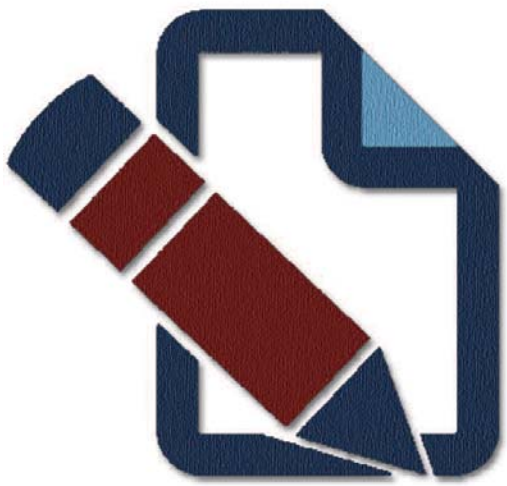
Understanding the Interim Final Rule

An Analysis of the Federal Reserve's Proposed Rules Governing Appraisal Practices



Presented By:

Valuation Review

Dodd Frank Update

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Dear Readers,

This special report provides an in-depth look into the Federal Reserve Board's (FRB) Interim Final Rule, a rule that will clearly dictate the future of appraising in the U.S. The rule addresses two of the most important issues that appraisers have faced over the past decade: pressure and compensation.

While elements of the rule may not please everyone in the valuation industry, appraisers should reflect on the FRB's rule as the first step toward getting what they have long wanted: to be paid a fair rate for their work.

In the boom years when appraisers were being pressured for a value conclusion, there was generally enough work available to allow appraisers to pick and choose their assignments. Today, appraisers have reported that the assignments that are available are sometimes going to the lowest bidder, not necessarily to the most experienced appraiser. This rule could go a long way to putting an end to both issues in the appraisal world.

It is vital to remember that the interim final rule is not yet set in stone. There is a 60-day comment period that ends on Dec. 27, 2010, and the FRB is looking for additional comments on almost every aspect of the rule.

For years, appraisers have reported to us that their complaints went unheeded. Never was there a time more ripe for appraisers to take control of their destiny and ensure a level of respect and professionalism the profession has long deserved. For those appraisers tired of having their professional fate decided by others, now is the time to make their voices heard.

Sincerely,

Syndie Eardly
Editorial Director

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KNOWLEDGE... THE COMPETITIVE ADVANTAGE

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Interim Final Rule promises much change for appraisers

The Federal Reserve Board issued its Interim Final Rule on appraisal independence, as mandated by the Dodd-Frank Act. In this first chapter, Valuation Review *breaks down the rule to explain what it means for you, while the second part will assess the reaction from across the industry.*

When the Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted on July 21, it promised to shake up the regulations of the financial system in America, and in particular, the mortgage industry, widely regarded as one of the leading players in the 2008 financial crisis and subsequent recession.

A member of the Appraisal Institute hailed the bill as a "win for appraisers," since it contained 61 pages devoted entirely to appraisal regulatory reform. But while the legislation was initially applauded throughout the independent appraiser community, it soon became clear that the devil was in the details, as various industry participants requested clarification on exactly how the bill would be implemented.

But now the effects of the Dodd-Frank Act are being felt. In recent weeks, both Fannie Mae and Freddie Mac, under the auspices of the Federal Housing and Finance Agency, created a new set of appraiser independence rules to replace the outgoing and much-criticized Home Valuation Code of Conduct (HVCC).

At the same time, the Government Accountability Office (GAO), the official body charged with conducting a year-long study into the entire appraisal process, issued a status update on its investigation, including an outline of the data it will study on purchase and refinance transactions, as well as the interviews it will undertake in order to fully understand and evaluate the current effectiveness of the appraisal industry.

But arguably the most important consequence of the Dodd-Frank Act was unveiled on Oct. 18, when the Federal Reserve Board (FRB) announced its Interim Final Rule — 132 pages of provisions aimed at ensuring the independence of real estate appraisers when valuing residential homes as part of a mortgage transaction. The rule amends Regulation Z in the Truth in Lending Act (TILA), implementing Section 129E.

