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## HVCC's Sunset and Other Appraisal Reforms on the Horizon

K&L Gates published this alert prior to July 21, 2010, the date on which President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act into law. However, this alert discusses the final version of the bill that would eventually be signed into law.

Congress is poised to eliminate the contentious Home Valuation Code of Conduct, (the "HVCC"), and with the HVCC set to sunset, more expansive (and expensive) appraisal reforms are on the horizon. Tucked within the massive Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") are provisions that will strengthen appraiser independence and enforcement, regulate the use of broker price opinions ("BPOs"), set standards for pricing of appraisals and appraiser valuation model products ("AVMs"), and subject appraisal management companies ("AMCs") to potential federal and state oversight.

The Mortgage Reform and Anti-Predatory Lending Act (the "Mortgage Reform Act"), Title XIV to the Dodd-Frank Act, will create enforceable federal appraisal independence standards within the Truth in Lending Act ("TILA") and amend existing appraisal requirements contained in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"). Other K&L Gates client alerts will describe the abundant other provisions in the Mortgage Reform Act and the larger Dodd-Frank Act relating to residential mortgage lending, including the creation of the new Consumer Financial Protection Bureau (the "Bureau"), the imposition of new mortgage loan origination and servicing requirements, the dilution of federal preemption of state laws for national banks (and the remaining entities with federal thrift charters) and their operating subsidiaries, and the consequences of the new "skin in the game" requirements under the new risk retention rules. In addition, other alerts from K&L Gates will address other aspects of financial reform in the Dodd-Frank Bill on [the K&L Gates web site specially dedicated to Financial Services Reform](#).

The new TILA appraisal independence standards, similar to the HVCC's restrictions, will prohibit the parties involved in residential real estate transactions from influencing the independent judgment of an appraiser through collusion, coercion, and bribery, among other activities. Unlike the HVCC, however, the Mortgage Reform Act does not expressly bar mortgage loan originators from ordering appraisals, although it preserves the ability for regulators to do so by regulation. While the HVCC may be fading into the sunset, don't expect the same fate for AMCs, AVMs, and BPOs.

If you recall, the HVCC originated from an executed settlement among New York Attorney General Andrew Cuomo, the Federal Housing Finance Agency, Fannie Mae, and Freddie Mac (collectively the "GSEs"), that codified an appraiser code of conduct by contract.<sup>1</sup> The HVCC, effective May 1, 2009, applies to mortgage lenders that sell residential mortgage loans, *i.e.* conventional loans to the GSEs.<sup>2</sup>

To avoid violating the HVCC's ban on relying on appraisers "selected, retained, or compensated in any manner" by mortgage brokers, real estate agents or any other third party, lenders have continued their use of appraisals from AMCs, in part because these companies act as intermediaries between the lender and appraiser. Critics of AMCs suggest that appraisals are being performed by people who do not have geographic proximity to the property to be appraised, lack the detailed, "hands on" knowledge of the geographic areas to conduct a quality appraisal, and that AMCs are forcing appraisers to accept less than the reasonable market value for their work. As a result of the Mortgage Reform Act, AMCs, subject to certain exceptions, will be subject to registration and state and federal oversight (with similarities to the Nationwide Mortgage Licensing System ("NMLS") established for loan originators), and fee appraisers must be paid "reasonable and customary" fees by AMCs, reflecting what the appraiser would typically be paid for the assignment absent the involvement of an AMC, with violations subject to harsh penalties under TILA.

### I. Appraisal Independence

Currently, creditors, mortgage brokers and their affiliates engaged in mortgage origination of residential mortgage loans secured by the consumer's principal dwelling are subject to the appraisal standards of the Federal Reserve Board ("FRB" or "the Board"), found in a final rule ("FRB Rule") implementing TILA, effective on October 1, 2009.<sup>3</sup> The FRB Rule was promulgated not pursuant to specific authority under TILA to regulate appraisals but pursuant to TILA's broad authority to adopt regulations that prohibit, in connection with residential mortgage loans, acts or practices that the Board finds unfair or deceptive.<sup>4</sup> In addition, federally regulated institutions are also subject to the appraisal standards in FIRREA, and the banking agency regulations and guidelines prescribing rules on appraisals. Presumably, the current regulations and Interagency Appraisal and Evaluation Guidelines<sup>5</sup> ("Interagency Guidelines") will be modified in response to the joint rulemaking mandate of the Mortgage Reform Act.

The Mortgage Reform Act provides new appraiser independence standards in a stand-alone section within TILA, Section 129E. Their purpose is to strengthen the independence of appraisers from any

improper, coercive influences of loan transaction insiders, and to establish standards governing conflicts of interest. The FRB is charged with issuing interim final regulations further specifying acts or practices that violate appraisal independence and defining any term in Section 129E no later than 90 days after the Mortgage Reform Act's enactment. Presumably, the current FRB Rule will be modified in response to this mandate.

Significantly, civil penalties are available against "each person" who violates Section 129E. For a first violation, a person would be subject to a civil penalty of \$10,000 for each day the violation continues. For any subsequent violations, a person would be subject to a civil penalty of \$20,000 each day the violation continues. These civil penalties are in addition to the "enforcement provisions referred to in section 130 [of TILA]."

