April 30, 2008

The Honorable James B. Lockhart III
Director
Office of Federal Housing Enterprise Oversight
1700 G Street, NW
4th Floor
Washington, DC 20552

Mr. Richard F. Syron
Chairman and Chief Executive Officer
Freddie Mac
1551 Park Run Drive
McLean, VA 22102-3110

Mr. Daniel H. Mudd
Chairman and Chief Executive Officer
Fannie Mae
3900 Wisconsin Avenue, NW
Washington, DC 20016-2892

Dear Director Lockhart, and Messrs. Syron and Mudd:

The Mortgage Bankers Association (MBA)[1] submits this comment letter to express its concerns regarding the cooperative agreements (Agreements) signed by Fannie Mae and Freddie Mac (the GSEs), the Office of Federal Housing Enterprise Oversight (OFHEO) and New York State Attorney General Andrew Cuomo (NY AG) on March 3, 2008. MBA strongly suggests the Agreements and related Home Valuation Code of Conduct (Code) be withdrawn. If they are not withdrawn, then MBA believes they must be modified to reflect MBA's concerns for safety and soundness, as well as operational and procedural complications.

MBA takes no exception to valid efforts by OFHEO to restore confidence in the mortgage market through its regulatory activities respecting the GSEs. In fact, MBA

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 370,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

supports the objectives of ensuring sound underwriting practices, reducing mortgage fraud and making home valuations more reliable. MBA believes appraisals that substantially or materially overstate and/or understate the market value of properties can be harmful to lenders and unsuspecting consumers.

Nonetheless, MBA believes the Agreements and Code pose serious procedural and substantive concerns that present safety and soundness risks to the GSEs and financial institutions generally. Despite the Agreement's effect on lenders and the housing finance industry, there was no opportunity for industry or public comment prior to the development of the Agreements and Code. For these reasons, MBA urges OFHEO to open the process to revise the Agreements and Code in conformance with the requirements of the Administrative Procedures Act (APA),[2] following consultation with federal financial institution regulators, or at a minimum, mitigate these risks by incorporating the following Code modifications.

Moreover, without waiving its procedural objections, MBA notes that key terms of the Agreements and Code lack sufficient clarity and cause difficulties in determining the Code's scope. MBA's concerns are addressed in more detail below. MBA also offers suggested modifications to the Agreements and Code and request they be considered to ameliorate the Agreement's and Code's shortcomings.

Background

According to the NY AG, the Agreements are the byproduct of a state-based legal action initiated against a financial institution and its appraisal firm subsidiary. The GSEs were subpoenaed by the NY AG to provide information relevant to the case in November 2007. The Agreements between the NY AG, OFHEO, and the GSEs were announced to the public on March 3, 2008. The negotiations did not include public input or testimony from interested parties.

Issued in conjunction with the Agreements, the Code applies to all financial institutions engaged in mortgage-related transactions with the GSEs beginning January 1, 2009. The Code's operational and procedural restrictions on the manner in which financial institutions obtain home valuation appraisals will require significant operational restructuring by financial institutions to comply with the Code. A federally chartered financial institution must comply with the Code even if its primary regulator reviewed, examined and approved its existing appraisal-related activities for safety and soundness and consumer protection compliance. This causes conflict because some sections of the Code are incompatible with federal regulatory guidance on the same topic.[3]

[2] 5 U.S.C. §§ 551 *et. seq.*
[3] *See* Interagency Appraisal and Evaluation Guidelines, FRSS 3-1577 (Oct. 27, 1994); Interagency Statement on Independent Appraisal and Evaluation Functions, FRSS 3-1577.1 (Oct. 27, 2003).

General Substantive Concerns

MBA recognizes that appraisers are subject to significant pressure by various actors in the mortgage process such as borrowers, real estate agents, mortgage brokers and sometimes even commissioned employees of lenders. But MBA does not believe, that lenders as lenders or their affiliates present the same policy concerns respecting appraisers as the other transaction participants mentioned here.