Comments on the rule are due within 60 days of publication in the Federal Register, which occurred on Oct. 28, meaning it will be technically effective on Dec. 27. However, the FRB has decided to leave compliance optional until April 1, 2011, in order to give lenders and appraisal management companies (AMCs) time to prepare any necessary changes.

According to the FRB, the interim final rule is designed to do two things. The first is "to ensure that real estate appraisals used to support creditors' underwriting decisions are based on the appraiser's independent professional judgment, free of any influence or pressure that may be exerted by parties that have an interest in the transaction."

The second stated aim of the FRB was to ensure that appraisers are paid "customary and reasonable fees" by creditors and their agents. This has emerged as the most hotly debated topic in all of the recent legislation. Battle lines have been drawn, with independent appraisers and firms on one side, and national AMCs and lenders on the other. The question is not what, but who determines "customary and reasonable" — the appraisers themselves, or the AMCs that have taken the lion's share of the market since the advent of the HVCC?

In addition to these two topics, the rule also takes on the role of reporting appraisal violations, which clearly was not addressed by the Independent Valuation Protection Institute (IVPI), the failed attempt at enforcement of the HVCC. Despite repeated promises from Fannie Mae and Freddie Mac, it never saw the light of day, essentially making a mockery of the HVCC.

The interim rule also addresses the idea of conflicts of interest, a huge issue in the mortgage industry, where ownership of companies can be far from transparent. To address a problem evident in similar legislation, the FRB tried to close the door on any loopholes. "[The rule] is designed to ensure that consumers are protected regardless of the valuation method chosen by the creditor, and to prevent circumvention of the appraisal independence rules," it stated.

Starting with appraiser independence, the rule expands on the prohibitions against the coercion and pressuring of appraisers that has been part of Regulation Z since October 2009. While the existing prohibitions in Regulation Z only apply to closed-end loans, the new rule also encompasses home equity lines of credit (HELOCs), casting a much wider net of protection than the HVCC. It also includes numerous examples of actions that are considered to be coercion, including those mentioned in the Dodd-Frank Act. Essentially, coercion, bribery or financial inducement is prohibited under the final rule, while requesting additional information or suggesting additional comparables for consideration in a report, are both permitted.

Part of Congress' intent was for the rule to apply to all of the players in the mortgage industry, including creditors, AMCs, appraisers, mortgage brokers, Realtors, title insurers and other firms that provide settlement services. Moreover, it applies to "any person who performs valuation services, performs valuation management functions, and to any valuation of the consumer's principal dwelling, not just to a licensed or certified 'appraiser,' an 'appraisal management company,' or to a formal 'appraisal.'"

This last statement can be interpreted to include Realtors and specifically broker price opinions (BPOs). This is supported by a later section, that states, "a 'valuation' is an estimate of value prepared by a natural person, such as an appraisal report prepared by an appraiser or an estimate of market value prepared by a real estate agent." So although Realtors will not have to prepare a BPO in line with the Uniform Standards of Professional Appraisal Practice (USPAP), it will be illegal for their clients to provide financial incentives for them to reach a desired number. In all likelihood though, this will not halt the growth in popularity of BPOs as a valuation tool, as its overriding appeal lies in its cheap cost.

Unlike BPOs, automated valuation models (AVMs) appear to have escaped the rule's grasp. "The definition of 'valuation' does not include an estimate of value produced exclusively using such an automated system," the rule states. Interestingly though, the developer of an AVM can be subjected to the same pressures as an appraiser and is thus protected.

Creditors and other providers of settlement services, including AMCs, will not be allowed to change the value in an appraisal report.

"Alterations to a valuation generally should be made by the person that prepares the valuation," the rule says, though it did invite comment on what can be changed in an appraisal report that doesn't affect the valuation conclusion.

Creditors will also be prohibited from extending credit to a consumer if the creditor is aware that any prohibited action, such as coercion or bribery, has occurred, or if the appraiser or AMC has a prohibited financial interest in the property or the transaction itself. This is connected to the extensive section of the rule that deals with supposed conflicts of interest.