The Mortgage Reform Act also adds several appraisal related provisions which apply only to "higher-risk mortgages," found in another new section of TILA, 129H, described in more detail below. Both sections 129E and 129H would be considered "enumerated consumer laws" and would be assigned to (or transferred to) the new Bureau. (For more information on the Bureau's enforcement authority, see our earlier client alert, [Consumer Financial Services Industry, Meet Your New Regulator.](#))

According to the new legislation, the HVCC will sunset and "have no force and effect" when FRB prescribes its interim final regulations on appraisal independence due within 90 days of enactment. Further, the FRB, OCC, FDIC, NCUA, FHFA and the Bureau (hereinafter, the "federal agencies") may:

- jointly issue regulations, interpretative guidelines, and general statements of policy with respect to acts and practices that violate appraisal independence.
- jointly issue regulations that would make appraisals portable between lenders for a consumer credit transaction secured by a 1-4 unit single family residence that is the principal dwelling of the consumer.

### A. Applicability

Section 129E of TILA would make it unlawful in extending credit or in providing any services for a consumer credit transaction secured by the principal dwelling of the consumer to engage in any act that violates the appraisal independence standards, as set forth below. Section 129E of TILA does not expressly restrict lenders' use of appraisals from certain sources. For that matter, these new appraisal requirements also do not expressly require or prevent lenders to accept an appraisal from a mortgage broker, loan originator, or other interested party. While a matter of contention in the Conference Committee, the insertion of language requiring lenders to accept appraisals ordered by mortgage brokers and loan officers was rejected.

Through silence, Section 129E arguably permits lenders and the GSEs to continue to rely on AMCs as a means to provide independent appraisals, regardless of the HVCC's elimination. Further, Section 129E preserves the ability of the Board to impose such restrictions between appraisers and loan officers, as prescribed by regulation. However, when promulgating the FRB Rule on appraisal standards, the Board expressly rejected the request to restrict lenders' use of appraisals from certain sources. The preamble to that rule stated: "[a] few large banks and a financial services trade association suggested that the Board prohibit mortgage brokers from ordering appraisals, as the GSE Appraisal Agreements do. The Board declines to determine that any particular procedure for ordering an appraisal necessarily promotes false reporting of value."<sup>6</sup>

### B. Requirements and Prohibitions

Under the new section 129E, the following violates appraisal independence:

Any appraisal of a property offered as security for repayment of the consumer credit transaction [] in which a person with an interest in the underlying transaction compensates, coerces, extorts, colludes, instructs, induces, bribes, or intimidates a person, appraisal management company, firm or other entity

conducting or involved in an appraisal, or attempts, to compensate, coerce, extort, collude, instruct, induce, bribe, or intimidate such a person, for the purpose of causing the appraised value assigned, under the appraisal, to the property to be based on any factor other than the independent judgment of the appraiser.

This "catch-all" provision, which closely resembles the parallel provision in the HVCC, prohibits a wide range of enumerated conduct toward not only a person "conducting" an appraisal, but anyone "involved in an appraisal." The FRB Rule, by contrast, is narrower, as the catch-all provision only prohibits attempting to "coerce, influence or otherwise encourage" an appraiser. The FRB Rule is less inclusive because it directs the appraisal coercion provisions against certain specific parties (creditors, mortgage brokers or their affiliates), whereas the prohibitions found in the new TILA section apply more broadly to any person "extending credit" or "providing any services" in connection with the consumer credit transaction.

The new TILA section also imposes a conflict of interest standard by prohibiting an appraiser conducting, and an AMC procuring or facilitating, an appraisal in connection with a consumer credit transaction secured by the principal dwelling of the consumer from having a direct or indirect interest, financial or otherwise, in the property or transaction involving the appraisal. The Interagency Guidelines for financial institutions is narrower than Section 129E, as it does not permit an appraiser to appraise any property in which the appraiser has an interest, direct or indirect, financial or otherwise, but is silent with regard to AMCs. Hopefully, the Board will confirm in its interim final regulations that an AMC affiliate of a lender does not have an indirect interest in the transaction merely as a result of its common ownership.

Similar to the FRB Rule and the HVCC before it, the legislation attempts to address some of the vagueness concerns about what types of activities are prohibited, by providing examples of specific

allowable and prohibited conduct. Compared to the HVCC, which lists ten examples of prohibited practices,<sup>7</sup> the new TILA section provides three, in addition to the general “catch-all” provision above. Under the new appraisal independence requirements, the following actions are prohibited: (1) mischaracterizing or suborning a mischaracterization of the appraisal value of the securing property; (2) seeking to influence the appraiser or otherwise to encourage a targeted value to facilitate the making or pricing of the transaction; and (3) withholding or threatening to withhold timely payment for an appraisal report or for appraisal services rendered.

The FRB Rule, on the other hand, enumerates five prohibited actions, with slightly more specificity than the new TILA section.<sup>8</sup> Section 129E of TILA includes three examples of permitted activity already stated in the FRB Rule, although it would allow “any person with an interest in the real estate transaction,” including, but not limited to, a mortgage lender, mortgage broker, mortgage banker, real estate broker, AMC, or an employee of an AMC, to engage in the permitted behavior.<sup>9</sup> For example, under the new TILA rule, a consumer may ask an appraiser to consider additional comparables, provide further detail, or correct errors. Overall, the legislation reiterates similar examples of allowable and prohibited conduct, but requires the Board to promulgate interim final regulations specifying acts or practices that violate appraisal independence within 90 days of the Mortgage Reform Act’s enactment.

