Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

May 27, 2008

The Honorable James B. Lockhart III
Director
Office of Federal Housing Enterprise Oversight
1700 G Street, N.W.
Washington, D.C. 20552

Dear Director Lockhart:

This letter provides the views of the Office of the Comptroller of the Currency (OCC) with respect to the "Home Valuation Protection Program and Cooperation Agreements," executed by OFHEO, the Attorney General of the State of New York (NYAG), and Fannie Mae and Freddie Mac (collectively, the GSEs), and the "Home Valuation Code of Conduct," which accompanies the Agreements.[1] The OCC has substantial concerns about the unintended adverse consequences of the Agreements and Code for the safe, sound, and efficient operation of national banks' residential mortgage lending activities, as well as for the cost of mortgage credit to consumers. For the reasons set forth below, we do not concur with the Agreements and Code[2] and believe they should be withdrawn because of their likely adverse consequences and because they violate or conflict with Federal law in fundamental respects.[3]

The OCC strongly endorses the principle that real estate appraisals must be conducted free from influence or coercion by any party – lenders, brokers, or other participants in the mortgage lending process. But this objective should be achieved directly, through the application of strong standards, rigorously enforced by the federal and state regulators of mortgage lenders, brokers, and appraisers – not by dictating the corporate and internal organizational structures of lenders.[4]

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[1] Our letter refers to these documents collectively as "the Agreements and Code."

[2] Agreements, p. 3 (Whereas Recital ¶ 11).

[3] Agreements, § III (14) ("If any provision of this Agreement or the attached Code is found to be violative of federal law or regulation, the violative provision will be null and void.")

[4] For example, the Code would bar lenders from using appraisers employed by the lender, an affiliate of the lender, an entity in which the lender has an ownership interest, an entity that has an ownership interest in the lender, a "settlement service provider," an entity in which a settlement service provider has an ownership interest, or appraisal management companies in which a lender has an ownership interest of more than 20 percent or otherwise controls

Such standards already exist for federally regulated depository institutions, which are subject to an extensive federal framework governing appraisal practices, including Federal laws, regulations and supervisory standards.

The structure-driven approach of the Agreements and Code conflicts with the standards-based approach Congress has enacted as the foundation for the federal framework for appraisal regulation; has significant, unintended negative consequences for lenders and borrowers; and has major legal flaws.

As we explain in more detail below, the Agreements and Code are, in practical effect, regulation of the corporate and internal operations of residential real estate lenders on a nationwide scale, accomplished through restrictions on the eligibility of loans sold to Fannie Mae and Freddie Mac that are based largely on the organizational structures used by lenders to obtain appraisals for such loans. In our opinion, this *de facto* regulation of the corporate and internal operations of mortgage lenders will lead to the following unintended and adverse consequences. First, we are concerned that major portions of the Code will undermine, rather than enhance, the quality and reliability of appraisals. Second, application of the Code will unnecessarily raise mortgage origination costs for lenders, thereby increasing the cost of mortgage loans for consumers, without actually enhancing protections and other consumer benefits. Third, we have significant concerns that compliance with the Code will disrupt mortgage appraisal processes that generally are functioning well for depository institutions and consumers. A disruption of this type is not only unnecessary, but it comes when the housing and mortgage markets are under significant stress. Finally, by impeding availability of sound mortgage credit, the Code directly conflicts with various ongoing federal efforts to restore credit availability and confidence in the housing and mortgage markets. For these reasons alone, the Agreements and the Code should be withdrawn.

Moreover, the Agreements and Code present substantial legal issues. We agree with points made in comment letters recently sent to the GSEs[5] that the Agreements and the Code together constitute a "rule" establishing binding norms of wide applicability, adopted contrary to the rulemaking requirements of the Administrative Procedure Act (APA).[6] The practical effect of the Agreements and Code is to dictate corporate and internal organizational relationships and the placement of particular lending-related functions of a substantial portion of the residential mortgage industry. The fact that the means by which this is accomplished are labeled an

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the company. Lenders are permitted to use in-house appraisers only for functions that are specified in detail in the Code, and the Code dictates internal reporting lines and permissible internal communications and supervisory relationships in connection with loan production and appraisal functions. The Code also specifies the internal quality control testing that a lender must do – going so far as recommending a 10 percent sample – and details requirements for how a lender must receive complaints arising from the appraisal process, including mandating a telephone hotline and email that may be attended only by a member of the lender's Office of General Counsel, Chief Compliance Officer or other "independent officer."