The new provision, TILA Section 129E(d), states that "no certified or licensed appraiser conducting, and no appraisal management company procuring or facilitating, an appraisal in connection with a consumer credit transaction secured by the principal dwelling of a consumer may have a direct or indirect interest, financial or otherwise, in the property or transaction involving the appraisal."

However, the FRB recognizes that the statement "direct or indirect, financial or otherwise" could be broadly interpreted to include any employee, contract or otherwise, who would benefit from having his or her company increase its loan volume. It does not want this to be the case and cites the Interagency Guidelines and the HVCC in its explanation.

Moreover, the conflict of interest extends to AMCs versus having in-house staff appraisers, which the FRB describes as being more effective. "Some creditor representatives have informally reported to the board that, based on their experience and quality control testing, appraisals performed by an in-house collateral valuation function are of higher quality than appraisals performed by third parties, including those ordered through third-party AMCs," the FRB stated.

In essence, the interim final rule allows institutions to continue to use in-house appraisers, as long as there is an established firewall between the valuation and loan production arms of the institution. For those lenders or credit unions that are too small to set up such firewalls, such as those in a rural area or where the appraiser is also the loan officer, the FRB suggests a set of guidelines similar to the ones in the Interagency Guidelines should be employed. So while the rule generally prohibits any conflict of interest, it also provides a safe harbor to ensure compliance with the conflicts of interest prohibition by a creditor's in-house valuation staff or affiliated AMC, or appraisal company, if firewalls and other specified safeguards are in place. This also applies to other settlement service providers.

The conflict of interest issue can be ascribed in part to financial compensation, which is an integral part of the interim final rule. As mentioned before, the FRB wades into the reasonable and customary fee debate. Despite attempts by some AMCs and banks, the FRB decided against delaying the implementation of the provision in the Dodd-Frank Act that requires appraisers to be paid a reasonable and customary fee. Instead, the rule states "a creditor and its agent must pay a fee appraiser at a rate that is reasonable and customary in the geographic market where the property is located."

How this is to be determined is the interesting part: "The marketplace should be the primary determiner of the value of appraisal services," the rule states. But it gives two possible presumptions of compliance. The first says that an appraiser is paid a customary and reasonable fee if the fee is "reasonably related to recent rates" paid in the relevant market, and if the creditor or agent has taken into account the scope of work and type of property. The creditor or agent cannot participate in price-fixing or other anticompetitive actions.

The second presumption of compliance is if the creditor or agent establishes a fee based on third-party information, such as the appraisal fee schedule issued by the Department of Veteran's Affars (VA) or other surveys or reports performed by an independent third party. The Dodd-Frank Act states clearly that AMCs cannot be included as independent third parties when it comes to establishing market rates.

What this means is that lenders will have to rely on independent fee schedules, such as the VA's or Mercury Network's Appraisal Fee Reference, and will likely refer to the VA schedule as the 'standard' for demanding payment. Roughly translated, this means that appraisers offered an assignment that they feel is woefully under-compensated can use the VA schedule as a guide for what they feel is adequate payment. Lenders eager to avoid violating the final rule will see the VA fee as a safe harbor.

But for AMCs looking to get around this, there is a potential loophole: reasonable and customary fees don't apply to appraisal firms or a lender's in-house appraisers. "The board understands that these companies or firms often pay their appraisers on an hourly basis and provide their employees with office services as well as health insurance and other employment benefits," the rule states. "Requiring that they pay their staff appraisers customary and reasonable fees for each appraisal assignment could be unduly financially burdensome for these entities, and ultimately could undermine their viability as an avenue for appraisal services." This could mean that AMCs or lenders with in-house appraisers will look at hiring more staff employees, as opposed to dealing with a panel of appraisers, though it would obviously depend on the financial viability of such a move.

