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# ***CONSUMER MORTGAGE COALITION***

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January 16, 2009

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Currency  
250 E Street, SW  
Mail Stop 1-5  
Washington, DC 20219  
Attn.: Docket No. OCC-2008-021  
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Re: Proposed Interagency Appraisal and Evaluation Guidelines

Dear Sir or Madam:

The Consumer Mortgage Coalition (the "CMC"), a trade association of national residential mortgage lenders, servicers, and service-providers, appreciates the opportunity to submit these comments on the Proposed Interagency Appraisal and Evaluation Guidelines (Proposed Guidelines or Guidelines). The Proposed Guidelines would update and clarify supervisory expectations for the appraisal and evaluation programs of institutions regulated by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration (the "Agencies"). The Agencies note that "[i]ndependent and reliable collateral valuations are

core to a regulated institution’s real estate credit decisions.”<sup>1</sup> We strongly support the use of quality appraisals and we support the Agencies’ efforts in this regard.

While we support the Proposed Guidelines, and particularly their acknowledgment of lenders’ use of agents, such as appraisal management companies, to help ensure quality appraisals, we cannot emphasize enough the need for uniform appraisal requirements that are consistently and vigorously enforced, across all channels of mortgage lending, not just lending by federally regulated institutions. The subprime mortgage crisis has demonstrated the significant dangers of uneven and fragmented regulation of the financial services industry. We believe it is imperative that regulation be made as uniform as possible to avoid a repeat of these problems. We also include comments on the specific provisions of the Proposed Guidelines.

## **I. Background**

### **A. *Lenders Want Accurate Appraisals***

Lenders, including CMC’s member lenders, have a strong interest in maintaining the quality of appraisals and preventing appraiser misconduct, because lenders incur losses from faulty appraisals.

When a loan defaults for any reason, lenders lose money if they own the loan. Even if an originating lender sells a loan before it defaults, the investor can often require the originating lender to make the investor whole for the default. When a loan defaults because of an inflated or faulty appraisal, the lender’s losses are especially high – the lender still incurs the costs of ceased loan payments and the costs of foreclosure, and in addition the lender cannot recover the property’s appraised value because it was overstated. Loans with inflated appraisals often quickly turn into “early payment default” loans, which the lender must buy back regardless of whether it had any reason to know of problems with the loan. A single loss caused by an inflated appraisal can wipe out a lender’s profits on dozens of properly underwritten loans. Therefore, a lender has a strong incentive to protect itself from inflated appraisals. The accuracy and integrity of the appraisal are enhanced when the appraiser is selected, managed, and compensated by a person – the lender or an appraisal management company – that stands to incur losses from an inflated appraisal. This principle is reflected in the selling guides for the government-sponsored entities Fannie Mae and Freddie Mac (the GSEs) and in federal banking regulations, which recognize that a properly managed appraisal function using in-house appraisers or an appraisal management company is fully consistent with safety and soundness.

### **B. *Lenders Minimize Appraisal Risks***

Lenders use a number of methods to minimize their appraisal risks. The use of appraisal management companies, in particular, has provided enormous benefits to lenders and to

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<sup>1</sup> Proposed Guidelines, 73 Fed. Reg. 69647, 69649 (November 19, 2008).

the appraisal process over the years. Contracting with an appraisal management company enhances a lender's ability to obtain accurate appraisals, because it imposes additional layers of insulation between loan-production staff and the individual appraiser. Through a combination of highly-trained personnel and sophisticated software applications, appraisal management companies have created systems that allow them to manage the appraisal process efficiently and to maintain high standards of accuracy, quality, and service. Because they serve a number of customers, appraisal management companies can maintain a nationwide network of high-quality in-house and independent appraisers that is more extensive than that of even the largest lender. The management company's national footprint allows a lender to move into a new geographic market quickly without having to develop its own network of appraisers and discover, often through trial and error, which individuals can be relied on to produce accurate and timely appraisals. The management company's specialized knowledge allows it to react quickly to changes in market conditions and legal requirements.