### **C. Mandatory Reporting of USPAP Noncompliance**

Section 129E would mandate that any “mortgage lender, mortgage broker, mortgage banker, real estate broker, AMC, employee of an AMC, or “any other person involved in a real estate transaction involving an appraisal in connection with a consumer credit transaction secured by the principal dwelling of a consumer” who has “a reasonable basis to believe” that an appraiser has failed to comply with the Uniform Standards of Professional Appraisal Practice (“USPAP”), is violating applicable laws, or is otherwise engaging in unethical or unprofessional conduct must report the matter to the applicable state appraisal boards. The Interagency Guidelines provide that financial institutions are “encouraged” to make referrals

directly to state appraisal board when an appraiser violates USPAP, or applicable state law, or engages in other unethical or unprofessional conduct. Upon the issuance of the Board’s interim final regulations, federally regulated institutions will need to follow the stricter requirements of TILA. Further, in these interim final regulations, hopefully the Board will clarify the meaning of the phrase “involved in a real estate transaction,” but it appears reasonable to interpret that provision to be limited to those who are directly involved with the origination of the transaction (and not, for example, an investor or other party who becomes connected with the transaction principally after the closing of the loan). This duty to tattle is subject to the remedies discussed below.

### **D. Fees for Appraisers**

In addition to establishing appraisal standards, Section 129E requires that lenders and their agents must compensate fee appraisers<sup>10</sup> (as opposed to staff appraisers) at a “customary and reasonable” rate for appraisal services in the market area of the property being appraised. The issue of “reasonable and customary” appraisal fees came to the forefront a few months ago when the Federal Housing Administration changed how appraisals must be ordered and required that appraisers’ fees should be reasonable and customary. According to Section 129E, evidence of a fee’s “reasonableness” may be established by objective third-party information, such as government agency fee schedules, academic studies, and independent private sector surveys, but not by assignment orders by known AMCs. Some contest that it is misleading to calculate “customary” fees by intentionally excluding AMCs from the analysis, as it omits approximately two-thirds of all of the appraisals done in the United States. In other words, how does one calculate bona fide market value when excluding comparables—rather ironic when talking about appraisers. The new law also suggests that the customary and reasonable fee may reflect the increased time, difficulty, and scope of the work required for a complex assignment.

### **E. Penalties and Duty of Care Extending Credit**

While the new Section 129E does not explicitly impose a duty of care on appraisers with respect to consumers, it does prohibit a creditor from

extending credit if the creditor “knows” at or before loan consummation of a violation of the appraisal independence requirements in connection with a transaction secured by the consumer’s principal dwelling, unless the creditor documents that it has acted with “reasonable diligence” to determine that the appraisal does not materially misstate or misrepresent the value of the dwelling. This is not a new requirement as the FRB Rule currently provides the same prohibition. Under the Commentary to the FRB Rule (which may inform how TILA’s prohibition will be interpreted), “reasonable diligence” means that the creditor must obtain a new appraisal. The FRB Commentary also states that a misstatement or misrepresentation about a dwelling’s value is not material if it does not affect the credit decision or the terms on which credit is extended.

Civil penalties also are available against “each person” who violates Section 129E; they are not limited to creditors. For a first violation of Section 129E, a person would be subject to a civil penalty of \$10,000 for each day a violation continues. Further, for subsequent violations the penalty increases to \$20,000 per day. The assessment of these fees will be imposed by a federal banking agency under section 108(a) of TILA (until the enforcement authority is transferred to the Bureau), as applicable, or by the FTC under Section 108(c) (against those individuals not under the supervision of the entities named in Section 102(a)).

The penalty provisions assert that these civil penalties are in addition to the “enforcement provisions referred to in Section 130,” which would appear to limit the applicability of other provisions referred to in Section 130.

#### **F. Effective Date for Section 129E**

The FRB is charged with issuing interim final regulations specifying acts or practices that violate appraisal independence and otherwise defining terms used in Section 129E no later than 90 days after the Mortgage Reform Act’s enactment. The Mortgage Reform Act generally states that a section of the Act will take effect when any required rulemaking process is complete and final regulations implementing the pertinent section become effective.

With respect to Section 129E, the FRB is charged with promulgating interim implementing regulations, and since this rulemaking authority may cover any aspect of Section 129E, arguably the section in its entirety will become effective upon the FRB’s promulgation of the interim final regulations.

#### **G. Higher-Risk Mortgages**

Section 129H of TILA is added to impose additional appraisal requirements in connection with the origination of “higher-risk” mortgages. A “higher-risk mortgage” is a residential mortgage loan secured by a principal dwelling that is: (1) not a qualified mortgage (as defined in Section 129C);<sup>11</sup> and (2) a loan with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction, as of the date the interest rate is set: (a) by 1.5 or more percentage points, in the case of a first-lien residential mortgage loan having an original principal obligation amount that is equal to or less than the Freddie Mac conforming loan amount for a residence of the applicable size, as of the date the interest rate is set; (b) by 2.5 or more percentage points, in the case of a first-lien residential mortgage loan having an original principal obligation amount that is more than the Freddie Mac conforming loan amount for a residence of the applicable size, as of the date the interest rate is set; and (c) by 3.5 or more percentage points, in the case of a subordinate-lien residential mortgage loan. A higher-risk mortgage does not include a reverse mortgage loan that is a “qualified mortgage.” Given the limitations on non-qualified mortgages in the ability to repay requirements of the Mortgage Reform Act and the risk retention provisions in the larger Dodd-Frank Act, a “higher-risk mortgage” could be aptly renamed a “higher likelihood of never being made mortgage.”