The rule also deals with reporting any misconduct by an appraiser. Anyone involved with the transaction that has a "reasonable basis" to believe that an appraiser's conduct is a violation of state or federal law, "must report the failure to comply to the appropriate state licensing agency." Unlike the HVCC, the interim final rule contains real penalties for any violations: up to $10,000 a day for the first violation and $20,000 a day for subsequent violations. State attorneys general will be able to prosecute any actions within three years of the original violation. Enforcement of TILA will come under the remit of the new Consumer Financial Protection Bureau (CFPB).

How does all this affect appraisers? The interim final rule from the FRB is the first concrete step towards the implementation of the landmark reform of appraisal regulations in the Dodd-Frank Act, and as such, will reinforce the appraiser independence movement that has been a hallmark of recent legislation. This focus on securing an appraiser's neutrality when conducting an appraisal has been the driving force behind the HVCC and the Interagency Guidelines. It is nothing new, and should only make an impact if the CFPB ruthlessly enforces the law to the letter. In addition, the sections of the rule that call for mandatory reporting of appraiser misconduct will only make a difference if backed up by real, and timely, fines.

However, it is the stance on reasonable and customary fees, and the allowance of lenders and other financial institutions to have in-house appraisers that could really change the appraisal industry. On the one hand, appraisers should be happy that the federal government is denying the AMCs the chance to dictate fees. With the provision that lenders can use the VA fee schedule as a standard marker for what is reasonable and customary, one of the unintended consequences of the HVCC is finally addressed.

On the other hand, the increase in fees for appraisers will likely result in higher costs for an AMC, which in turn, would be passed back to the lender, and, ultimately, the consumer. In an effort to ensure the removal of bias in an appraisal, the government has given the green light for the business model of an AMC middleman to continue, and is seemingly unwittingly causing costs to increase for the consumer.

Because the rule allows lenders and other institutions to use their own in-house staff for appraisal functions, lenders that are able to do so will likely keep operations close to home in an effort to stave down costs. This could result in a rash of new hires for staff appraisers, while AMCs will have to look very closely at their operating costs and decide what the best course of action is to continue to generate profits.

For questions or comments about this article, please contact David Napuk at dnapuk@octoberresearch.com.

Industry reaction to the Interim Final Rule

In chapter one, we looked at the Federal Reserve Board's Interim Final Rule, the appraiser-centered implementation of the Dodd-Frank Act that will replace the controversial HVCC. In this story, we canvass the thoughts and reaction from across the industry on what the rule will mean for business, and whether it will be a success or failure.

"The interim rule is a good start on a complicated issue," said **Richard Maloy**, chair of the Appraisal Institute's Government Relations Committee. He was referring to the Interim Final Rule, released on Oct. 18, by the Federal Reserve Board (FRB). The rule was the implementation of the Dodd-Frank Act, the far-reaching financial reform legislation that passed this summer amid much fanfare.

In the previous edition of *Valuation Review*, we analyzed the bill and took a look at what it could mean for the different sectors of the appraisal industry. To find out how the bill will affect both independent appraisers and appraisal firms and management companies (AMCs), we spoke to several experts to canvas their reaction to the rule. The overriding conclusion, regardless of which side of the fence you sit on, is that the rule is a move in the right direction, but lacks the clarity needed to make it a defining moment in the ongoing changes to the appraisal industry. Instead, both appraisers and AMCs are concerned that the vague wording of several passages could lead to misinterpretations and potentially, a loss of business.

However, the rule can still be somewhat influenced by outside comments. The FRB has given 60 days after the publication of the rule in the federal register for public comments on particular sections of the rule. This means you have until Dec. 27 to get your thoughts to the FRB. Judging by the interviews conducted for this article, the staff at the FRB dealing with the comments will have their hands full — everyone involved said they were going to add their comments. As **Griff Straw**, president of Solidifi U.S., the national appraisal services provider, said, "We won't be shy about sharing our thoughts with the FRB."

So how has the industry reacted to the rule? Most saw it as going further than the Home Valuation Code of Conduct (HVCC), which it is replacing, but some saw it as nothing but more of the same. The online forums were ablaze with debate about what it could mean for independent appraisers. One appraiser labeled the legislation as the "Dodd-Frankenstein Act" and said the rule was just "a rehash" of previous regulations. "Am I missing something? Because what I've read so far is basically vague, ambiguous and lacks specificity — just like so much of the regulation before it," she wrote.