Because appraisal management companies specialize in valuation, they have been able to improve the valuation process in many ways, including:

- Improving appraisers' awareness of secondary market and investor requirements.
- Quality-control programs that are customized to meet each lender's needs. Independent appraisers, by contrast, typically rely on their customers or investors to detect and correct errors.
- Independent management of appraiser panels, including minimum qualifications for appraisers to meet before acceptance on the panel, as well as ongoing quality control to remove under-performing appraisers.
- Immediate payment to the appraiser for a completed appraisal, regardless of the outcome or value.
- Significant capital and errors and omissions insurance, both of which most individual appraisers lack.
- The ability of lenders to receive waivers from the GSEs and other investors, which reduces lender costs or creates other competitive advantages for them.
- A network of independent appraisers, which allows appraisal management companies to provide better, more consistent service, a high quality product, and a more consistent customer experience to borrowers. Like their counterparts who are employed by lenders, appraisers retained by appraisal management companies have an incentive not to inflate values because their management companies will be liable for an improperly conducted appraisal.

Appraisal management companies have also been at the leading edge of improvements in technology. They began requiring electronic delivery of appraisal reports in the 1990s, which has now become the standard in the industry, resulting in many process and service efficiencies. Other technological innovations for which appraisal management companies are responsible include:

- Use of the XML data protocol as a standard reporting format, which has facilitated electronic data transmission, valuation, quality control, and

- underwriting.
- Electronic valuation underwriting software that uses the XML data for automatic quality control.
  - Data-entry software used by appraisers that contains rules to prevent the transmittal of a report that does not meet minimum quality standards.
  - Automated valuation models and other electronic valuation products, which have significantly benefited lenders and consumers by providing more accurate and more cost effective valuations.
  - A direct interface with the lender's loan-origination system, allowing for automatic entry of the current status of the appraisal into the system, as well as automatic emails to the lender.

As a result of these improvements to the process, the speed with which appraisals can be produced has improved dramatically. It was not unusual ten years ago for an appraisal to take three to four weeks to be completed, which often delayed funding of the loan. It is now common for an appraisal to be completed in five days or less, which has been a significant benefit to borrowers and lenders.

As noted, investments by lenders and by diversified service providers have facilitated the development of new valuation products and technology that allows real estate to be valued more accurately and efficiently. They also allow appraisal management companies to guarantee – with real capital – the integrity of the appraisal, which is not feasible for an individual appraiser.

A lender's participation in a joint venture with appraisal management companies can also strengthen its appraisal program. Taking advantage of the appraisal management company's specialized expertise, such a lender puts itself at the cutting edge of these improvements in the appraisal process for the competitive advantages that they can derive for their lending operations.

Participating in a joint venture facilitates the integration of the appraisal with other parts of the underwriting process, allowing for the appraisal process to be customized and tailored to the lender's needs. Lenders also see appraisal management services as an attractive investment and wish to have an ownership stake in technological improvements that are developed at great expense. The appraisal technology platform, which is typically proprietary to a particular joint venture, can interface directly with the lender's other systems.

The Proposed Guidelines require that an institution or its agent must directly select and engage appraisers, and that the person who selects or oversees the selection of appraisers should be independent from the loan production area. Use of an appraisal management company to oversee the selection of the appraiser fully satisfies this requirement. The appraisal management company is hired by senior management, and is fully independent from the institution's loan officers and loan production staff.

## **II. Need for Uniform Regulation and Consistent, Vigorous Enforcement**

As the consumer mortgage industry sorts through the aftermath of the subprime crisis, we believe that improvements are necessary, not the least of which relates to regulatory gaps. The industry is subject to several sources of regulation, not necessarily planned for today's world, with certain gaps that are subject to exploitation. For example, five separate federal regulators issued the Proposed Guidelines, each of which regulates one aspect of the industry. All five together, however, do not regulate the entire industry. A sixth regulator, the Federal Housing Finance Agency (FHFA), regulates the government-sponsored enterprises (GSEs), two of which, Fannie Mae and Freddie Mac, have their own appraisal requirements. As with the Proposed Guidelines, the GSE appraisal requirements do not govern the entire industry. In addition to the five Agencies behind the Proposed Guidelines, and in addition to FHFA and the GSEs, there are mortgage industry regulators in every state. This convoluted regulatory system permits gaps in regulatory oversight.

The subprime crisis demonstrates the dangers of applying regulations to some industry segments but not others. Some industry players weave in and around the various regulators and their inevitably differing emphases on enforcement, to find niches they can exploit. By finding areas with less regulation and less regulatory enforcement, they can find lower operating costs than their more heavily regulated competitors can achieve. Some subprime lenders were state chartered non-depository institutions. None of the Agencies regulated them. Further, they could avoid GSE lending requirements by selling loans to non-GSE investors. (GSE fees are an independent reason lenders have tried to sell loans to non-GSE investors.) Nevertheless, by using this business arrangement, a lender can make itself exempt from the federal regulation that governs most mortgage lenders.