Appraisals are services conducted for the benefit of lenders, and serve as the primary valuation tool for a mortgage loan's collateral. Appraisals are a means to verify the price agreed to between the buyer and the seller in a real estate transaction, and to test whether the buyer and seller might have been engaged in any collusion. When a home is over-appraised, lenders are left with a security interest that may not satisfy the debt in the event of foreclosure, and the over-appraisal may also lead to a claim for recourse. In this respect, lenders' interests are aligned with borrowers and a lender would be acting against its own interest were it to coerce an appraiser into over-inflating a property's value.

<u>The Code's Compliance Costs Do Not Effectuate Consumer Benefits</u>

The Code, as written, requires significant changes to lenders' business operations respecting appraisals. Specifically, Section VI of the Code prohibits lenders from relying on appraisals ordered or performed in house or by an affiliated entity. This is purportedly to prevent appraiser coercion. Unfortunately, the Code overlooks the fact that coercion is just as likely to be done by the borrower, or a real estate agent acting on behalf of the borrower. Moreover, the Code would hold the lender liable regardless of who performed the coercion.

MBA finds it notable that the Agreements and Code present no evidence to support the assertion that unaffiliated appraisers are less likely to be coerced than their in-house counterparts. Also missing from the Agreements and Code is documentation supporting the qualitative aspects independent appraisers *vis a vis* their financial institution-related counterparts. Without such a rationale, MBA finds no justification for quashing the current supervisory structure for federally chartered financial institutions, which calls for in-house appraisal departments or subsidiary appraisal companies to be routinely examined by the financial institution's chartering authority. Under the Code, this supervisory oversight would be eliminated. As a consequence, financial institutions would be required to rely on appraisers with limited accountability, comparatively little or no capital or net worth requirements, or even regular examinations. The Code would, in effect, significantly reduce oversight and accountability for much of the appraisal industry, a result that would seem contrary to the NY AG's objectives.

For financial institutions with in-house appraisal departments or subsidiaries, there are likely to be significant costs involved in recasting their corporate structures, terminating contracts, and rewriting business plans, policies and procedures. Each financial institution doing business with the GSEs would also incur costs associated with establishing and maintaining its own toll-free hotline to respond to appraisal inquiries. There would also be increased costs associated with litigation risk management activities in response to appraisal liability issues. On the other hand, all of these costs would ultimately be passed on to consumers. Many of these costs would be reduced, if not eliminated, if MBA's suggested modifications to the Code are implemented.

Finally, to the extent appraisals are not as effective by virtue of the Agreements and Code, any risks caused by mis-valued collateral might cause financial institutions and the GSEs to hold higher capital levels to offset any additional exposure from these risks. In light of the unprecedented liquidity concerns currently in the housing finance system, MBA requests that OFHEO reevaluate the justification for issuing the Code with such immediacy and finality.

The Code Supersedes Existing Statutory Provisions

Although the Code would formally apply only to loans eligible for purchase by the GSEs, it would have a major impact on the way federally regulated or federally insured institutions and their holding companies do business. As a practical matter, the GSEs' underwriting requirements have set the standard for the entire U.S. residential mortgage market. In fact, the clear intention of the NY AG and OFHEO in adopting the Agreements is to create a new national standard for home valuation that differs significantly from the appraisal standards instituted by Congress in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA).[4] In announcing the Agreements, the NY AG stated his belief that the Code would "be the model for the rest of the industry."[5] Originators of nonconforming loans have modeled their underwriting standards on those of the GSEs because those standards have been accepted by the secondary market. As mentioned above, the Code supersedes conflicting provisions of existing federal appraisal regulations. One of the unforeseen consequences of the Code is loans not complying with the Code would be unmarketable even if they comport with federal regulations because they conflict with the GSEs' new industry standards. Moreover, contrary to the NY AG and OFHEO, federal financial institution regulators recognize the role of the GSEs in setting rigorous underwriting standards by exempting loans that meet the GSEs' standards for appraisals from the agency regulations.[6]