Better than the HVCC

Others, however, thought the rule was a step above the HVCC. Straw said that while the rule captured the spirit of the HVCC, it addressed a number of its weaknesses. "It is far better for appraisers and ultimately, for everyone else in the value chain," he said. "It was clear that Dodd-Frank was going to reflect closely the FHA appraiser independence guidelines, and we've agreed with that effort from the beginning. Independent, well-compensated appraisers do better work."

The Appraisal Institute's Maloy agreed with Straw that addressing the fee issue was a welcome, if obvious attempt to correct some of the unintended consequences of the code. He added that he was encouraged by the increased emphasis on appraiser competency within the appraisal independence discussion. "The interim rule attempts to address the one issue that has been left out of the appraiser independence discussion — appraiser competency. Our initial review of the interim rule is that the Fed has gotten it half right. The other half will require some clarification, but we think it's within reach," he told *Valuation Review*.

Jennifer Creech, president of InHouse Inc., the parent company of Orange, Calif.-based AMC InHouse Solutions, called the rule "stricter," "tougher" and "more complex" than the HVCC. This was echoed by **Brian Coester**, CEO of the Coester Appraisal Group, a national AMC based in Gaithersburg, Md. He said the length of the rule, which clocks in at 132 pages, made implementation difficult, compared to the shorter HVCC, which was only four pages long. "The HVCC was very simple and straightforward," he said. "It was only a few pages and got right to the point. The FRB's rule, however, is very wordy and quite a bit longer, which can cause problems with implementation."

On the whole, AMCs were relatively pleased with the rule. **Steve Haslam**, CEO of StreetLinks National Appraisal Services, a national AMC headquartered in Indianapolis, said he was glad that appraiser independence was finally addressed in one protocol that applies to everyone. "I think the architects of the rule have done a good job thus far trying to achieve the goal of independence while taking into consideration the individual concerns of all the various stakeholders," he said.

Don Kelly, executive director of The Real Estate Valuation Advocacy Association (REVAA), an association dedicated to the improvement of the real estate valuation industry, said the FRB had made "substantial progress" in helping to ensure appraiser independence. "The action taken by the FRB will help protect appraisers from undue influence and allow for a market-based determination of appraisal fees, as those costs are ultimately borne by consumers and home buyers," he said.

The rule gives more leeway

Other areas of the real estate industry also welcomed the rule, in particular homebuilders. **Joe Robson**, the immediate past chairman of the National Association of Home Builders, was pleased that the rule allowed builders more leeway in asking appraisers to consider additional information in their report, including comparable properties. "That's critical to our members because in far too many cases we're seeing appraisals based on inappropriate comparables," he said. "It is particularly important that homebuilders be allowed to provide appraisers with information to assist in appraising new construction."

Indeed, some AMCs found that the rule contained more freedom than they had initially believed. InHouse's Creech said that she found the rule "not as restricted as I thought it would be." She specifically pointed to the section that allows for volume discounts in the payment of appraiser fees as an example of how the rule gives some leeway to AMCs.

But this just illustrates the difference of opinion between independent appraisers and AMCs, as one appraiser has already expressed his opposition to this section to the FRB. His argument was that AMCs would promise a volume of orders for a lesser fee, but wouldn't be able to provide that many assignments in one month. AMCs should be required to pay the appraiser for the guaranteed appraisals since that was part of the agreement. "If the AMCs actually believe in volume discounts," he wrote, "then they should be held to pay for these discounts."

Will AMCs have to change procedures?

Most AMCs that were interviewed didn't mention any need to change their procedures in order to comply with the rule, despite the FRB giving a six-month grace period for companies and lenders to adjust their systems accordingly. StreetLinks' Haslam and Solidifi U.S.' Straw both said that their systems already had the built-in firewalls that ensured appraiser independence, even before the HVCC was introduced.