Uneven regulation generally leads to avoidance of the stricter regulation. It is not enough that just those transactions subject to the Agencies' jurisdiction will be subject to strict controls ensuring that (i) unbiased and competent appraisers are selected by independent employees or agents of the institution, (ii) appraisals meet USPAP standards and contain sufficient information to support the institution's credit decision, (iii) appraisals are based on the appropriate regulatory definition of market value, (iv) evaluations performed in lieu of appraisals for exempt transactions provide a reliable estimate of the collateral's market value, using acceptable means, such as AVMs, and under consistent rules for requiring a property inspection, and (v) an institution has a robust appraisal and evaluation review function, that takes into account the risk of the transaction, and a monitoring plan to ensure on-going compliance. The recent crisis tells us that all mortgage transactions must be under these types of controls. Moreover, the enforcement of existing appraisal regulations is uneven. Without consistent enforcement, uniform rules will not promote quality appraisals across the mortgage market.

The need for uniform regulation is why Congress has enacted laws to create more uniform appraisal requirements. In responding to the savings and loan crisis, Congress enacted the Financial Institutions Reform, Recovery, and Enforcement Act of 1989

(FIRREA).<sup>2</sup> Among many other things, FIRREA established a stronger federal presence in appraisal regulation, and required the Agencies to maintain a uniform national appraisal standard. FIRREA established an Appraisal Subcommittee within the Federal Financial Institutions Examination Council (FFIEC) to improve the quality of appraisals. Appraisers today are licensed or certified by the states, according to criteria determined by the states, under FFIEC oversight. FIRREA did, however, make clear that the Agencies may establish more stringent appraisal requirements. The Agencies:

may require compliance with additional standards if [an agency] makes a determination in writing that such additional standards are required in order to properly carry out its statutory responsibilities.<sup>3</sup>

Moreover, FIRREA also permits the Agencies to set more stringent certification or licensing requirements for appraisers than the state requirements.

Nothing in this title shall be construed to prevent any Federal agency or instrumentality under this title from establishing such additional qualification criteria as may be necessary or appropriate to carry out the statutory responsibilities of such department, agency, agency, or instrumentality.<sup>4</sup>

Further, the Agencies, through the FFIEC's Appraisal Subcommittee, must monitor the states' policies, practices and procedures and "shall not" recognize appraiser certifications and licenses from states that do not meet minimum standards.<sup>5</sup>

In addition, FIRREA made sure the Agencies have very strong enforcement powers over appraisers.<sup>6</sup>

Again in 2008, by enacting the Housing and Economic Recovery Act of 2008 (HERA),<sup>7</sup> Congress created more federal regulation over appraisers. Congress gave the FHFA enforcement authority that mirrors that of the Agencies, including authority to take enforcement action against appraisers.<sup>8</sup>

Given the lessons of the savings and loan crisis and of the subprime crisis, and given the 2008 reiteration of the 1989 Congressional mandate that appraisers be regulated

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<sup>2</sup> Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub L. No. 101-73, 103 Stat 514.

<sup>3</sup> 12 U.S.C. § 3339.

<sup>4</sup> 12 U.S.C. § 3345(d).

<sup>5</sup> 12 U.S.C. § 3347.

<sup>6</sup> See, e.g. 12 U.S.C. §§ 1813(u)(4) and 1786(r)(3), which define an "institution-affiliated party," that is, the parties over whom the Agencies have enforcement authority, to include independent contractors, explicitly including appraisers.

<sup>7</sup> Pub. L. No. 110-289, 122 Stat. 2654 (July 30, 2008).

<sup>8</sup> HERA gives the FHFA enforcement authority over an "entity-affiliated party." HERA § 1002, 122 Stat. 2660, defines this term to mirror the definition of "institution-affiliated party" in federal banking and credit union law, and explicitly includes appraisers. Thus, FHFA has authority over appraisers that mirrors the authority that the banking agencies and NCUA have over appraisers.

uniformly, it is imperative that the Agencies do what they can to reach this goal. Thus, as with the Guidance on Nontraditional Mortgage Products Risks,<sup>9</sup> which now widely applies across the country to all lenders, we very strongly urge the Agencies, working through FFIEC, and working with FHFA, the regulator of the GSEs, state regulators and the Conference of State Bank Supervisors (CSBS), to ensure that every appraisal and every appraiser for every consumer mortgage loan made in this country be subject to the same requirements as set forth in the Proposed Guidelines, and to the same healthy fear of enforcement actions. FFIEC and the CSBS are in a better position than anyone to determine which states are lagging in regulatory attention to appraisals. The Agencies, through FFIEC and working with all the state regulators, should be diligent in preventing states from easing their oversight. Only when this happens will a niche for appraisal weaknesses cease to exist.