The federal financial institution regulators have used their FIRREA-authorized discretion to issue rules that implement the FIRREA provisions, which go far beyond the minimum

[4] 12 U.S.C. §§ 3331-3353.
[5] *See* http://www.oag.state.ny.us/press/audio/3.3.08.Fannie&FreddieAgreementPressConference.mp3 at 16:13.
[6] *See, e.g.,* 12 C.F.R. § 225.63(a)(10)(ii).

standards required by the statute to comprehensively regulate the property evaluation process of financial institutions and their holding companies.[7]

The Agreements also conflict with both established and developing action by other federal regulatory agencies. For example, the Home Owners Equity Protection Act[8] is implemented through regulations promulgated by the Board of Governors of the Federal Reserve System (Board).[9] Proposed modifications to the regulations that will have an impact on all lenders are currently under consideration by the Board.[10] The Board's proposed modifications include a prohibition against appraiser coercion. In comments submitted to the Board's proposal, MBA expressed concern that the Code and the proposal would conflict with each other if they were both implemented. MBA requests that the Code, at a minimum, be modified for consistency with the Board's proposal.

It is important to reiterate the applicability of these regulations not only to lenders and their affiliates, but also to "institution-affiliated parties," including independent contractors such as appraisal management companies, as well as to individual staff appraisers and fee appraisers.[11] Thus, appraisal-management companies providing services to federally regulated institutions and their affiliates are already subject to a regulatory scheme that has been in effect for almost two decades and has worked well. In practice, the federal regulations have served as a *de facto* standard even for lenders that are not directly subject to them.

Procedural Concerns

MBA is aware of the *ex post facto* request for input initiated by the GSEs and OFHEO. However, MBA believes OFHEO's participation in the Code's issuance triggers formal procedural requirements mandated by the APA. Considering that the Agreements and Code have a significant effect on the lending industry, MBA members were harmed by the lack of opportunity to provide input in advance. Further, given the apparent divergence between OFHEO's action and existing statutory mandates, MBA specifically withholds endorsement of the Agreements and Code, and requests that submission of this letter not be construed as complicity with the procedural aspects of OFHEO's and the GSEs' request for input regarding the Agreements and Code.

Federal agencies, including OFHEO, are required to comply with the APA when promulgating rules and regulations. A rule is defined as "the whole or a part of an agency statement of general or particular applicability and future effect designed to

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[7] *See* 12 C.F.R. §§ 225.61-.67. The Federal Reserve Board's version of the regulations is cited in this letter. The other federal financial institution agencies' regulations are substantially similar. *See* 12 C.F.R. §§ 34.41-.47 (Office of the Comptroller of the Currency); *id.* pt. 564 (Office of Thrift Supervision); *id.* pt. 323 (Federal Deposit Insurance Corporation); *id.* pt. 722 (National Credit Union Administration).
[8] 15 U.S.C. § 1639
[9] 12 CFR Part 226
[10] 73 Fed. Reg. 1671-1735 (Jan. 9, 2008).
[11] *See* 12 U.S.C. § 1818(u)(1), (4).

implement, interpret, or prescribe law or policy."[12] In order for an agency to issue a rule, it must publish a notice of proposed rulemaking, solicit and consider public comments, and publish a final regulation that explains the basis and purpose of the regulation, and the agency's consideration of public comments.[13] All interested members of the public are entitled to have their comments considered, not just the regulated entities.

The APA requires rulemaking proceedings to be open to public comment so that interested parties can participate, point out unintended shortcomings or suggest alternatives. It also ensures there is a public record of the agency's deliberations.

Also, as a complement to the APA, the Regulatory Flexibility Act requires agencies to evaluate the recordkeeping and compliance burden imposed by the regulation, the impact of the regulation on small businesses and the steps taken to mitigate significant adverse impact.[14] A final analysis must also be conducted to summarize and respond to significant issues raised after the initial analysis. Other related Executive Orders require consultation with affected industries.