One exception though was the Coester Appraisal Group, where Coester admitted, "We will have to adjust the way the appraisal process is established. Things like scope of work and letter of transmittal, as well as the way appraisals are assigned, will have to be adjusted to comply with the current regulations. We are working on new engagement letters as well."

Customary and reasonable fees

Coester also revealed that he would have to work with vendors and staff to determine what constitutes a customary fee for an assignment. The section of the rule that mandates that appraisers be paid a "reasonable and customary fee" is undoubtedly the most discussed and debated provision in the entire 132 pages. Essentially, it gives two presumptions of compliance, that is, two ways for AMCs, lenders and appraisal firms to ensure that they comply with the rule.

The first presumption of compliance is that a lender or its agent has paid a customary and reasonable fee if the fee is reasonably related to recent rates paid for appraisal services in the relevant geographic market, and, in setting the fee, the creditor or its agent has taken into account specific factors, which include, for example, the type of property and the scope of work. One interpretation of this means that recent rates can include fees paid by AMCs to independent appraisers.

Under the second presumption of compliance, a creditor or its agent are presumed to have paid a customary and reasonable fee if it is based on rates established by third party information and/or fee surveys and reports that are performed by an independent third party that do not include fees paid by AMCs to fee appraisers. The FRB specifically mentioned the Department of Veteran's Affairs as the standard for a fee survey.

The Appraisal Institute's Maloy said that these two presumptions appear to contradict each other. "One presumption relies on data that excludes appraisal assignments from appraisal management companies, while the other may allow their inclusion," he said. "We believe Dodd-Frank clearly outlines AMC fees be excluded from consideration." However, the FRB didn't give any examples of fee surveys beyond the VA, leading other industry experts to agree that this was the part of the rule that needed the most explaining.

Jim Kirchmeyer, CEO of Kirchmeyer & Associates, a national real estate appraisal and consulting company based in Buffalo, N.Y., said the reasonable and customary fee section was still unclear, despite having read the document multiple times. "It boils down to this: The lender or AMC will be compliant if they 1) pay the appraiser the same rate that is on an acceptable fee schedule or survey; or 2) Pay the appraiser the market rate," he said. "Interpretations on what is customary and reasonable will be endless. The lender, the AMC, and the appraiser will all have differing points of view."

Kirchmeyer wasn't wrong. One appraiser wrote online, "I think the FRB just kicked the 'reasonable fee' can down the road. I'm glad they mentioned it and the VA and all, but the answer is still for appraisers to get strong and insist they be paid or no work."

Creech was adopting a wait-and-see approach. "The rule says that you can use a third-party source who is unbiased to determine reasonable and customary fees. But nobody knows who that is yet," she said. "We also can determine fees by looking at rates paid to appraisers within the last 12 months, but we're wrestling with that and are waiting on a better definition. We need more clarification."

Straw argued that, for Solidifi U.S., reasonable and customary fees are the fees that appraisers ask for in their markets. "We don't set them, the marketplace does, and an objective third-party survey will reflect this, just as the rule intends," he said. Haslam had a similar answer. Maloy, meanwhile, said the FRB should provide a safe harbor for the presumption of compliance relying on third party fee schedules or surveys. "Some clarification that such schedules or surveys should be prepared in accordance with generally accepted research standards would be important to include in the final rule," he said.

For Maloy, the lack of specificity could undermine the intention of the rule by allowing for loopholes to be exploited. "We call on the Fed to ensure the final rule includes the specificity necessary for industry players in the marketplace," he said. "Without specificity, those involved will find ways to get around the Dodd-Frank Act's intent." This sentiment was repeated by an appraiser online, who wrote, "Those it seeks to regulate will surely find clever ways to stealth under its radar, just like before — which is exactly how we got into the current economic collapse to begin with."

The enforcement issue

Essentially, though, the success, or failure, of the rule relies on its enforcement. Unlike the HVCC, the interim final rule has fixed penalties for violations at $10,000 a day per violation for first offenders and $20,000 a day for repeat offenders. Although Creech warned that a small lender with systemic violations could be put out of business with the fines, most welcomed the tougher line. Maloy noted that not only will enforcement fall to the newly-created Consumer Financial Protection Bureau (CFPB), but that it will be backed up by state attorneys general. These "cops on the beat," as he calls them, have taken a keen interest in the importance of sound appraisal management.