The FHFA recently finalized a Home Valuation Code of Conduct (HVCC)<sup>10</sup> that establishes a number of appraisal requirements for loans that the GSEs purchase. This HVCC is similar to the Proposed Guidelines in design and effect, as both are aimed at ensuring sound appraisal practices, but the HVCC and Proposed Guidelines differ in many specifics. It is critical that these two sets of requirements be made uniform, at least for residential loans, to prevent uneven regulation from creating incentives for some lenders to obtain marketplace cost advantages by using inaccurate or inflated appraisals.

Another reason to conform the requirements of the Proposed Guidelines and the HVCC is the lack of any reason for differences. The HVCC will apply only to loans the GSEs can purchase, while the Proposed Guidelines will apply to, among others, loans the GSEs cannot purchase, such as residential loans above the conforming loan limit.

If an appraisal practice is unsafe and unsound for the GSEs, the same practice is also unsafe and unsound for banks, thrifts, and credit unions. The risks are uniform and the regulatory requirements should likewise be uniform.

A distinction in regulatory requirements based on the conforming loan limit has no rational basis. Appraisals on homes under the conforming limit are no different than appraisals on homes above that limit. The conforming limit usually changes annually, and it varies by geographic area. Yet the appraisal requirements have not changed to follow conforming loan limit changes, and they have not varied for Alaska, Guam, Hawaii, and the Virgin Islands as the loan limit does. Appraisal requirements have not changed to follow the conforming loan limit because there is *no connection* between the conforming loan limit and how an appraiser appraises a house. Therefore, there should be *no difference* in appraisal requirements for loans above or below the conforming loan limit.

Rather, this distinction exists merely because FHFA cannot mandate requirements for loans the GSEs cannot purchase. This type of differing treatment by different regulators

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<sup>9</sup> 71 Fed. Reg. 58609 (October 4, 2006).

<sup>10</sup> Available here: <http://www.ofheo.gov/media/news%20releases/HVCCFinalCODE122308.pdf>

is contrary to express Congressional direction that this country have uniform national appraisal standards, as described above.

The Agencies, FFIEC, FHFA, state regulators, and CSBS should work together to ensure that both the Proposed Guidelines and the HVCC are consistent with each other and are uniformly applied to all consumer loans by all lenders.

With this overarching approach, we appreciate the opportunity to present more specific comments on the Proposed Guidelines.

### **III. Comments on Specific Provisions**

#### **A. *Appraisals Ordered By Third Parties***

A significant difference between the HVCC and the Proposed Guidelines is the following HVCC prohibition, absent from the Proposed Guidelines:

The lender will not accept any appraisal report completed by an appraiser selected, retained, or compensated in any manner by any other third party (including mortgage brokers and real estate agents). The lender may accept an appraisal prepared by an appraiser for a different lender, including where a mortgage broker has facilitated the mortgage application (but not ordered the appraisal), provided the lender: (1) obtains written assurances that such other lender follows this Code of Conduct in connection with the loan being originated ....<sup>11</sup>

The Proposed Guidelines would permit the use of appraisals that third-parties order,

provided that the institution determines that the appraisal is valid, conforms to the Agencies' appraisal regulations, and is otherwise acceptable. . . . If an institution relies on a third party originator or its agent for the appraisal, the standard of independence still applies. For example, an engagement letter should confirm that the institution transferring the appraisal, not the borrower, was the original client that selected the appraiser and ordered the appraisal.<sup>12</sup>

These differences between the HVCC and Proposed Guidelines raise three issues: (1) should lenders be able to accept appraisals ordered by mortgage brokers and real estate agents ("non-lender third parties"), (2) where an appraisal was ordered by a non-lender third party, what standards of independence apply to the appraisal, and (3) where an appraisal was ordered for another lender, what assurances or confirmations are required that the appraisal complied with the requirements of the HVCC and Proposed Guidelines.

As discussed above, there is no logical basis for permitting appraisals ordered by non-lender third parties on some consumer loans but not on other consumer loans. At the

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<sup>11</sup> HVCC § III.A.