Section 129H effectively prohibits BPOs or AVMs for the origination of a higher-risk mortgage by requiring a licensed or certified appraiser to conduct an appraisal by visiting the interior of the mortgage property. Further, if a higher-risk mortgage is used to finance the purchase of a mortgage property from a person within 180 days of that person’s purchase of the property at a price that was lower than the current sale price, the creditor must obtain a second appraisal from a different licensed or certified appraiser at no cost to the applicant. In addition to any other liability to any person under TILA, a

creditor found to have willfully failed to obtain an appraisal as required by this section will be liable to the applicant or borrower for \$2,000.

A creditor must provide one copy of each appraisal in connection with a higher-risk mortgage to the applicant without charge, at least three days prior to the transaction closing date. Section 129H also indicates that a creditor must provide a disclosure to the applicant at the time of the initial loan application that the appraisal is for the sole use of the creditor, and given its placement in the statute, it appears limited to higher-risk mortgages, but this conclusion is not free from doubt. Further confusing the matter is that this disclosure may be inconsistent with forthcoming rules on portability.

The federal agencies would be required to jointly prescribe regulations to implement the appraisal requirements for higher-risk mortgages and may jointly exempt, by rule, a class of loans if the federal agencies determine that the exemption is in the public interest and promotes the safety and soundness of creditors. According to the Mortgage Reform Act, a section or provision of the Act will generally not take effect until any required rulemaking process is complete, and final regulations implementing the pertinent section or provision are final. The rulemaking process must be finalized within 18 months of the “transfer date” (when the functions are transferred to the Bureau), and the final regulations must take effect within a year of their issuance. Since implementing regulations are required, it appears that Section 129H will take effect when the regulations are finalized.

## II. Changes to FIRREA and Guidance on use of BPOs, AVMs, and Appraisal Reviews

### A. Background

Twenty-one years ago, Congress enacted FIRREA in response to the S&L crisis.<sup>12</sup> FIRREA instituted appraisal reforms designed to enhance the quality of appraisals. Title XI of FIRREA requires federal banking agencies to establish appraisal standards for “federally related transactions,” which are defined as those real estate-related financial transactions that a federal banking agency engages in, contracts for, or regulates and requires the services of an appraiser.<sup>13</sup>

Subsequent banking agency regulations and Interagency Guidelines prescribe rules concerning the selection and monitoring of appraisers, approaches that an appraiser should use, and which transactions do not require an “appraisal,”<sup>14</sup> but do require at least an “evaluation.”<sup>15</sup> For example, according to the federal banking agencies, the requirements to obtain a full appraisal are not required for residential mortgage loans that are less than \$250,000, HUD- or VA-insured loans, and residential mortgage loans whose appraisals conform to Fannie Mae or Freddie Mac appraisal standards for that category of real estate.<sup>16</sup> While the federal banking agencies already suggest when an “evaluation” rather than an “appraisal” is required, Congress wades in by proposing a set of circumstances where an “evaluation” by a broker is insufficient.

### B. Limitations on Broker Price Opinions

FIRREA will be amended to provide that “in conjunction with the purchase of a consumer’s principal dwelling, broker price opinions [“BPOs”] may not be used as the primary basis to determine the value of a piece of property for the purpose of a loan origination of a residential mortgage loan secured by such piece of property.” The Mortgage Reform Act defines “broker price opinion” to mean “an estimate prepared by a real estate broker, agent, or sales person that details the probable selling price of a particular piece of real estate property and provides a varying level of detail about the property’s condition, market, and neighborhood, and information on comparable sales, but does not include an automated valuation model . . .” While the requirements of FIRREA are generally applicable to “federally related transactions,” the BPO restriction, on its face, applies more broadly to transactions involving “residential mortgage loans” secured by a “consumer’s principal dwelling.”

While the Mortgage Reform Act would essentially prohibit the use of BPOs as the primary basis for determining market value for certain mortgage originations, BPOs would not be prohibited entirely. For example, it appears that BPOs could be used in refinancings, establishing home equity lines of credit, and in connection with loss mitigation and collection efforts, to the extent not prohibited by state law.

### C. Standards for AVMs

The Mortgage Reform Act also adds a section to Title XI of FIRREA regarding quality control of AVMs. Advances in technology have prompted increased use of AVMs to derive values for residential transactions without resort to, or to supplement, an appraisal. The Home Affordable Mortgage Program, for example, authorizes AVMs (and BPOs) in lieu of appraisals to determine if a loan qualifies for a modification. Notably, the Mortgage Reform Act defines AVM to mean “any computerized model used by mortgage originators and secondary market issuers to determine the collateral worth of a mortgage secured by a consumer’s principal dwelling,” and obligates the federal agencies, in consultation with the Appraisal Subcommittee and the Appraisal Standards Board of the Appraisal Foundation to promulgate regulations to implement the quality control standards for AVMs. Such standards must, at a minimum: (i) achieve a high level of confidence in the estimates produced by AVMs; (ii) protect against the manipulation of data; (iii) seek to avoid conflicts of interest; and (iv) require random sample testing and reviews of AVMs (but the sampling does not expressly have to be carried out by a certified or licensed appraiser).

Since the provision requires implementing regulations, it would appear that this provision would become effective upon the effective date of those future regulations. Interestingly, the federal agencies are responsible for enforcing compliance with the future quality control regulations for those entities they regulate, and the FTC, the Bureau and the state Attorneys General are responsible for enforcing compliance with the future quality control regulations for all other participants in the market for appraisals of “1-4 unit single family residential real estate.” Similar to the BPO provisions above, it appears that this section of FIRREA applies beyond “federally related transactions.”

