fully compatible with the purposes of the Leveraged Lending Guidance and that provisions in either document can form the basis for similar provisions in the Leveraged Lending proposal; and,

Qualifications For Business Appraisers: With respect to the qualifications of business appraisers (and other non-real property appraisal disciplines), the appropriate template is found in the IRS Appraisal Guidelines whose definition of a "Qualified Appraiser" establishes clear and effective qualification requirements for business appraisers and personal property appraisers. While these qualification requirements are directed at appraisers who provide tax-related valuation services, the "Qualified Appraiser" definition is entirely appropriate (and we think essential) for the Leveraged Lending Guidance and its safety and soundness purposes. [6]

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[6] The Internal Revenue Service's definition of a "Qualified Appraiser" states that "the term 'qualified appraiser' means an individual who (1) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in (cont.)

Qualifications For Real Estate Appraisers: The provisions of the Interagency Appraisal Guidelines relating to real estate appraisal practice provide the appropriate template for compliance with the Leveraged Lending Guidance when the business appraiser conducting a going concern valuation of a firm determines that a separate valuation of real estate assets is required.

III. Additional Discussion

IRS' "Qualified Appraiser" definition is important in the context of the banking agencies' Leveraged Lending proposal because it establishes qualifications for non-real property appraiser disciplines (i.e., business appraisers and personal property appraisers) – something the Interagency Appraisal Guidelines does not do. Because the Tax Code requires valuations of all categories of property for various Income, Estate and Gift Tax purposes and because IRS wanted to improve the reliability of appraisals prepared for and filed by taxpayers, it determined that it needed a definition of "Qualified Appraiser" that encompassed all appraiser disciplines and all categories of intangible and tangible property (e.g., business enterprise appraisals, including intangibles; machinery and equipment appraisals; art appraisals). For business appraisers and personal property appraisers, IRS' definition of a "Qualified Appraiser" requires individuals to have an appraisal credential from a recognized professional appraisal organization that is awarded on the basis of demonstrated competency and verifiable educational achievement relating to the type of property for which the appraisal is performed (there are several other

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regulations prescribed by the Secretary, (2) regularly performs appraisals for which the individual receives compensation, and (3) meets such other requirements as may be prescribed by the Secretary in regulations or other guidance. Section 170(f)(11)(E)(iii) further provides that an individual will not be treated as a qualified appraiser unless that individual (1) demonstrates verifiable education and experience in valuing the type of property subject to the appraisal, and (2) has not been prohibited from practicing before the Internal Revenue Service by the Secretary under § 330(c) of Title 31 of the United States Code at any time during the 3-year period ending on the date of the appraisal." 03 *Transitional terms-qualified appraiser* (1) *Appraisal designation.* An appraiser will be treated as having earned an appraisal designation from a recognized professional appraiser organization within the meaning of § 170(f)(11)(E)(ii)(I) if the appraisal designation is awarded on the basis of demonstrated competency in valuing the type of property for which the appraisal is performed. (2) *Education and experience in valuing the type of property.* An appraiser will be treated as having demonstrated verifiable education and experience in valuing the type of property subject to the appraisal within the meaning of § 170(f)(11)(E)(iii)(I) if the appraiser makes a declaration in the appraisal that, because of the appraiser's background, experience, education, and membership in professional associations, the appraiser is qualified to make appraisals of the type of property being valued. *See also* § 1.170A-13(c)(5). (3) *Minimum education and experience.* An appraiser will be treated as having met minimum education and experience requirements within the meaning of § 170(f)(11)(E)(ii)(I) if — (a) *For real property* (i) For returns filed on or before October 19, 2006, the appraiser is qualified as a "qualified appraiser" within the meaning of § 1.170A-13(c)(5) to make appraisals of the type of property being valued. (ii) For returns filed after October 19, 2006, the appraiser is licensed or certified for the type of property being appraised in the state in which the appraised real property is located. (b) *For property other than real property* — (i) For returns filed on or before February 16, 2007, the appraiser is qualified as a "qualified appraiser" within the meaning of § 1.170A-13(c)(5) to make appraisals of the type of property being valued. (ii) For returns filed after February 16, 2007, the appraiser has (A) successfully completed college or professional-level coursework that is relevant to the property being valued, (B) obtained at least two years of experience in the trade or business of buying, selling, or valuing the type of property being valued, and (C) fully described in the appraisal the appraiser's education and experience that qualify the appraiser to value the type of property being valued.

related requirements). For real property appraisers, IRS' "Qualified Appraiser" definition is generally similar to the qualified appraiser provisions of the Interagency Appraisal Guidelines. It requires, among other things, a Certification or License from a state appraiser licensing agency depending on the type and complexity of real estate or interests in real estate being valued for tax purposes.