The request for market participant input undertaken by the GSEs as mandated by the Agreements does not satisfy OFHEO's obligation to abide by the APA. While MBA appreciates the GSEs accepting input from interested parties, it is a stretch to fully accept the announcement for the collection of comments on the matter through a simple posting on a Web site as "public notice." This is difficult when precedent for such announcements has been a venue of such notices, such as the Federal Register. Moreover, the GSEs are under no obligation to consider or account for input submitted to them, and, according to the Agreements, they may modify the Code only to "avoid unforeseen consequences."

With respect to compliance with the Regulatory Flexibility Act and Executive Orders, MBA believes that OFHEO would have found that a substantial number of entities would face a significant economic impact from enactment of the Code. MBA addresses this economic impact in the Operational Section below.

Jurisdictional Complications

MBA also believes the Agreements contain legal vulnerabilities associated with, among other things, jurisdictional complications. As mentioned above, the Agreements and Code confer duties and obligations on entities that were not parties to the Agreements. Moreover, a state attorney general initiated the Agreements, but the Agreements impact both state and federally chartered entities. Notwithstanding jurisdictional issues, the Agreements cause the well-established housing finance regulatory framework to be thrown into flux. Henceforth, the Agreements set a precedent for any state agency to

[12] 5 U.S.C. § 551(4).
[13] 5 U.S.C. § 553.
[14] 5 U.S.C. § 604.

alter the housing finance regulatory framework simply by negotiating an agreement with Fannie Mae or Freddie Mac. We urge OFHEO to take action in order to avoid this precedent-setting action. For example, we suggest OFHEO officially delay implementation of the Code and seek industry input through a formal notice and comment period pursuant to the APA.

Safety and Soundness, and Other Operational Concerns

MBA is gravely concerned the Code exposes the GSEs and other financial institutions to serious safety and soundness risks. As mentioned above, appraisals that overstate and/or understate the market value of properties are harmful to unsuspecting consumers. But it is equally important to consider that bad appraisals harm lenders and thereby increase the costs for consumers. Viewed in its proper context, appraisals are services conducted for the benefit of lenders, and serve as the primary valuation tool for lenders' collateral. When a home is over-appraised, lenders are left with a security interest that may not satisfy the debt in the event of foreclosure, and the over-appraisal may also lead to a claim for recourse. Moreover, lenders doing business with the GSEs' must represent and warrant compliance with applicable federal laws and the GSEs' appraisal requirements. According to the GSEs', noncompliance could result in the lender repurchasing the loan.

Whether they hold loans in their portfolio or sell them to investors on the secondary market, mortgage lenders will suffer losses when a default occurs due to fraud. As a general rule, lenders do not benefit from loans that default even when they have sold the loan into the secondary market. Lenders lose money even if they do not currently own the loan, because they usually must buy back fraudulent loans from the investor and then try to recover what they can from the parties who committed the fraud.

These potential losses give lenders a strong incentive to avoid overvaluation of the property that serves as security for loans that they originate. By contrast, few if any appraisers have the capital to make good on defaults caused by an erroneous or deliberately misleading appraisal. Lenders, therefore, have a strong interest in the veracity of appraisals, and for this reason, their interests are aligned with those of responsible consumers.

<u>Other Unforeseen Consequences</u>

Appraisal Hotline – Section VII of the Code requires lenders to establish telephone and e-mail hotlines to receive any complaints from appraisers, individuals or any other entities related to improperly influencing appraisers or the appraisal process. Given the timing of the delivery of the appraisal, and the notice that will accompany the appraisal, MBA is concerned that the lender hotline will be used primarily as a means for borrowers to call with questions about the general valuation of property rather than concerns about improper influence. It is likely that many consumers will have questions about reading and interpreting the appraisal, and will use the lender hotline to ask those questions. In effect, this injects the lender squarely into the process from which it was to be separated – a discussion about property value. The lender will be in a tenuous position to discern whether such questions amount to “complaints” that merit formal investigation, or whether no action should be taken, and risk inaction.