### D. Appraisal Reviews

The provision of FIRREA that requires federal banking agencies to prescribe appropriate standards for appraisals in connection with federally related transactions will be amended by the Mortgage Reform Act to add another minimum standard – that “the appraisal be subject to appropriate review for compliance with [USPAP].” During the Conference

Committee, additional language was stricken from this requirement, which previously conferred that all appraisal reviews for compliance with USPAP “including [an] appraisal review by a lender, AMC, or other third party organization, shall be performed by an appraiser who is duly licensed or certified by a State appraisal board.”

The deletion leaves open the possibility that professionals who are not certified or licensed appraisers in the state where the property is located may participate in appraisal reviews, although the type of review may be relevant. This is a contentious issue among state regulators, and getting attention by investors. For example, the Fannie Mae Selling Guide currently allows a desk review by a non-licensed or certified appraiser for quality control purposes. But that will change as Fannie Mae recently issued a policy change effective September 1, 2010, that a desk review which results in a change of the opinion of market value for something other than a mathematical error must be completed by an appraiser licensed in the state in which the property is located, and he or she must have access to the appropriate data sources and must possess the knowledge and experience to appraise the subject property with respect to both the specific property type and geographical location.<sup>17</sup>

### III. Appraisal Subcommittee’s New Role and Oversight of Appraisal Management Companies

Title XI of FIRREA will be amended to establish a real estate appraiser regulatory system involving an interrelationship among the federal government, the states, and the Appraisal Subcommittee of the Federal Financial Institutions Examination Council (“Appraisal Subcommittee”). Each state has a certifying and licensing agency (“state appraisal board”) that is responsible for supervising their appraisers’ appraisal-related activities. The Appraisal Subcommittee generally has the authority to: (1) ensure that the state appraisal boards meet requirements to certify/license appraisers and enforce appraisal standards in connection with federally related transactions; (2) ensure that the federal banking agencies implement appraisal standards for federally related transactions; and (3)

maintain a national registry for state certified and licensed appraisers.

### A. Appraisal Subcommittee's New Role

By amending FIRREA, the Mortgage Reform Act would bolster the authority of the Appraisal Subcommittee by giving it broad new powers and responsibilities to implement a regulatory framework to supervise the appraisal industry, including AMC's. The Mortgage Reform Act would also add a representative from the FHFA and the Bureau to the board of the Appraisal Subcommittee. The legislation greatly expands the scope of the Appraisal Subcommittee's responsibilities by authorizing it to:

- Monitor State Appraisal Boards. (1) Monitor the states' registration and supervision of the operations of AMCs; (2) Determine whether the state completes investigations, appropriately disciplines sanctioned appraisers and AMCs, and reports complaints to the national registries on a timely basis; and (3) Determine whether the state has adopted effective laws aimed at maintaining appraiser independence.
- Maintain National Registry for AMCs. Impose an annual registry fee for AMCs, and may impose a minimum registry fee to protect against AMC underreporting.
- Take Disciplinary Action. (1) Remove an appraiser or a registered AMC from a national registry on an interim basis pending state action; and (2) Impose sanctions against state appraisal boards that fail to have "effective appraiser regulatory programs."<sup>18</sup>
- Issue Regulations. Prescribe regulations on topics such as temporary practice, national registry, information sharing and enforcement.
- Establish Complaint Hotline and Encourage Appraiser Education. (1) Encourage states to accept pre-approved courses; (2) Establish an appraisal complaint hotline if it determines within 6 months that no national hotline exists; and (3) Follow up complaint referrals to state appraisal boards and federal regulators.

### B. Oversight of Appraisal Management Companies

AMCs – the business entities that administer networks of independent appraisers to procure real estate appraisal assignments on behalf of lenders - will soon become subject to a national registry and may become subject to supervision of state appraisal boards. The legislation would define the term "appraisal management company" to mean "in connection with valuing properties collateralizing mortgage loans or mortgages incorporated into a securitization, any external third party authorized either by a creditor of a consumer credit transaction secured by a consumer's principal dwelling or by an underwriter of or other principal in the secondary mortgage markets, that oversees a network or panel of more than 15 certified or licensed appraisers in a State or 25 or more nationally within a given year: (A) to recruit, select, and retain appraisers; (B) to contract with licensed and certified appraisers to perform appraisal assignments; (C) to manage the process of having an appraisal performed, including providing administrative duties such as receiving appraisal orders and appraisal reports, submitting completed appraisal reports to creditors and underwriters, collecting fees from creditors and underwriters for services provided, and reimbursing appraisers for services performed; or (D) to review and verify the work of appraisers."

We have started to see the enactment of state AMC registration laws. Currently, approximately 18 jurisdictions (12 of which were enacted in 2010) have enacted AMC registration laws and an additional eight or so jurisdictions currently have legislation pending. The definition of AMC in the federal law is similar to those found in state laws, although there are differences. For example, certain state laws may provide a de minimis exemption for AMCs (e.g. those that manage less than ten appraisals in a calendar year). Further, unlike the federal law, some of the state laws may not impose an exemption for AMCs that have less than a de minimis number of certified or licensed appraisers in their network. As described below, states must apply certain minimum standards in their registration of AMCs. Will the Appraisal Subcommittee consider a state that defines AMCs more narrowly than the Mortgage Reform Act to meet those minimum standards? A state appraisal

board can face sanctions for failing to have “effective” appraiser regulatory programs.