We believe the "Valuation Standards" provisions of the Leveraged Lending Guidance also must be relevant to all appraiser disciplines and to a wide variety of property whose value could affect a firm's ability to repay a leveraged loan; and a lender's assessment, during the underwriting process, of risk. We regard IRS's appraisal guidance as an excellent and readily available template for the non-real property appraiser qualifications provisions; and, we respectfully recommend that it become part of the Leveraged Lending Guidance.

What the banking agencies' Interagency Appraisal Guidelines and the IRS' definition of a "Qualified Appraiser" have in common is that they both address, in considerable detail, the valuation qualifications necessary to create a reliable presumption that the individual performing the appraisal will do so competently. They also share the basic ingredients of what constitutes a "Qualified Appraiser": Valuation-specific experience, training and education (including continuing education) adherence to Ethics requirements and, often, the ability to pass an exam. For business and personal property appraisers, a professional designation awarded by a recognized professional appraisal organization based on an individual's compliance with these factors is the appropriate qualifications standard. For appraisers of commercial real estate, both the Interagency Appraisal Guidelines and IRS guidance require a general certification awarded by a state appraiser licensing agency pursuant to Title XI of FIRREA. A real estate appraiser credential from a recognized professional appraisal organization would be part of the appropriate qualifications for valuing real estate or real property.

With respect to the issue of appraiser independence, we believe that the relevant provisions of the agencies' Interagency Appraisal Guidelines, as strengthened by the Dodd-Frank statute's appraiser independence provisions, are an appropriate template for adding substance to the independence requirements of the Leveraged Lending guidance; and are easily adaptable for that purpose. IRS' Appraisal Guidance also requires that the appraiser is independent of any conflicting interests.

Importantly, the appraiser qualifications and independence provisions of the federal Interagency Appraisal Guidelines not only govern the conduct of the appraiser involved in the loan origination, they also cover employees or contractors of the lender who are involved in any way in the appraisal process, including the lender's audit and review function relative to the appraisal.[7] As stated earlier in our comments, the valuation provisions of the Leveraged Lending

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[7] For example, the Interagency Guidelines state that "An institution should establish qualification criteria for persons who are eligible to review appraisals…Persons who review appraisals…should be independent of the transaction and have no direct or indirect interest, financial or otherwise, in the property or transaction, and be independent of and insulated from any influence by loan production staff. Reviewers also should possess the requisite education, expertise, and competence to perform the review commensurate with the complexity of the transaction, type of real property, and market. Further, reviewers should be capable of assessing whether the appraisal…contains sufficient information and analysis to support the institution's decision to engage in the transaction." "An institution should assess the level of in-house expertise available to review appraisals for complex projects, (cont.)

proposal should also include guidance governing the independence of lender employees or contractors involved in the appraisal function.

Confidence in the competency of business appraisers and in the objectivity of their going concern valuations will be seriously undermined if the Leveraged Lending guidance fails to specifically address appraiser qualifications and independence and adherence to USPAP or standards consistent with the substance and principles of USPAP.

IV. Conclusion

We believe that if the valuation provisions of the Leveraged Lending Guidance are strengthened along the lines our organizations recommend, the Guidance will represent a significant safety and soundness regulatory reform. We hope our comments are helpful to your agencies as you seek to perfect the Guidance and issue it in final form. Our organizations would be pleased to lend our assistance to your agencies in any way you think useful as you consider changes to the valuation provisions of the Guidance. We would also welcome an opportunity to meet with representatives of your agencies to discuss our views and recommendations in more detail. In the meantime, if you have any questions about our views or would like to arrange a meeting, please contact our government relations representative in Washington, DC, Peter Barash (202-466-2221, peter@barashassociates.com) or John D. Russell, Director of Government Relations for the American Society of Appraisers (703-733-2103, jrussell@appraiser.org).

Sincerely,

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high-risk transaction, and out-of-market properties. An institution may find it appropriate to employ additional personnel or engage a third party to perform the reviews.