[5] *See, e.g.,* Joint Letter from the American Bankers Association, American Financial Services Association, Consumer Bankers Association, Consumer Mortgage Coalition, Housing Policy Council/Financial Services Roundtable, Independent Community Bankers of America, Mortgage Bankers Association, and Real Estate Services Providers Council, Inc., to James B. Lockhart III, Director, OFHEO (April 30, 2008).

[6] 5 U.S.C. § 551 *et seq.*

"agreement" and "code of conduct" is not relevant to the determination whether the substance is, under the APA's standards, a rule that should have been adopted pursuant to the processes required by the APA and other federal statutes that govern federal agency rulemaking.
In addition, in our view, the *de facto* rulemaking represented by the Agreements and Code exceeds the scope of authority of OFHEO and the NYAG. We see no legal basis for OFHEO to share or delegate rulemaking authority to the NYAG, or to subject its ability to regulate the GSEs' safety and soundness to the veto or consent of the NYAG, as has happened here. Nor do we see a basis for OFHEO, using its safety and soundness authority with respect to the GSEs, to assume the role of dictating the corporate and internal organizational structures of lenders that sell mortgages to the GSEs. Moreover, in any case, provisions of the National Bank Act would prevent this *de facto* regulation from being applied to, or enforced against, national banks.[7]

Finally, it must be stressed that Congress has enacted federal legislation upon which an extensive regulatory scheme for appraisal standards and oversight for appraisers and depository institutions has been built. Appraisal standards have been established pursuant to and in furtherance of this federal legislation and Congressional mandates. The Code would impose a dramatically different new set of operational standards for appraisal practices on a national scale that would conflict with and effectively supersede the comprehensive federal scheme established by Congress.

If new national standards are needed to supersede the standards based on current Federal law, we believe those new standards should be determined by Congress, not imposed as the result of the settlement of private litigation between parties – none of which here has authority to regulate the vast majority of mortgage lenders affected by such standards. Indeed, none of the legislation currently under consideration by Congress to improve the appraisal process takes the draconian, structurally-driven approach embodied in the Agreements and Code.[8]

The remainder of this letter details the reasons for our views.

I. Detrimental Effects of the Agreements and the Code on Lenders and Consumers

The Agreement and the Code attempt to address appraiser independence issues by imposing restrictions on the corporate structures and internal organization used by lenders to obtain appraisals – dictating the organizational placement of this aspect of their lending functions. This is not only unnecessary but ill-advised. Based on our supervisory experience, the organizational placement of the function that provides an appraisal is not determinative of the appraisal's quality. Banks obtain appraisals from a variety of sources, including independent appraisal management companies; appraisal management companies that are affiliated with real estate settlement service providers; in-house staff appraisers; appraisers employed by affiliates or other companies in which the bank has an interest; and unaffiliated appraisers.

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[7] Unless indicated otherwise, references to national banks refer to national banks and their operating subsidiaries.

[8] *E.g.*, Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong., 1st Sess., title VII (appraisal provisions) (passed by the House of Representatives, Nov. 15, 2007); Fair Value and Independent Appraisal Act, S. 2860, (introduced in the Senate April 15, 2008).

We have found that a lender that carefully manages its appraisal process can obtain reliable appraisals whether they are performed by in-house appraisers, affiliated appraisers, or third parties. The keys to reliable appraisals include ensuring appraiser independence from the property being appraised; ensuring appraiser independence from the loan production process; conducting due diligence in the selection of an appraiser; and monitoring, and exercising quality control over, the entire appraisal process. The Code would force many institutions to change longstanding processes that are working well – for lenders and their customers.

For example, some of the largest national banks rely on in-house appraisers for most of their appraisal work, including original appraisals and second reviews of appraisals performed by other appraisers. Consistent with the federal banking agencies' rules and guidance described below, these banks manage their appraisal function and insulate it from the loan production function. They have found that their processes lead to accurate and better quality appraisals, lower costs, and lower delinquency and loan loss rates. If the Code forces lenders to change their appraisal processes and to adopt less efficient, and potentially less reliable processes, some of these lenders estimate that their origination costs may increase by at least 20 percent – or about $80 more per loan.[9] These increased origination costs will be passed on to consumers – with no corresponding increase in benefits to offset such costs.