<sup>12</sup> Proposed Guidelines p. 69655.



time a borrower first approaches a lender, it is sometimes uncertain whether the final loan will be above or below the conforming loan limit. If the rules differ for conforming and jumbo loans, how is a lender to know which rule applies in this case? Either the practice of using an appraisal ordered by a non-lender third party is safe and sound or it is not, and the conforming loan limit is not the criterion relevant to this question. It is important that the Proposed Guidelines and the HVCC be consistent on this significant question.

If the Guidelines will permit lenders to use appraisals ordered by non-lender third parties, some clarification is necessary about how the Proposed Guidelines would apply to these third parties. The Proposed Guidelines indicate that the lender should confirm that the third party transferring the appraisal, and not the borrower, was the original client who selected the appraiser and ordered the appraisal. Would non-lender third parties need to have reporting lines for those who order appraisals independent of loan production staff?<sup>13</sup> Would non-lender third parties who order appraisals be prohibited from communicating an expected value to an appraiser?<sup>14</sup> An effective enforcement mechanism for such requirements is not apparent.

In situations where an appraisal has been prepared for another lender, the Guidelines and the HVCC should be consistent on the steps a lender needs to take to confirm or receive assurances that the appraisal meets the standards of independence and other requirements of the Guidelines and HVCC. An important consideration with appraisals ordered for other lenders is that consumers benefit from portable appraisals. A consumer may apply for a loan at one lender, who will order an appraisal and charge the consumer. But the consumer may wish to change lenders before any loan closes. If the appraisal that the first lender ordered is not portable, the consumer would have to choose between going with a preferred loan at the new lender and paying for a second appraisal, or getting the loan the consumer no longer wants from the first lender. The purpose of the Proposed Guidelines is not to hinder consumer shopping.

Rather, enhancing consumers' ability to shop carefully for their mortgage loans is one of the most significant policies behind the recent, significant, changes to the regulation implementing the Real Estate Settlement Practices Act of 1974 (RESPA).<sup>15</sup>

It seems most appropriate to permit portable appraisals, consistent with safety and soundness. An absolute requirement that the second lender, upon receiving an appraisal prepared for a different lender, must, in every case, receive "written assurances" (as the HVCC requires)<sup>16</sup> that the first lender followed the HVCC does not consider the consumer's best interests. The first lender will not be willing to give such assurances to its competitor, the second lender. Similarly, the Proposed Guidelines' suggestion that the second lender obtain the original lender's engagement letter may not be in workable

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<sup>13</sup> See Proposed Guidelines p. 69652, which would impose this requirement on appraisals ordered by lenders' in-house staff.

<sup>14</sup> See Proposed Guidelines p. 69652, which would prohibit lenders from such communication.

<sup>15</sup> 73 Fed. Reg. 68204 (November 17, 2008).

<sup>16</sup> HVCC § III.A(1).

or in the consumer's interest because, as noted below in Section H, most appraisals are ordered electronically and a traditional engagement letter may not exist.

If the first lender is a regulated financial institution, and was required when it ordered the appraisal to comply with the Proposed Guidelines, the second lender should be able to reasonably rely on that lender's appraisal. If the appraisal is faulty, the first lender, not the second, should be deemed out of compliance with the Proposed Guidelines. The second lender would take any resulting credit loss of course, but should not be deemed out of compliance with the Proposed Guidelines.

The second lender can verify the safety and soundness of the appraisal. For example, if the appraiser, or the appraiser's employer, is able to provide assurances that the appraisal meets requirements, there is no reason why that should not suffice. In this case, the appraiser or the appraiser's employer would have given such assurances twice on the same appraisal – once to the first lender, and again to the second. This is more protection than would have existed had the first lender made the loan. If the appraisal were sufficient to support a loan by the first lender, and if the appraiser or employer again reiterated assurances that the appraisal is sound, there does not seem to be any safety and soundness reason why the same appraisal should not suffice for the second lender. Creating a disadvantage for consumers without a safety and soundness concern seems ill advised.

The most important issue for appraisals ordered by third parties is that the requirements be the same for all loans nationwide because the safety and soundness risks are the same.