### 1. National Registry of AMCs

In addition to new minimum requirements for AMCs, as set forth below, the legislation amends FIRREA to require the Appraisal Subcommittee to maintain a new national registry of AMC’s that includes AMCs that either are registered with and subject to supervision by a state appraiser or licensing agency or are subsidiaries owned and controlled by a federally regulated financial institution and regulated by a federal financial institution regulatory agency. This registry is in addition to the one for individual appraisers. To carry out the new functions of the Appraisal Subcommittee, the legislation provides authority for it to impose an annual registry fee on AMCs, in addition to the fees imposed on individual appraisers of federally regulated transactions.<sup>19</sup>

AMCs, both a state registered entity or a subsidiary of a federally regulated institution, would be required to pay an annual registration fee. For a company that has been in existence for more than one year, the AMC must pay \$25 (which amount may be increased to \$50 at the discretion of the Appraisal Subcommittee) multiplied by the number of appraisers working for or contracting with such company in such state during the previous year. For a newer AMC, the Appraisal Subcommittee would use a similar calculation, but would determine the appropriate multiple (rather than base it on the number of employees). It appears that the AMC, regardless of whether it is registered with the state or a subsidiary of a federally regulated entity, would pay this fee to the state for transmittal to the Appraisal Subcommittee. It is unclear how AMCs would have to report the number of appraisers working for or contracted by the AMC, in particular when appraisers may be licensed in multiple jurisdictions.

What is clear is that this registry may impose a significant financial burden on AMCs. The legislation provides authority for further increases to these registry fees, upon approval if needed, and to adjust for inflation. Moreover, these registry fees may be in addition to those registration fees imposed under state AMC laws.

### 2. Minimum Requirements for AMCs

Under the new regulatory framework for AMCs, the federal agencies must jointly by rule establish minimum requirements to be applied by a state in its AMC registration. At a minimum, they must require that the AMC: (1) register with and be subject to supervision by a state appraisal board in each state where the company operates; (2) verify that only licensed or certified appraisers are used for federally related transactions; (3) require that appraisals coordinated by the AMC comply with the USPAP; and (4) require that appraisals are conducted independently and free from inappropriate influence any coercion pursuant to the appraisal independence standards under Section 129E of TILA. These requirements are the floor – states are not prohibited from establishing requirements beyond the minimum standards promulgated by the federal agencies.

AMCs that are subsidiaries of a financial institution are subject to the above minimum requirements, although the Mortgage Reform Act expressly states that they would not need to register with the state appraisal boards. By inference, it appears, although it is not clear, that subsidiaries of federally regulated institutions would be subject to the supervision of their federal regulator, whereas non-federally regulated AMCs would be subject to the supervision of state appraisal boards.

The legislation suggests that a state must implement a regulatory scheme for AMCs within three years of the federal agencies finalizing their rules establishing minimum requirements, subject to an extension by the Appraisal Subcommittee. In this regard, the legislation provides that no AMC may perform services related to a federally related transaction in a state after 36 months from final rulemaking implementing the minimum standards “unless such company is registered with such state or subject to oversight by a federal financial institution regulatory agency.” It appears that the Mortgage Reform Act contemplates two registration “tracks” – one for those subject to federal supervision and one subject to state supervision.

While the Mortgage Reform Act describes a state appraisal board’s regulatory responsibilities with

respect to AMC registration, which includes processing complaints, completing investigations, disciplining and sanctioning AMCs and reporting complaints of the AMC to the national registry, there is no parallel requirement in place for those AMCs not subject to state registration. Because the Mortgage Reform Act does not clearly establish any requirements on the federal agencies to enforce or supervise those AMC subsidiaries, there is an apparent gap in the statute. By contrast, in the loan originator context under the SAFE Act, the federal agencies are expressly charged with developing and maintaining a system for registering employees of federally regulated institutions with the NMLS. The Mortgage Reform Act indicates that subsidiaries of federally regulated entities would be subject to the national registry, but does not indicate how those entities would register. If they were registered with the state appraisal board, the board would be obligated to provide that information to the Appraisal Subcommittee. The federal agencies could, by regulation, create parallel requirements to ensure that AMCs are subject to uniform oversight.

In addition to the minimum requirements noted above, the Mortgage Reform Act also imposes a restriction that an AMC cannot be registered by a state or included on the national registry if the company, in whole or in part, directly or indirectly is owned by any person who has had an appraisal license or certificate refused, denied, cancelled, surrendered in lieu of revocation, or revoked in any state. Owners of more than 10 percent of the company are subject to background investigations, and must be of good moral character, as determined by the state appraisal board, although it is unclear if this restriction applies to owners of AMCs that are not subject to state registration. Overall, it appears that the Mortgage Reform Act would attempt to ensure that those who commit appraisal fraud or those who lose their licenses or certificates cannot turn around and establish AMCs.

#### IV. Miscellaneous Changes

The Mortgage Reform Act also makes changes to the Equal Credit Opportunity Act (“ECOA”) and an amendment to the Real Estate Settlement Procedures Act of 1974 (“RESPA”) regarding the disclosure of appraisal-related fees on the HUD-1 Settlement Statement (“HUD-1”).<sup>20</sup>

#### A. ECOA and Copies of Appraisal Reports

Section 701(e) of ECOA currently requires a creditor to furnish an applicant for credit with a copy of the “appraisal report” used in connection with the applicant’s application for a loan, upon the applicant’s request. The Mortgage Reform Act amends this provision to make the furnishing of “any and all written appraisals and valuations” developed in connection with the application for a first-lien loan mandatory, rather than at the consumer’s request. It would also impose a specific time frame within which the copy must be provided (no later than three days prior to the closing of the loan, whether the creditor grants or denies the applicant’s request for credit or the application is incomplete or withdrawn). It would require a creditor to provide notification, at the time of application, to the applicant of the right to receive a copy of each written appraisal and valuation, and the creditor could not charge the applicant a fee for providing the copy.