Other large mortgage lending banks outsource their appraisal functions, and rely, to one degree or another, on appraisal management companies for these services. Appraisal management companies provide appraisal and other settlement-related services to lenders across the country, and these services are used for millions of loan transactions each year. These companies provide significant efficiencies for lenders – particularly small banks – by connecting the lenders with qualified appraisers in different markets throughout the country and by performing appraisal quality control reviews and monitoring functions for these lenders. The Code would restrict lenders' ability to use appraisals obtained from appraisal management companies, and this, too, will lead to market inefficiencies and higher origination costs.

Still other banks rely on appraisals performed on behalf of another lender in connection with certain real estate loan applications.[10] Before these appraisals are used, however, the lending bank will review them and take appropriate steps to verify their reliability. If lending banks are prohibited from using a reliable appraisal obtained by another lender in connection with a transaction, consumers will be subject to the unnecessary expense of paying for another appraisal and unnecessary delay in processing their loan applications.

All of these different appraisal processes have developed in response to evolution in the market, and have allowed lenders to compete and meet consumer demand for loans in a timely and cost effective manner. The Code will seriously disrupt existing, efficient, and prudent business

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[9] In addition, some of these banks employ several hundred staff dedicated to their in-house appraisal function. Because the Code will force lenders to substantially restructure their appraisal processes, it may also result in job terminations.

[10] This is expressly allowed under federal appraisal regulations. *See e.g.,* 12 C.F.R. 34.45(b)(2).

practices. We cannot identify any safety and soundness or customer protection reasons that would justify the extreme approach of the Code for depository institutions, given the comprehensive federal scheme governing appraiser independence and appraisal quality that is already in place.[11]

The mortgage market recently has experienced serious disruption due to a variety of factors. We are concerned that implementation of the Code will likely reduce, or at best slow, the availability of soundly underwritten mortgage credit at the very time that efforts are being made to assist the recovery in the credit markets. Indeed, in the current climate, where liquidity provided by the GSEs is essential to the functioning of the mortgage market, many lenders cannot just "vote with their feet" and sell loans that do not comply with the Code to other purchasers or keep them on their books. Such loans will be effectively unmarketable, and keeping loans in portfolio will act as a restraint on additional lending activities by the lender, thereby constricting credit.

II. Legal Issues

We believe that the Agreements and Code may not be implemented because they were adopted pursuant to a legally flawed process, which we discuss in detail below. The defects in the process have been highlighted in various comment letters filed with the GSEs.[12] We agree with those concerns.

A. The Agreements and Code Constitute a De Facto Rule Adopted in Violation of the APA

The Agreements and Code, and OFHEO's direction to the GSEs to apply them, fall squarely within the APA's definition of a "rule,"[13] notwithstanding the label attached to them.[14] During

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[11] We also note that the Department of Housing and Urban Development (HUD) does not impose restrictions similar to those contained in the Code on appraisals for loans insured by the Federal Housing Administration (FHA). For example, HUD permits use of appraisal management companies in connection with the origination of FHA-insured mortgages.[11] This raises the obvious question of why measures contained in the Code to restrict the types of individuals and entities that may conduct appraisals would be necessary in connection with loans sold to Fannie Mae and Freddie Mac, since the Federal government does not consider them to be necessary as a safety and soundness matter for loans insured by the FHA that are eligible as collateral for Ginnie Mae securities guaranteed by the full faith and credit of the United States.

[12] *Supra,* note 4.

[13] Under the APA, a rule is "the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency * * * * " 5 U.S.C. § 551(4).

[14] "Legislative rules . . . grant rights, impose obligations, *or produce other significant effects on private interests.*" *Batterton v. Marshall*, 648 F.2d 694, 701-02 (D.C. Cir. 1980) (emphasis added). *See Chem Service, Inc. v. EPA*, 12 F.3d 1256, 1267 (3d Cir. 1993) (noting that an agreement between the Environmental Protection Agency "would appear to fit within the definition of a rule because EPA has entered into a statement of general applicability and future effect designed to implement" statute at issue); *Avoyelles Sportsmen's League, Inc. v. Marsh*, 715 F.2d 897, 908 (5th Cir. 1983) ("we must look beyond the label to the substance of an administrative action in order to determine whether rulemaking procedures were required").