***B. Exemptions and Requirements for Loans That Qualify for Sale to a GSE***

The Proposed Guidelines, in Appendix A, exempt from the Guidelines' appraisal requirement loans that qualify for sale to a GSE (whether or not the loan is sold to a GSE) and loans that "involve a real estate transaction in which the appraisal conforms to Fannie Mae or Freddie Mac appraisal standards applicable to that category of real estate."<sup>17</sup> The Agencies seek comment on the GSE exemptions given recent events in the residential mortgage market.<sup>18</sup>

We urge the Agencies to retain the GSE exemptions because they help keep regulations consistent for different lenders. That is, if the GSEs were to exempt a particular type of loan from their requirement for a full appraisal but that exemption were not in the Guidelines applicable to depository institutions, some lenders would be permitted to make those loans without a full appraisal, while others would not have that ability. There can be no rationale for such a result. Because that result would create an opportunity for some lenders to create a marketplace cost advantage based on nothing more than uneven regulation rather than on safety and soundness, it should not be permitted.

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<sup>17</sup> Proposed Guidelines p. 69658.

<sup>18</sup> Proposed Guidelines p. 69651, n. 13.

The best regulatory practice is to make the Proposed Guidelines, the HVCC, and the GSEs' requirements and exemptions consistent with one another.

**C. *Clarification of GSE Exemption When GSEs Permit Use of AVMs***

There are, or may in the future be, instances when a GSE will purchase a loan above \$250,000 based on a qualifying automated valuation. The Proposed Guidelines exempt from the appraisal requirement certain loans that qualify for sale to the GSE, but do not mention automated evaluations. The best approach is to conform the Proposed Guidelines and the GSE appraisal requirements. We request clarification that the exemption from the appraisal requirement for loans that qualify for sale to a GSE will apply to loans that use an AVM in lieu of an appraisal, when such loan would be saleable to a GSE. Additionally, if such loan would be saleable to a GSE but for the fact that the loan amount exceeds the conforming loan limit, we request clarification that the exemption from the appraisal requirement for loans "in which the appraisal conforms to [GSE] appraisal standards applicable to that category of real estate"<sup>19</sup> applies when the loan meets GSE appraisal *or valuation* standards. Otherwise, again, lenders not subject to the Guidelines would have an exemption and a cost advantage not available to other lenders, based on uneven regulation and not on safety and soundness.

**D. *Loan Modifications***

Appendix A to the Proposed Guidelines, covering appraisal exemptions, discusses loan modifications and workouts. Among other things, it discusses situations in which a lender advances new monies, such as to repair a property, but does not necessarily need a new appraisal. The Proposed Guidelines also discuss changes to loan terms that do not involve advancing new monies and do not necessarily require a new appraisal.

Additional clarity here would be helpful, as lenders sometimes advance funds for taxes and insurance, and use many types of loan modifications. Advancing funds to pay property taxes and insurance on properties, a common occurrence, should not normally require an appraisal because lenders are merely acting to protect the collateral property and their lien position. The amount advanced is normally quite small compared to the value of the entire property. We request clarification that advancing funds in small amounts relative to loan size, such as for property taxes and insurance, does not require an appraisal.

Similarly, lenders may modify loan terms by capitalizing unpaid but accrued interest and unpaid fees and costs. These amounts may be added to a loan's principal balance, which could be considered an advance of monies and a change in loan terms, but should not normally require a new appraisal. We request clarification that capitalizing interest and fees does not require a new appraisal.

The Proposed Guidelines would permit institutions to use an existing appraisal or

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<sup>19</sup> Proposed Guidelines, Appendix A § 10. p. 69658.

evaluation to support a subsequent transaction in appropriate circumstances. We strongly support this approach. While in some cases this would not be appropriate, such as during periods of market volatility, volatile markets stabilize eventually. The ability to avoid unnecessary costs is always welcome.

***E. Secondary Market Purchases***

Appendix A to the Proposed Guidelines discusses the need for appraisals in secondary market loan purchases. The Appendix provides that appraisals are not required, among other times, when an institution purchases an investment grade (rated in one of the four highest rating categories by a nationally recognized statistical rating service (NRSRS)) mortgage-backed security and the issuer states publicly that the underlying loans are in compliance with the Agencies' appraisal regulations.

It would be helpful to clarify that the NRSRS rating refers to the original rating for a security, regardless of later changes in the rating. If, at creation of an MBS, its rating is sufficient to assume that appraisals on the underlying loans are sufficient, a later change in that rating should not be a reason to require new appraisals because the appraisals will not have changed. Absent a safety and soundness concern relating to faulty appraisals, lenders should not be required to order batches of appraisals on loans underlying an MBS merely because a rating is downgraded. Ratings can change for any number of reasons unrelated to quality of appraisals. Requiring batches of unnecessary appraisals would be disruptive to orderly markets, and would put NRSRS ratings to a use quite different than any use for which they were designed.