The Mortgage Reform Act would expand the statutory requirement to provide an “appraisal report” to cover “any and all written appraisals and valuations.” The definition of “appraisal report” under the current regulations of ECOA is arguably broad enough to include valuations, but the Mortgage Reform Act would clarify that such valuations, defined as “any estimate of the value of a dwelling developed in connection with a creditor’s decision to provide credit, including those values developed pursuant to a policy of a government sponsored enterprise or by an automated valuation model, a broker price opinion, or other methodology or mechanism,” would need to be provided to the borrower even if it is in addition to an appraisal.

The requirement that a creditor provide an applicant with a copy of an appraisal report promptly or no later than three days prior to closing is similar to the timing requirements on higher-risk mortgages under Section 129H of TILA. Moreover, these amendments are nearly identical to the requirements regarding appraisal reports under the HVCC.

According to the Mortgage Reform Act, a section or provision of the Act will generally not take effect until any required rulemaking process is complete, and final regulations implementing the pertinent section or provision are final. The amendments to

EOCA do not expressly require that an agency issue implementing regulations, and thus the effective date is unclear.<sup>21</sup>

## **B. RESPA and HUD-1 Settlement Statement**

The legislation adds a new subsection to Section 4 of RESPA that permits the HUD-1 form to include, in the case of an appraisal coordinated by an appraisal management company, a clear disclosure of (i) the fee paid directly to the appraiser by the appraisal management company; and (ii) the administration fee charged by such appraisal management company. Prior to the House and Senate Committee meeting, the itemization of the fees paid by a borrower and the disclosure of the persons or entities receiving the fees were mandatory.

## **V. Conclusion**

With the HVCC set to sunset, more expansive (and expensive) appraisal reforms are on the horizon. Although Congress has paved the way for substantial appraisal reform, the full extent of Congress' changes will not likely be known until the regulations on appraisal independence and the registration of AMCs are finalized and implemented.

[This client alert is part of a series of alerts focused on monitoring financial regulatory reform.](#)

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<sup>1</sup> Laurence E. Platt, Lorna M. Neill, *NYAG Leapfrogs Feds in Targeting Appraisals*, Mortgage Banking Alert, March 10, 2008, available at: <http://www.klgates.com/newsstand/Detail.aspx?publication=4375>.

<sup>2</sup> See "Home Valuation Code of Conduct," Federal Housing Finance Agency, available at <http://www.ofheo.gov/media/news%20releases/HVCCFinalCODE122308.pdf>. For more on the revised final Home Valuation Code of Conduct; see Phillip L. Schulman, Holly Spencer Bunting, *Appraisal Industry Remains Intact: FHFA Announces Revised Home Valuation Code of Conduct*, Mortgage Banking & Consumer Credit Alert, by January 13, 2009, available at: <http://www.klgates.com/newsstand/Detail.aspx?publication=5218>.

<sup>3</sup> The rule was published in the *Federal Register* on July 30, 2008. 73 Fed. Reg. 44,522. To read more about the FRB Rule more generally, see Kristie D. Kully, Laurence E. Platt, *Satisficing Subprime: New HOEPA Rules Might Just Be Good Enough*, Mortgage Banking and Consumer Credit Alert, August 5, 2008, available at: <http://www.klgates.com/newsstand/Detail.aspx?publication=4809>.

<sup>4</sup> See 15 U.S.C. § 1639 (l)(2).

<sup>5</sup> See, e.g., *Interagency Appraisal and Evaluation Guidelines* (Oct. 27, 1994) (issued jointly by the OCC, FRB, FDIC, and OTS) found at: OCC: Comptroller's Handbook, Commercial Real Estate and Construction Lending (1998) (Appendix E).

<sup>6</sup> 73 Fed. Reg. 44,522, 44566.

<sup>7</sup> The Home Valuation Code of Conduct ("Code") provides a lengthy and expressly non-exhaustive list of specific examples of prohibited conduct. See "Home Valuation Code of Conduct," Federal Housing Finance Agency, available at <http://www.ofheo.gov/media/news%20releases/HVCCFinalCODE122308.pdf>.

<sup>8</sup> The FRB Rule also presents "examples" of violations, which appear to be non-exhaustive: (1) Implying to an appraiser that retention of the appraiser depends on the amount at which the appraiser values the consumer's home; (2) Excluding an appraiser from consideration for future engagement because the appraiser reports a value of consumer's principal dwelling that does not meet or exceed a minimum threshold; (3) Telling an appraiser a minimum reported value of a consumer's principal dwelling that is needed to approve the loan; (4) Failing to compensate an appraiser or to retain the appraiser in the future because the appraiser does not value a consumer's principal dwelling; and (5) Conditioning an appraiser's compensation on loan consummation.