the last quarter of 2007 and first quarter of 2008, the GSEs' securitizations and direct loan purchases constituted more than 70 percent of the mortgages originated.[15] Thus, in the current marketplace, dictates of the Agreements and Code would impose new structural and organizational requirements on lenders accountable for financing an overwhelming portion of the U.S. residential real estate business. Moreover, because of the increasingly dominant role of the GSEs, it is impractical for lenders to maintain two different mortgage appraisal systems. The new requirements therefore would effectively displace major portions of the existing federal statutory and regulatory appraisal standards. These effects – new requirements dictating structure and organization of lenders' appraisal functions,[16] resulting in a significant and costly change in their underwriting practices and the displacement of current Federal statutory and regulatory standards – cause the Agreements and Code to constitute a "rule" under the APA. As such, their requirements could have been issued, and may be applied – if at all – only after compliance with the procedures prescribed by the APA and with the other legal requirements that apply to the federal rulemaking process.[17] No such procedures or requirements were followed here.[18]

The informal expression of views to the GSEs by market participants that is permitted by the Agreements[19] does not cure the failure to conduct a rulemaking that comports with federal requirements, including notice-and-comment procedures and cost-benefit analyses. A proper rulemaking process in this situation would explore all dimensions of the impact of the Agreements and Code on the lending market, including potential unintended consequences in the form of adverse consequences for competition, and the prospect of higher prices for consumers without benefits that offset such costs. Moreover, in this instance, whatever OFHEO might think about the comments received, it is paralyzed from acting on them because the Agreements subject its ability to react to the consent of the NYAG. This outcome – the imposition of binding requirements without the opportunity for meaningful participation by the lenders who are directly affected by them and without the ability to react to comments received – violates fundamental requirements of the APA.

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[15] Inside Mortgage Finance (April 25, 2008).

[16] *See* footnote 4, *supra.*

[17] Other requirement applicable to federal agency rulemaking include those imposed pursuant to the Regulatory Flexibility Act, the Unfunded Mandates Reform Act of 1995, Executive Order 12866, "Regulatory Plannning and Review," and Executive Order 13132, "Federalism."

[18] Moreover, because APA procedures and requirements were not followed with regard to the Agreements and the Code, the opportunity for objective judicial review provided by the APA to determine whether an agency exceeded its authority or acted in an arbitrary or capricious manner has been circumvented. Under the APA, an agency must employ a rational decision-making process, and failure to do so may result in the agency's action being set aside as arbitrary and capricious. *See Motor Vehicle Manufacturers' Association v. State Farm Mutual Insurance Co.,* 463 U.S. 29, 41 (1983) (court may not sanction agency action when the agency merely offers conclusory and unsupported postulations in defense of its decisions or when it ignores contradictory evidence in the record).

[19] Agreements, § I (1).

B. The Agreement and Code Exceed the Scope of OFHEO's Authority to Regulate the GSEs

The Agreements and Code also embody an impermissible sharing by OFHEO of authority with the NYAG. We see no basis for OFHEO to effectively share or tie whatever authority it has as a safety and soundness regulator of the GSEs to the will of the NYAG via the Agreements and Code.[20]

Imposition of the standards in the Agreements and Code on the GSEs, and thereby on lenders that sell mortgages to the GSEs, purports to be done jointly by OFHEO and the NYAG. They also reserve certain ongoing authority to the NYAG.[21] This sharing of authority with a state government official is impermissible under well-recognized standards governing delegations by federal agencies.[22]

Moreover, OFHEO could not have unilaterally imposed the requirements mandated by the Code. OFHEO's safety and soundness authority with respect to the GSEs may not be used as a pretext for imposition of requirements that effectively regulate the corporate structures and internal operations of lenders that sell loans to the GSEs. While OFHEO may well have a safety and soundness basis to require the GSEs to apply various qualitative checks on appraisals obtained in connection with loans sold to them, OFHEO crosses the line into regulation of entities outside its domain when it dictates requirements – as here – on the corporate structures and internal organization and operations of banks and other lenders that sell loans to the GSEs.

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[20] *See* 12 U.S.C. 4513(e) ("The Director may delegate *to officers and employees* of the Office any of the functions, powers, and duties of the Director, as the Director considers appropriate.").

[21] *E.g.*, Agreements, §§ II (6) (NYAG must approve membership of the Independent Valuation Protection Institute jointly with OFHEO); III (10) (GSEs agree to cooperate with the NYAG and OFHEO "to effect and accomplish the terms of" the Agreements).