***F. Automated Valuation Models (AVMs)***

The Proposed Guidelines state:

With prior approval from its primary regulator, an institution may employ various techniques, such as automated tools or sampling methods, for performing pre-funding reviews of appraisals or evaluations supporting lower risk single-family residential mortgages.<sup>20</sup>

Some institutions have already received approval from their primary regulators to use AVMs. We request clarification that the Guidelines would not require those institutions to repeat the approval process after the Guidelines become final before continuing to use AVMs.

In addition, Appendix B, Evaluation Alternatives, would permit the use of AVMs “for a transaction in which an evaluation is permitted by the Agencies’ appraisal regulations.” Appendix B details the policies and procedures institutions should have in place for using AVMs. Generally, the Appendix appropriately establishes sound requirements, yet at the same time permits flexibility for the specific circumstances and lending operations of

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<sup>20</sup> Proposed Guidelines p. 69656.

different lenders. This flexibility is welcome because lenders do differ. The flexibility is also welcome because information technology continues to advance rapidly. Flexibility in regulatory guidelines permits lenders to take advantage of technology improvements quickly.

We believe, however, that lenders should not be required to obtain the prior approval of their primary regulator to employ new valuation techniques. Rather, lenders should be able to exercise their judgment about the use of new valuation methods unless the Agencies and FHFA determine that such methods are unacceptable.

Appendix B further outlines criteria that a lender should address in determining whether an AVM is an appropriate valuation alternative for a given transaction. There is an apparent conflict within Exhibit B as to development of such criteria. The second paragraph of Exhibit B states that the lender “should establish criteria for determining the extent to which an inspection of the collateral is necessary to determine that the property is in acceptable condition for its current or projected use.” The Property Condition section of Exhibit B requires the lender to ask “Is sufficient information available to assess whether the property is in average or above-average condition consistent with its intended use.” The latter determination can only be made through a property inspection, implicitly requiring an inspection even in cases where the lender's criteria for determining when an inspection is necessary may not require one. We believe that this conflict should be removed by eliminating the first item in the Property Condition section.

#### ***G. Prohibition on Communicating a Homeowner's Estimate of Value***

The Proposed Guidelines would prohibit lenders from communicating to appraisers what a homeowner's estimated property value to be.<sup>21</sup>

Homeowners are able to tell appraisers their beliefs directly. Homeowners may be present during an appraisal and can have an opportunity to give appraisers messages that lenders cannot influence, and may never learn about. Prohibiting lenders from communicating to appraisers indirectly what homeowners can readily communicate directly would add a compliance cost and burden on lenders with no apparent benefit.

Professional appraisers well know that homeowners tend to overestimate the value of their homes. In fact, the entire purpose of having a profession dedicated to valuing real estate is that it is difficult for anyone not trained in the profession to estimate values accurately. It seems reasonable to assume that professional appraisers know better than to be persuaded by a homeowner's bias. There seems no reason to require lenders to bear the costs of ensuring that their staff and agents do not communicate a piece of information that a homeowner may nevertheless give the appraiser.

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<sup>21</sup> Proposed Guidelines p. 69652.

## ***H. Electronic Documentation***

FIRREA, enacted in 1989, requires appraisals to be “written.”<sup>22</sup> In 2000, Congress enacted the Electronic Signatures In Global and National Commerce Act,<sup>23</sup> (the E-Sign Act), which provides for the acceptance of electronic records even when an older law may have required physical paper records:

(a) IN GENERAL.—Notwithstanding any statute, regulation, or other rule of law (other than this title and title II), with respect to any transaction in or affecting interstate or foreign commerce—

(1) a signature, contract, or other record relating to such transaction may not be denied legal effect, validity, or enforceability solely because it is in electronic form; and

(2) a contract relating to such transaction may not be denied legal effect, validity, or enforceability solely because an electronic signature or electronic record was used in its formation.<sup>24</sup>

The Proposed Guidelines in several places would require certain documentation to be “written” or to be “in the credit file,” and one provision states that institutions should “discuss” certain matters with appraisers.<sup>25</sup> Today, much documentation and communication is electronic. As long as the required documentation is reasonably retrievable from its electronic storage, such as by loan number, there should be no requirement for paper and no requirement regarding physical location of the electronic file. As long as required discussions are electronic, they should meet the purposes of the Proposed Guidelines. We request clarification that when the Proposed Guidelines require

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<sup>22</sup> FIRREA § 1110, Pub L. No. 110-73, 103 Stat 514, codified at 12 U.S.C. § 3339(2).