Clarify Retaliation – MBA is also concerned about the phrase “retaliate, in any manner or method.” Without further clarification, this could put lenders in an untenable position in certain cases. For example, if a borrower was appropriately denied credit after calling the hotline, does the Institute evaluate whether that denial was retaliation? Likewise, if an appraiser suspected of fraud calls the hotline, is the lender at risk for a claim of retaliation by taking action in regard to the suspected fraud?

Quality Control – Section VIII of the Code of Conduct requires lenders to perform a quality control review of a randomly selected 10 percent (or other statistically significant percentage) of the appraisals, valuations or evaluations that are used by the lender, including the results of automated valuation models (AVMs), brokers price opinions or “desktop” evaluations. MBA members who are federally regulated currently have robust quality control programs in this regard that have been designed in cooperation with their regulator, but they are not based on a randomly selected 10 percent. MBA assumes that these programs meet the “statistically significant percentage” requirement, but is concerned that the Institute may assert the authority to direct certain aspects of our quality control programs. It is MBA’s position that, to the extent that a lender has established quality control procedures in conjunction with its primary regulator, its quality control should be sufficient.

Quality Control Reporting – Lenders are also required to report the results of quality control testing to the Institute. It is unclear what “results” have to be reported, who will have access to those results, and what action will be taken based on the results. To the extent that results may include customer information or detailed information regarding MBA’s quality control process (particularly with AVMs), we have a significant concern about protecting proprietary information and maintaining confidentiality. MBA questions whether requiring lenders to provide results of quality control testing to the Institute furthers the goals of the Code.

Duty to Report Certain Conduct – In addition to reporting on investigations through its hotline and quality control reports, lenders are required to report illegal or unethical conduct by appraisers to the Institute. Unlike other reporting requirements placed on banks, such as Suspicious Activity Reports (SARs), there is no “safe harbor” for institutions providing reports. It is questionable whether an agreement of this nature could include an enforceable safe harbor provision, one that lenders could on rely if challenged by a third party. This general reporting requirement may open lenders up to liability and, in some cases, may put protection granted for other mandated reporting, such as SARs, at risk. The questionable status of an enforceable safe harbor again raises the question of the procedural and implementation concerns expressed earlier in this letter.

Privacy Concerns – These reports will necessarily include customer information. Lenders are required under federal laws to maintain the confidentiality of that information. They can provide customer information to third parties only after ensuring the third party will have sufficient protections in place, and will limit its use and disclosure of the customer information. It is unclear what controls will be in place for the Institute to handle and safeguard this information, or how that information will be used or disclosed. Given the funding amounts set out in Section 9 of the Agreements, it is questionable whether the Institute will have sufficient capital to afford technology to appropriately safeguard and segregate customer information. It is MBA's position that the Institute would need to enter into individual agreements with lenders to safeguard customer information and must be subject to security audits by an independent third party.

Risks Assumed from Reporting – In some situations, such as appraisal fraud, these reporting requirements may conflict with other obligations, such as the confidentiality requirement for SARs, placing lenders at risk.

Registry for Appraisal Fraud – MBA agrees with the establishment of a national registry for appraisal fraud, misconduct and violations of the Uniform Standards of Professional Appraisal Practice (USPAP). However, it is our view that neither the role nor governance of this Institute is adequately clarified. Also, given the scope of authority for the Institute set out in the Agreements, MBA has serious concerns about the adequacy of funding or infrastructure in terms of the January 1, 2009 effective date.

The Agreements establish and fund the Institute which has authority to:

- Monitor and study the integrity of appraisal processes;
- Propose amendments to the Code for approval by the NY AG and OFHEO'; establish a complaint hotline for customers,
- Field complaints from appraisers;
- Mediate certain customer complaints;
- Receive quality control reports from lenders;
- Receive information on lender investigations and illegal and unethical appraiser activity; and
- Make bi-annual public reports.