[22] *See United States Telecom Ass'n v. FCC,* 359 F.3d 554, 565-566 (D.C. Cir. 2004) ("when an agency delegates power to outside parties, lines of accountability may blur, undermining an important democratic check on government decision-making. Also, delegation to outside entities increases the risk that these parties will not share the agency's 'national vision and perspective,' * * * and thus may pursue goals inconsistent with those of the agency and the underlying statutory scheme.") Although "a federal agency may turn to an outside entity for advice and policy recommendations, provided the agency makes the final decisions itself.... An agency may not, however, merely 'rubber-stamp' decisions made by others under the guise of seeking their 'advice'... nor will vague or inadequate assertions of final reviewing authority save an unlawful subdelegation." *Id.* at 568. *See also Texas Office of Public Utility Counsel v. FCC,* 265 F.3d 313, 326-329 (5th Cir. 2001) (*TOPUC), cert. denied,* 535 U.S. 986 (2002) ("An agency abdicates its role as a rational decision-maker if it does not exercise its own judgment, and instead cedes near-total deference to private parties' estimates – even if the parties agree unanimously as to the estimated amount."); and *Sierra Club v. Sigler*, 695 F.2d 957, 962 (5th Cir. 1983) ("[A]n agency may not delegate its public duties to private entities... particularly entities whose objectivity may be questioned on grounds of conflict of interest.").

C. *Neither OFHEO nor the NYAG Is Authorized to Set Requirements or Restrictions Governing the Real Estate Lending Operations of National Banks*

There are additional reasons why the *de facto* regulation imposed by the Agreements and Code may not be applied or enforced with respect to national banks. Federal law expressly and specifically reserves to the OCC the authority to regulate and supervise national banks' real estate lending activities. That exclusive OCC authority encompasses national banks' arrangements and procedures for assessing the value of the collateral securing their loans, which is the subject of existing OCC regulations with which the Code conflicts. Moreover, the NYAG cannot regulate national bank activities through requirements imposed on third parties. Nor does joining up with OFHEO – which, as discussed above, also does not have authority to regulate lenders' corporate structures and internal organization – immunize the NYAG's role in the Agreements from nullification by operation of the Supremacy Clause.[23]

Twelve U.S.C. § 371 is a federal authorization for national banks to "make, arrange, purchase or sell" real estate loans subject to "such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order." This grant of authority is unqualified and exclusive to the OCC, except to the extent Congress itself imposes requirements or restrictions on national banks' real estate activities.[24] The means – including the structure and organization used by a national bank to obtain appraisals of the collateral securing a real estate loan – is an essential component of the authority to engage in the real estate lending activities authorized to national banks by section 371.

The Code provisions, by purporting to dictate organizational placement of a national bank's appraisal functions, conflict with this authorization and with OCC regulations and guidance, in fundamental respects.[25]

Moreover, application of the Code to establish requirements for the exercise of national banks' real estate lending authority would defy the long-established principle that states may not regulate or supervise national bank activities through requirements imposed on third parties. The NYAG's requirement that the GSE's implement the Code as a condition for termination of the NYAG's investigation causes the Agreements to take on the nature of a consent order. The NYAG's participation in the Agreements also involves assertions of state sovereignty that

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[23] "Diverse and duplicative superintendence of national banks' engagement in the business of banking, we observed over a century ago, is precisely what the NBA was designed to prevent * * *." *Watters v. Wachovia Bank, N.A.*, 127 S.Ct. 1559, 1568 (2007).

[24] 12 U.S.C. § 371; OCC Preemption Determination and Order Concerning the Georgia Fair Lending Act, 68 Fed. Reg. 46264 (Aug. 5, 2003) (notice of request for preemption determination); 69 Fed. Reg. 1904 (January 13, 2004) (final preemption determination and order). Section 371 expressly subjects national banks' real estate lending activities to the real estate lending standards promulgated by the OCC and the other Federal banking agencies pursuant to 12 U.S.C. § 1828(*o*). These standards, which appear at 12 C.F.R. Subpart D, provide that determinations of the value of real estate will be made in accordance with the OCC regulation and agency guidance.

[25] *See* 12 C.F.R. 34.41 - 34.47.

purport to regulate and supervise national bank lending activity through the GSEs.[26] Neither the NYAG, nor OFHEO through its acquiescence in the terms of that regulation, can transmute the nature of that state assertion of authority.