But Straw wasn't as confident. He called the enforcement an "uncomfortable uncertainty" and said it wasn't clear who would be enforcing the rule come April 2, since the CFPB won't be operational until July. "When more than one regulator is involved, inconsistency in enforcement often results and this makes things uncomfortable," he said.

However, Straw said that the rule was "a very good step" in terms of compensating appraisers for what they do, protecting their findings, and keeping them "independent from undue influences that endanger loan quality."

He is also in favor of appraisers being fully compensated, as, in his opinion, it leads to a sounder mortgage industry overall. We think appraisers should receive their full fees because we have found that full fees mean better appraisal results. It's the most important document in the loan file, and it's no place for the lowest bidder to be doing the work."

In that respect alone, the interim final rule is indeed a step in the right direction.

Report details research gathered for Interim Rule

The Federal Reserve Board's Division of Consumer and Community Affairs sent out questionnaires and conducted a series of interviews with industry participants to determine what to address in the Interim Final Rule, concerning appraisal independence. A recent report issued by the division details that research.

The Federal Reserve Board's (FRB) Division of Consumer and Community Affairs conducted a series of conference calls with interested parties and sent out questionnaires, probing the industry for input in preparation for the interim final rule implementing the appraisal independence requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

On Oct. 28, they released a memorandum summarizing the findings culled from a diverse group of respondents, including state appraiser licensing and certifying agencies, appraisal associations, lending institutions, secondary market representatives, consumer groups, real estate and mortgage trade groups, appraisers and appraisal management companies.

Customary and reasonable fees

Clearly one of the most contentious topics addressed in the interim final rule is that of customary and reasonable fees.

The board reported that appraisers expressed concern over unreasonably low fees and their inability to negotiate with appraisal management companies (AMCs) for higher fees, resulting in appraisal assignments being given to the lowest-cost appraiser, without regard for appraisal quality.

Anecdotally, appraiser representatives and state regulators stated that consumer costs for appraisals ordered through AMCs are higher than for appraisals ordered directly from the appraiser and that appraisal costs for consumers generally have risen since the Home Valuation Code of Conduct (HVCC) took effect. Some appraiser representatives and one state regulator requested that the interim final rule require creditors and AMCs to rely on published fee studies, such as the Department of Veteran's Affairs (VA) fee schedules, to determine how much to pay the appraiser.

On the other hand, AMC and some creditor representatives expressed a preference for the Federal Housing Administration (FHA) approach to its requirement that fee appraisers be paid "customary and reasonable" fees, which is oriented toward letting the market decide. They stated that AMCs have not raised their fees post-HVCC because they are still competing with other AMCs for creditors' business, and that consumer costs have not been materially impacted. They also expressed concerns that existing fee studies do not establish "customary and reasonable" rates for appraisal services, in part because they do not differentiate between the costs of performing the appraisal and the costs of managing the appraisal process. In addition, some AMC and creditor representatives noted that the VA fee schedules, for example, are a benchmark for the highest rate that could be charged in a given state, not the rate that is "customary and reasonable," and that they are intended for a distinct appraisal product (appraisals for VA loans), not average appraisals.

The AMCs suggested that the interim final rule should not address the "customary and reasonable" fee provision because the FRB needed to gather and assess more information.

Appraisal independence

Several participants raised concerns regarding the prohibition on "instructing" or "inducing" an appraiser to base a conclusion of value on anything but the appraiser's independent judgment. According to some participants, the terms "instruct" and "induce" should not be interpreted to mean that creditors cannot criticize an appraiser's report in order to improve the quality and accuracy of the next report submitted by that appraiser.

Others requested that the interim final rule clarify that giving an appraiser a copy of the home purchase contract is not "inducing" the appraiser not to use independent judgment in violation of The Truth in Lending Act (TILA). A few participants expressed the opposite view regarding the home purchase contract, arguing that providing the sales contract to the appraiser is a form of indirect coercion and should be banned.