Institute's Authority – The Agreements describe the Institute simply as an independent entity. Although loosely defined, the Institute has a great deal of authority and will receive a significant amount of sensitive and confidential information. Board members must be approved by the NY AG and OFHEO, but there is very little information on its governance. It is unclear how many board members the Institute will have, how long they will serve, or what governance standards will be in place.

Institute Must be Objective – The Institute may affiliate with an existing academic, professional and/or industry organization. MBA is concerned as it appears that the

Institute may have very broad latitude to affiliate with an organization that is antagonistic toward mortgage lenders. Given the absence of governance provisions, and its ability to affiliate with another organization of its choice, there is a concern that the Institute could become focused on a specific agenda of that organization.

Adequate Funding – The Agreements set out mandated contributions from the GSEs, which appear to be $2 million in the first year. It is questionable whether this is sufficient to allow the Institute to have adequate capital, infrastructure or expertise in place by January 1. This is significant for several reasons, one being the sensitive information that it will receive from lenders across the industry. Such information must be safeguarded and segregated to acceptable standards through a security program.

Complaint Mediation – The Institute, in its judgment, can mediate complaints. It is unclear what mechanism and process will be used for this mediation, or what complaints might be subject to mediation. Assuming the Institute is claiming the authority to mediate customer complaints, it seems that the Institute may be mediating a dispute that ultimately leads to a final determination of property value. This is of concern because the final determination of property value will drive many aspects of a particular loan. If the Institute undertakes this type of mediation, the loan transaction would not be able to be structured, or may have to be restructured, based on the outcome. It is MBA's position that the Institute should not be used to mediate complaints, particularly complaints where mediation ultimately leads to a final determination of property value.

Relation to Other Rules – A primary concern with the Institute is clarification on where it fits within the existing framework. Title XI of FIRREA establishes an oversight structure for real estate appraisals and appraisers that involves several entities. It is unclear how the Institute interacts with the Appraisal Subcommittee, the Appraisal Foundation (which creates USPAP), the Appraisal Standards Board and the Appraiser Qualifications Board. It is also unclear what a lender obligations are if the standards from the Institute (through recommended changes to the Code conflict with those established pursuant to FIRREA. Creating the Institute without sufficient governance, clarity and structure will add confusion to this area.

Automated Valuation Models – While the Code is directed at appraisals, there are several references to AVMs. For example, AVMs are included in Sections I (9), Section VI and Section VIII. Including AVMs in the scope of this Code raises significant concerns to MBA. AVMs are not synonymous with appraisals. In contrast to an appraisal, AVMs are designed to function without subjective, human involvement. Also, there are few widely accepted, uniform standards for AVMs. Lenders routinely use both an AVM and an appraisal in many situations, including the origination process. A common example would be an initial AVM followed by an appraisal. Under Section I, 9, this practice may be contrary to the Code of Conduct, even though it has no impact on appraiser independence.

In addition, it is also of concern that Section VIII, quality control, applies to AVMs. MBA's federally regulated members have established strong quality controls in this area in close coordination with their regulators. Quality control in the area of AVMs remains subjective and complex, as there is not a universal, objective standard for AVM quality. Further, quality control reports on AVMs will likely contain sensitive and proprietary information.

Without clarification based on a clear understanding of the role of AVMs, these provisions will have unintended negative consequences in the marketplace. Therefore, it is MBA's position that AVMs should not be incorporated in the Code.

Implementation Clarification – Section 12 of the Agreements purports to terminate most provisions of the Agreements to 28 months from the time of execution. However, because the Code provisions regarding the Institute do not terminate, it is unclear what happens to these obligations after 28 months. MBA requests clarification regarding the length of these obligations, the duration of the Agreements and Code, and by adding specificity to the effect of Section 12 of the Agreements.

Second Appraisals – Limitations on ordering a second appraisal in Code Section I, 9 conflict with certain requirements to obtain a second appraisal for certain high value property. This requirement is based on property value, not loan amount. The increased GSE loan value limit authorized by the Economic Stimulus Act of 2008 likely will cause a significant number of properties to be subject to this requirement. Therefore, MBA requests the second appraisal requirements of the Code be modified.