State authorities may not interfere with national banks' real estate lending authority under federal law by coercing third parties not to do business with them. Nor do states have the power to require national banks to choose between their right to operate under federal law, and their ability to sell loans to GSEs. Because the provisions of the Code obstruct, impair or condition the exercise of national bank real estate lending powers, they are nullified by operation of the Supremacy Clause.

Finally, neither OFHEO nor the NYAG, nor the Independent Valuation Protection Institute (IVPI) that the Agreements would establish, may assert visitorial powers over national banks. The OCC's exclusive supervisory authority over national banks is prescribed by 12 U.S.C. § 484, which provides: "No national bank shall be subject to any visitorial powers except as authorized by Federal law." As set forth in our regulations, "visitorial powers" includes the "[r]egulation and supervison of activities authorized or permitted [for national banks] pursuant to federal banking law."[27] This reservation of visitorial authority to the OCC, exclusive of state or unauthorized federal visitation, prohibits those aspects of the Code that purport to authorize any form of visitation of national banks by the NYAG, OFHEO or the IVPI.

D. An Extensive Federal Framework Governing Appraisal Standards Based on Federal Law Already Exists; Changes in Those Standards Should Be Made By Congress, Not Via Settlement of Private Litigation

Appraisal practices of insured depository institutions are already subject to an extensive framework of Federal law, regulations, standards, and oversight. If finalized, the Code will supersede these federal legal requirements in many respects. Congress established the current framework. If it is to be superseded, Congress should make that decision – not OFHEO and not the NYAG.

The appraisal practices of federally regulated institutions are subject to comprehensive oversight by the federal banking agencies and to the uniform appraisal standards established by the Congress in Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) – the "Real Estate Appraisal Reform Amendments." Title XI of FIRREA does not mandate appraisals but directs the federal banking agencies to prescribe standards for the

[26] The statutes cited by the NYAG as the basis for its investigation of the GSEs provide no authority for the remedy against lenders that the NYAG has attempted to impose here. The NYAG has cited provisions of the Martin Act and New York's Executive Law as authority for his investigation. *See* Letter from Andrew M. Cuomo to Daniel H. Mudd (November 6, 2007) (citing N.Y. Gen. Bus. Law § 352, N.Y. Exec. Law § 63(12)); Letter from Andrew M. Cuomo to Richard M. Syron (November 6, 2007) (same), available at www.oag.state.ny.us/press/2007/nov/nov7a_07.html. Neither statute provides authority for the NYAG, directly or indirectly, to impose a de facto regulatory scheme on third parties like the lenders purportedly subject to the Code of Conduct.

[27] *See* 12 C.F.R. 7.4000(a)(2)(iii).

performance of real estate appraisals, in accordance with the Administrative Procedures Act.[28] Regulations issued by the federal banking agencies to implement this Congressional directive expand on the statutory baseline requirements and comprehensively regulate the process for property evaluations by regulated financial institutions. These regulations generally require that an institution obtain an appraisal for a "federally related transaction" that adheres to specified appraisal standards including compliance with the Uniform Standards of Professional Appraisal Practice ("USPAP") promulgated by the Appraisal Standards Board of the Appraisal Foundation.[29]

It is important to note that, in contrast to provisions in the Code, the federal banking agencies' regulations expressly permit the use, and regulate the conduct, of in-house staff appraisers by banks in real estate lending transactions. OCC regulations require staff appraisers to be "independent of the lending, investment, and collection functions and not involved, except as an appraiser, in the federally related transaction," and such appraisers further are prohibited from having any interest in the property being appraised.[30] Similarly, OCC regulations permit the use of fee appraisers, provided that they have no interest in the property or the transaction. Finally, appraisals by appraisers engaged by another institution also are permitted for use by national banks in real estate lending transactions, subject to similar independence requirements and compliance with the other requirements in OCC regulations on appraisals.[31] The Agreements and Code are in direct conflict with these authorities.[32]

These federal standards are actively applied through the supervisory process. For example, the *Interagency Appraisal and Evaluation Guidelines* set forth supervisory standards for real estate-related transactions and provide that bank examinations will include a review of the institution's appraisal policies and procedures, including those establishing criteria for selecting and

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[28] *See* 12 U.S.C. 3336, 3339.