<sup>23</sup> Public Law 106-229, 114 Stat. 464.

<sup>24</sup> 15 U.S.C. § 7001.

<sup>25</sup> The Proposed Guidelines require:

- “written [appraisal] engagement letters” to be “in [the] permanent credit file” (Proposed Guidelines p. 69652);
- The engagement letter “documents the appraiser’s and lender’s expectations (p. 69661);
- All evaluations should be “documented in the credit file” (p. 69655);
- Institutions should have “documentation in the credit file” supporting the validity of an existing appraisal or evaluation used in a subsequent evaluation, (p. 69655); it may engage in the subsequent transaction based on “documented” equity (p. 69657);
- Institutions should “discuss” appraisal needs and expectations with appraisers (p. 69654);
- Institutions should “document the content of the review [of an appraisal or evaluation] in the credit file” (p. 69656);
- When an institution does not get an appraisal because it takes an interest in real property only in an abundance of caution, it must “document and retain in the credit file” its analysis supporting an exemption from the appraisal or evaluation requirement. (p. 69657);
- When relying on an appraisal exemption for loans eligible for sale to government sponsored entities, or that conforms to GSE appraisal standards, the Proposal would require institutions to “Maintain adequate documentation” of the exemption (p. 69658);
- In using automated valuation models, institutions must “document the results” of validation testing and audit findings, and “document” the correlation of any tax assessment valuation to market values (p. 69660).

matters to be “documented” or to be “written” or to be “in” the credit file, that reasonably retrievable electronic versions of the required documents, otherwise meeting the requirements of the Proposed Guidelines, are acceptable without regard to their electronic form or location. And we request clarification that the need to “discuss” matters with appraisers may be met without regard to form but may be, for example, by electronic mail.

Similarly, the Proposed Guidelines require written engagement letters when ordering appraisals, and says institutions should include the engagement letter in its permanent credit file.<sup>26</sup>

We request clarification that there may be one agreement that covers terms common to each appraisal engagement, and less comprehensive documentation for subsequent property appraisals. The main agreement could include, for instance, terms governing the need to meet appraisal quality standards, and to maintain information security safeguards. Subsequent documents or communication between the same parties should need to contain only terms unique to the subsequent appraisals.

By this method, it would also be unnecessary to maintain the entire agreement, both parts, in each loan file. As long as the loan file contains sufficient information to make all parts of the appraiser’s engagement letter retrievable, the intent of the proposal should be met.

#### ***I. Minimum Appraisal Standards***

The Proposed Guidelines state that “When ordering appraisals, an institution should convey to an appraiser that the Agencies’ minimum appraisal standards must be followed.”<sup>27</sup> We believe it should not be necessary to convey this requirement each time an appraisal is ordered, particularly if it is addressed in the financial institution’s agreement with the appraiser or appraisal management company. In addition, adherence to the Agencies’ minimum standards is a USPAP requirement. Specifying that certain USPAP requirements be met opens questions as to whether the lender expects all USPAP requirements to be met.

#### ***J. Program Compliance***

The Proposed Guidelines state that “The compliance process should ensure that all appraisers and persons performing evaluations are subject to periodic evaluation of the quality of their work.”<sup>28</sup> The Proposed Guidelines should be clarified to provide that such evaluations need not be performed by lenders directly, particularly in instances where the lender uses an appraisal management company that has adequate controls for the evaluation of all the appraisers it employs or has under contract.

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<sup>26</sup> Proposed Guidelines p. 69652.

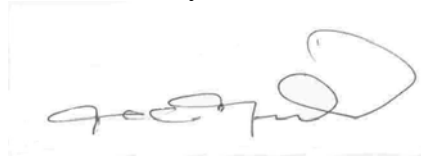
<sup>27</sup> Proposed Guidelines, p. 69654.

<sup>28</sup> Proposed Guidelines p. 69656.

**IV. Conclusion**

We support the Agencies' continuing efforts to strengthen and modernize their appraisal guidelines. It is important that the Proposed Guidelines and the HVCC be uniform, be uniformly applied to all lenders and all consumer loans, and be uniformly enforced. We strongly urge the Agencies, FHFA, FFIEC, state regulators, and CSBS to ensure consistent requirements and consistent enforcement for all appraisals nationwide. We further urge the Agencies not to impose new requirements that apply only to some mortgage industry participants.

Sincerely,

A handwritten signature in black ink, appearing to read "Anne C. Canfield", enclosed in a thin black rectangular border.

Anne C. Canfield  
Executive Director