Sharing Sales Contracts – Section I, 6 of the Code prohibits a lender from providing an estimated or desired valuation or target amount to the appraiser. The appraiser may be provided a copy of the sales contract. From an operational perspective, appraisers may be provided with certain data elements from the sales contract, but not an actual copy of the sales contract. MBA believes this practice is consistent with the intent of this provision, and the language should be clarified to accommodate this practice.

Loan Servicing – The last paragraph of Code Section VI allows lenders to obtain or prepare appraisals for transactions other than mortgage originations. This should be clarified to include obtaining appraisals for servicing functions, such as an assessment of whether mortgage insurance is still needed for a particular borrower.

Consumer protection

MBA is also concerned about the negative impact of the Code on consumers. One of the benefits of in-house or subsidiary appraisal departments is that, through economies and efficiencies of scale, lenders are able to offer a package of services at a lower cost than the same services priced separately. Oftentimes, other services subsidize the appraisal, thus lowering the appraisal's cost. Therefore, because the Code requires appraisals to be conducted by an unaffiliated entity, the appraisal's cost is likely to be higher. Consumers pay these costs as part of the mortgage transaction.

MBA also finds the quality control requirements outlined in Section VIII impose an onerous and costly threshold on lenders yet provide inadequate guidance on critical procedural elements. For example, Section VIII contains no specifications on the quality control data to be tested and reported. The lack of standard criteria will result in each institution establishing its own quality metrics, thus cross-company comparisons will be difficult if not impossible.

Consumers have also benefited from the reduced appraisal time, new and improved valuation products and other technological improvements generated by in-house, subsidiary or affiliated appraisal firms. In-house or otherwise related appraisal firms also receive a higher level of quality control and consistency. For example, many financial institutions incorporate appraisal review panels, or quality control software.

Recommendations

MBA reiterates its endorsement of federal and state efforts to enhance the oversight of appraisal providers and develop more robust consumer protections. We generally support provisions of the Code that further refine the definition of appraisal-related misconduct (Code Section I). MBA also endorses the Code's provisions requiring the lender to select, retain and provide for compensation of the appraiser (Section III). We also support the flexibility provided in Section III for a lender to use an appraisal management company or to rely on an appraisal obtained by a correspondent lender. The Code's provisions (Sections IV and V) to establish firewalls between loan production staff and those who select appraisers are also supported by MBA.

With respect to Section VI of the Code, MBA requests a modification to allow the use of in-house and affiliate appraisers and appraisal service-providersif the lender represents and warrants that it is in compliance with appraisal regulations and guidelines issued by the federal banking agencies. Another approach MBA would endorse is to require staff appraisers and affiliated companies to be organizationally and financially independent from loan-production staff.

If this recommendation is not approved, MBA requests clarification of the term "employed by" in Section VI so that it is interpreted by its plain meaning and does not include independent contractors.

With respect to Section VIII, MBA requests more clarity regarding the quality control review and reporting process. We specifically request that lenders be permitted to rely on their own quality control procedures so long as they first demonstrate the procedures' reliability and validity.

Many of MBA's members have extensive correspondent lending relationships. MBA believes lenders should be able to reasonably rely on the representations and warranties of these correspondent lenders in regard to their compliance with the Code. Clarification of this point would allow lenders and correspondents to understand their respective Code obligations.

MBA also suggests definitions of critical terms be incorporated into the Code. Attachment 1 to this letter provides a list of terms MBA believes are critical to Code compliance.

Conclusion

MBA believes the Agreements and Code are a useful catalyst for initiating improvements to the appraisal oversight process. We urge OFHEO and the other parties to the Agreements to reopen the negotiations to permit the public and other interested parties to have an opportunity to share their views and establishing an appraisal code of conduct that has the support of the entire financial services industry. Finally, as indicated, MBA requests that submission of this letter not be construed as concurrence with the procedural aspects of OFHEO's and the GSEs' request for input regarding the Agreements and Code. MBA notes that the compliance date of January 1, 2009 is only eight months away. Given the scope of changes necessary to comply with the Code, MBA requests a prompt response to our concerns.