[29] *See* 12 C.F.R. 34.44. In addition to compliance with USPAP standards, the minimum requirements include that the appraisal: (i) be in writing and contain sufficient information and analysis to support the institution's decision to engage in the transaction; (ii) analyze and report appropriate deductions and discounts for proposed construction or renovation, partially leased buildings, non-market lease terms, and tract developments with unsold units; (iii) be based upon the regulatory definition of market value; and (iv) be performed by State-licensed or -certified appraisers in accordance with requirements of the regulation. *Id.*

[30] 12 C.F.R. 34.45.

[31] *See generally* 12 C.F.R. 34.45.

[32] All mortgage originations by national banks and their operating subsidiaries are also subject to regulations requiring the bank to adopt prudent real estate lending policies relating to appraising the value of the mortgaged property. See 12 C.F.R. 34.62; App. A. An additional source of regulatory standards for banks are the real estate lending guidelines and real estate lending safety and soundness standards, which include a requirement that institutions have real estate appraisal and evaluation programs and that they comply with existing regulatory and supervisory requirements regarding appraisals. *See* 12 C.F.R. Part 30, Appendix A (safety and soundness standards for residential mortgage lending include complying with the Part 34 appraisal standards and the Interagency Appraisal and Evaluation Guidelines);12 C.F.R. Part 34, subpart 3, Appendix A (real estate lending standards include establishing and maintaining real estate lending policies that provide for real estate appraisal and evaluation programs).

monitoring appraisers to ensure their independence.[33] The federal banking agencies also issued a joint statement on *Independent Appraisal and Evaluation Functions*.[34] This statement makes clear that appraiser independence requirements, including that an appraiser may not have any direct or indirect interest in the property and that selection of appraisers must be safeguarded from influence by loan production staff, are applicable to all real estate related transactions – whether or not they are a "federally related transaction." The banking agencies' *Frequently Asked Questions on the Appraisal Regulations and Interagency Statement on Independent Appraisal and Evaluation Functions* provides additional guidance to federally supervised banks on selecting an appraiser and ordering an appraisal, accepting a transferred appraisal, reviewing appraisals, appraiser independence regulations, and other appraisal-related issues.[35]

The federal banking agencies oversee compliance with their rules through ongoing supervision and regular examinations.[36] This supervisory process results in adjustments, corrections, and remediation on an ongoing basis by banks. If a bank or any institution-affiliated party, including staff appraisers and fee appraisers, is found to have violated any applicable requirements concerning appraisals, they may be subject to removal and prohibition orders, cease and desist orders, and the imposition of civil money penalties. Other enforcement tools include memoranda of understanding as well as communications in an examination report of "matters requiring attention" of bank management and boards of directors.

The new standards for mortgage lending and appraisal practices that the Code would dictate would displace many of these federal standards, with significant national policy implications for the availability of credit and the smooth functioning of the mortgage market.

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In conclusion, we appreciate this opportunity to present our views and concerns. As discussed above, we have serious concerns that implementation of the Agreements and Code will have unintended and meaningful negative implications for the safe, sound, and efficient operation of the mortgage lending industry, as well as for the cost of mortgage credit to consumers, without

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[33] 1994 Interagency Appraisal and Evaluation Guidelines.

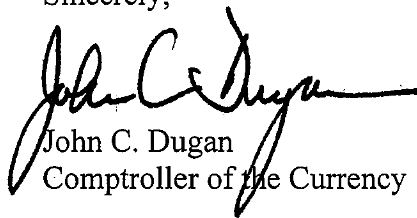
[34] OCC Advisory Letter 2003-9 (October 28, 2003).

[35] OCC Bulletin 2005-6 (March 22, 2005).

[36] *See* OCC Comptroller's Handbook, *Retail Lending Examination Procedures*, at 33, (December 2004); OCC Comptroller's Handbook, *Commercial Real Estate and Construction Lending*, at 25 (March, 1998); OCC Comptroller's Handbook, *Mortgage Banking* (March 1996).

offsetting benefits. We do not concur with the Agreements and Code[37] and believe they should be withdrawn because of their likely adverse consequences and because they violate or conflict with Federal law in fundamental respects.[38]

Sincerely,



John C. Dugan
Comptroller of the Currency

[37] Agreements, p. 3 (Whereas Recital ¶ 11).

[38] Agreements, § III (14) ("If any provision of this Agreement or the attached Code is found to be violative of federal law or regulation, the violative provision will be null and void.")