<sup>9</sup> Under section 129E of TILA, it is permitted to ask an appraiser to provide one or more of the following services: (1) Consider additional, appropriate property information, including the consideration of additional comparable properties to make or support an appraisal; (2) Provide further detail, substantiation, or explanation for the appraiser's value conclusions; and (3) Correct errors on the appraisal report. Under the FRB Rule, a creditor, mortgage

broker, or its affiliate may also: (1) Obtain multiple appraisals of a consumer's principal dwelling, so long as the creditor adheres to a policy of selecting the most reliable appraisal, rather than the appraisal that states the highest value; (2) Withhold compensation from an appraiser for breach of contract or substandard performance of services as provided by contract; and (3) Taking action permitted or required by applicable federal or state statute, regulation, or agency guidance.

<sup>10</sup> Section 129E provides that the term "fee appraiser" means a person who is not an employee of the mortgage loan originator or AMC engaging the appraiser and is: (1) a state licensed or certified appraiser who receives a fee for performing an appraisal and certifies that the appraisal has been prepared in accordance with the USPAP; or (2) a company not subject to the requirements of FIRREA that utilizes the services of state licensed or certified appraisers and receives a fee for performing appraisals in accordance with the USPAP.

<sup>11</sup> A "qualified mortgage" means any closed-end residential mortgage loan for which all the following apply: (i) The regular periodic payments for the loan may not: (I) Result in an increase of the principal balance; or (II) Except for certain balloon loans, described below, allow the consumer to defer repayment of principal; (ii) The terms of the loan do not result in a balloon payment (i.e., a scheduled payment that is more than twice as large as the average of earlier scheduled payments), except under certain circumstances; (iii) The income and financial resources relied upon to qualify the obligors on the loan are verified and documented; (iv) In the case of a fixed rate loan, the underwriting process is based on a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments; (v) In the case of an adjustable rate loan, the underwriting is based on the maximum rate permitted under the loan during the first 5 years, and a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments; (vi) The loan complies with any guidelines or regulations the Board establishes relating to ratios of total monthly debt-to-income or alternative measures of ability to pay regular expenses after payment of total monthly debt, taking into account the borrower's income levels and such other factors the Board establishes; (vii) The total points and fees payable in connection with the loan do not exceed 3 percent of the total loan amount (the Board is required to prescribe a points and fees threshold for "smaller loans" to meet the requirements of this presumption, considering the potential impact on rural areas and other areas where home values are lower); and (viii) The loan term does not exceed 30 years, except as such term may be extended under certain circumstances, such as in high-cost areas.

<sup>12</sup> Pub. L. No. 101-73, 103 Stat. 183 (1989).

<sup>13</sup> 12 U.S.C. § 3350(4).

<sup>14</sup> "Appraisal" is defined as "a written statement independently and impartially prepared by a qualified appraiser setting forth an opinion as to the market value of an adequately described property as of a specific date(s), supported by the presentation and analysis of relevant market information." 12 C.F.R. §§ 225.62(a), 323.2(a), 34.42(a), 564.2(a).

<sup>15</sup> The federal banking agencies have determined that "[a] formal opinion of market value prepared by a State licensed or certified appraiser is not always necessary." See, e.g., 12 C.F.R. §§ 225.63(b), 323.3(b), 34.43(b), 564.3(b).

<sup>16</sup> See 12 C.F.R. §§ 225.63(a), 323.3(a), 34.43(a), 564.3(a).

<sup>17</sup> See Fannie Mae Ann. SEL-2010-09: Selling Guide Updates and Additional Guidance on Appraisal-Related Policies (6/30/2010); see also 2010 Fannie Mae Selling Guide/B4-1.4-21, Appraisal Report Review: Valuation Analysis and Final Reconciliation (06/30/2010); 2010 Fannie Mae Selling Guide/D1-3, Lender Post-Closing QC Mortgage Review.

<sup>18</sup> A program's effectiveness would be based on "an analysis of the licensing and certification of appraisers, the registration of appraisal management companies, the issuance of temporary licenses and certifications for appraisers, the receiving and tracking of submitted complaints against appraisers and appraisal management companies, the investigation of complaints, and enforcement actions against appraisers and appraisal management companies."

<sup>19</sup> The Mortgage Reform Act also raises the annual registry fee for individual appraisers from a fee not to exceed \$25 to a fee not to exceed \$40.

<sup>20</sup> The Mortgage Reform Act also tasks the Government Accounting Office with the conduct of two studies, one involving the improvements in the appraisal process and the effects of the changes to the appraisal requirements of the Home Valuation Code of Conduct on the industry, and, the second involving the ability of the Appraisal Subcommittee to monitor and enforce state and federal certification requirements and standards. The Government Accounting Office must provide a report on the first study within 12 months of the enactment of the Mortgage Reform Act, as well as a report on the second study within an 18-month period.

<sup>21</sup> On the one hand, the Mortgage Reform Act says that any section of the Mortgage Reform Act "for which regulations have not been issued on the date that is 18 months after the designated transfer date shall take effect on such date." This would seem to say that those provisions of the Mortgage Reform Act that do not specifically require the applicable regulator to adopt implementing regulations do not become effective until 18 months after the designated transfer date, unless the applicable regulator decides to adopt regulations to implement the provisions anyway, and specifies an earlier effective date in those regulations. On the other hand, others have asserted that the foregoing effective date applies only to those provisions of the Mortgage Reform Act for which the applicable regulator is required to issue regulations. This would mean that the provisions for which a regulator is not required to issue regulations (either because regulations are authorized, but not required, or the section is silent with respect to implementing regulations) would be subject to the Dodd-Frank Act's default effective date - which is the day after the President signs the bill. This would be an alarming and unreasonable result given the time it would take to implement the many statutory requirements in an orderly manner.