Please do not hesitate to contact me if you have questions concerning MBA's perspective.

Regards,

Kieran P. Quinn, CMB
Chairman
Mortgage Bankers Association

Attachment 1

Suggested Definitions

Affiliate: Define in accordance with RESPA. RESPA provides that an affiliated business arrangement exists when: (1) a person in a position to refer settlement business, or an "associate" of such person, has an "affiliate relationship"[15] with, or a direct or beneficial ownership interest of more than one percent in, an entity to which business is referred; and (2) either of such persons directly or indirectly refers settlement service business to the provider or affirmatively influences the selection of that provider.

Appraisal Management Company: Define as a vendor management company that manages independent, licensed and certified third-party appraisers, and that may or may not offer other settlement services besides appraisals.

Appraisal report: Clarify to mean any document which follows USPAP standards 1 or 2 and includes a value opinion.

Employed by: Define expressly to exclude independent contractors and to mean a formal, employer-employee contractual relationship, consistent with both general legal principles (see, e.g., 53 Am. Jur. 2d, Master and Servant, § 2) and the Internal Revenue Service description of an employee versus an independent contractor (see IRS Revenue Ruling 87-41, 1987-1 C.B. 296.

Increased Compensation: Section I of the Code sets out broad prohibitions designed to prevent using fees or bonuses to influence the valuation to be determined by an appraiser. MBA agrees with this premise, but believes that certain clarification is necessary to avoid unintended consequences. For example, it is routine to make extra payment for "rush" appraisals, or to pay mileage on long-distance appraisals. Clarification is necessary to ensure that these routine fees are not prohibited as increased compensation for an appraiser.

Instruction: As used in the preamble of Section I, this word should be removed. This word is ambiguous and cannot be clearly defined in a way that will be workable in the Code. For example, this word could be confused with standard "instructions" that a lender may provide to request special analysis due to declining markets or soft values, or to consider the impact of a limited access easement of which the lender is aware and needs to inform the appraiser about. It could also be confused with the USPAP Scope of Work process, when an appraiser must identify an appraisal problem to be considered in the appraisal. This process requires input (and perhaps "instruction") from the lender. The other words used to define improper pressure are adequate without the use of "instruction."

See 12 U.S.C. § 2602(7).

List: As used in Section 1, Part 6, should be clarified. Appraisal management companies maintain various, appropriate “lists” to manage the appraiser panels. Such lists may include specific information about appraisers’ geographic competence; jurisdictions in which they are licensed; appraisal products for which appraisers have special expertise; and/or the level of licensing (licensed or certified). The word “list” should be removed and replaced with “approved panel”, as used in Section V.

Mortgage Broker: The Code should clarify this definition to prevent any unintended application of the Code’s limitations.

Qualifications of Employees: Section V of the Code addresses the qualifications of lender employees involved with selecting appraisers for an approved panel. MBA requests clarification of these standards.

Settlement Services: Section VI, (5), of the Code incorporates the definition of settlement services found in the Real Estate Settlement Services Providers Act (RESPA). Read literally, lenders selling to the GSEs could not use appraisers employed by appraisal management companies, even if the appraisal management company was not affiliated with a lender.

Small Bank: Section IV of the Code provides allows an exception to the “absolute lines of independence” standards for institutions unable to achieve that standard because of small size and limited staff. For those institutions, the lender must “clearly demonstrate that it has prudent safeguards to isolate its collateral evaluation process from influence or interference from its loan production process.” The language in Section IV does not provide sufficient guidance or clarity to know which institutions might be sufficiently small to avail themselves to this provision, and what safeguards would be sufficient to meet this standard. Without clarification, institutions may struggle to either make or rely upon this representation.

Vendor Management Company: Defined as an entity that manages independent, licensed and certified third-party service providers that offer one or more types of products and services necessary to close a mortgage loan to mortgage lending institutions.