Questions were also raised about the meaning of the prohibition on "compensating" an appraiser. Several participants expressed the view that the interim final rule should clearly permit paying an appraiser higher compensation for a more difficult assignment. Others pointed out that creditors may reasonably reduce or withhold an appraiser's compensation for failing to meet contractual obligations, such as for missing the deadline for submitting the appraisal report.

Another issue raised was whether the interim final rule should prohibit coercion and conflicts of interest in any method of valuing a property for a consumer credit transaction, or solely in appraisals conducted by state-licensed or state-certified appraisers. Most participants agreed that broker price opinions (BPO) and other types of valuations performed by persons who are not state-licensed or state-certified should be covered by the interim final rules, in order to protect consumers in home-secured consumer credit transactions for which appraisals are not required or performed. Others disagreed, stating that BPOs are based more on automated and electronic data than appraisals, and thus afford fewer opportunities for coercion than appraisals. Similarly, it was argued that automated valuation models (AVM) should not be covered because they are derived from objective, electronic data, and thus are not subject to coercion.

Exceptions

Participants generally supported including in the interim final rule the illustrative list of expressly permitted conduct provided in TILA, Section 129E(c), as well as permitted conduct listed in Regulation Z, 12 CFR 226.36(b)(1)(ii). Some stated that the HVCC resulted in confusion about who could communicate with the appraiser and what types of communication are permissible. This reportedly delayed or prevented resolution of technical issues and questions regarding appraisal reports.

Several participants requested that the interim final rule make clear that loan production staff can communicate with appraisers about particular issues related to the quality and accuracy of the appraisal. Similarly, others stated that lines of communications between loan originators and appraisers that do not involve coercion but help ensure accurate appraisals are needed. For example, participants pointed out that sometimes basic elements of the appraisal are wrong — the property is inaccurately described or the sale date is inaccurate. Participants argued that it is inefficient if only the underwriter is able to communicate with the appraiser.

Prohibition on conflicts of interest

All participants agreed that creditors have increased the use of AMCs since the HVCC took effect, in part due to a concern about whether they could successfully implement the internal firewalls separating loan staff and the appraiser that the HVCC otherwise required. Several participants, however, stated that they had concerns about the quality of AMC-ordered appraisals, stating in particular that AMCs often seem to select appraisers based solely on price and turnaround time, without regard to the appraisers' knowledge of the local market in which the property is located. State regulators responding to the board's questionnaire reiterated these concerns.

Many participants requested that the interim final rule include provisions that allow in-house appraisers to perform and order appraisals, as long as clearly defined structural separation of appraisal staff from loan production exists.

Some expressed the view that in-house appraisals tended to be of better quality than appraisals performed and ordered by independent third parties. Representatives of small institutions stressed, however, that some exemptions from any firewall provisions for smaller institutions also were critical.

Similarly, some participants expressed concerns that entities affiliated with a creditor might be considered to have an "indirect" interest in the transaction solely due to the affiliation.

Mandatory reporting

Many participants voiced concerns that the requirement to report appraisers for "unethical or unprofessional" conduct was too broad. They emphasized that the interim final rule should require reporting only of material misconduct, to prevent state appraiser certifying and licensing agencies from being overwhelmed with reports. To further prevent frivolous reporting, several participants also suggested that the interim final rule require a person reporting misconduct articulate reasonable, fact-based grounds for alleging that misconduct has occurred.

Some participants pointed out that an appraiser violation may not be apparent until a few years after consummation, such as when a borrower defaults and an investigation is conducted. They therefore suggested that the interim final rule include provisions regarding the required timing for reporting, such as a reasonable time after knowledge of a violation or potential violation, rather than after the violation or potential violation actually occurred.

A few creditors expressed concerns that the mandatory reporting requirement exposed reporting parties to defamation liability. These participants requested that the interim final rule incorporate a provision that would protect persons who comply with the mandatory reporting requirement from defamation suits.

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