TAVMA
Title/Appraisal Vendor Management Association

April 22, 2008

VIA UPS

Home Valuation Code of Conduct Response
Attn: Senior Vice President
Credit Risk Oversight
Freddie Mac
1551 Park Run Drive
Mail Stop D2Z
McLean, VA 22102-3110

Re: Comments on Proposed Home Valuation Code of Conduct

To whom it may concern:

The Title and Appraisal Vendors Management Association ("TAVMA") appreciates this opportunity to provide comments on the proposed Home Valuation Code of Conduct ("Code") for appraisals. TAVMA has a unique perspective on the appraisal issues that the Code addresses since many of its members are large appraisal firms, vendor management companies ("VMCs") and appraisal management companies ("AMCs") that provide real estate appraisals. TAVMA has followed the issue of appraisal independence closely for many years and has provided drafting comments for both state and federal proposals on the issue.

TAVMA is a non-profit professional organization headquartered in Pittsburgh, Pennsylvania that represents more than 80 companies engaged in the real estate settlement services industry. TAVMA promotes the vendor management industry and presents its members' positions to government and media, protects its members' rights to do business without unfair and anticompetitive legislation and regulations, and provides useful information about issues impacting the real estate settlement services industry.

TAVMA's members share the concerns of Fannie Mae and Freddie Mac (collectively, the "GSEs") and others regarding appraisal independence and undue influence upon property valuations. We therefore support and applaud state and federal efforts to implement appraisal reform and safeguard appraisal independence, which is crucial to the integrity of the mortgage process. However, the current draft of the Code, as well as Freddie Mac's interpretation of its provisions in a March 5th bulletin, are overly broad and go farther than is necessary to accomplish the Code's objectives. In fact, the current scope of the Code actually may hinder rather than promote the very goals the parties seek to achieve. If the GSEs interpret the Code to prohibit lenders from retaining appraisals from VMCs and AMCs, the result will be a sharp reduction in the availability of appraisers and competition within the industry. Such a broad interpretation also will, among other things, increase costs to consumers without improving the quality of appraisals, hinder appraisal independence and further strain the mortgage market, and ultimately jeopardize the financial safety and soundness of Fannie Mae and Freddie Mac. Certain clarifications are essential to ensure that these types of unintended consequences do not ensue.

Below TAVMA (I) offers an Executive Summary of its comments, followed by: (II) a brief introduction to and summary of the Code provisions; (III) a discussion of the legality of the Code's adoption through Cooperation Agreements; (IV) an explanation of how VMCs and AMCs operate and their role in the appraisal process; (V) a comparison of the language of the Code to published interpretations thereof respecting application of the Code's prohibitions to VMCs and AMCs; (VI) a discussion of the ramifications of excluding VMCs and AMCs from the appraisal business; (VII) recommendations for revisions to the Code that TAVMA believes will further the parties' underlying goal of appraisal independence while avoiding at least some of the pitfalls created by the current draft and interpretations; and (VIII) a brief conclusion of TAVMA's concerns and recommendations. We hope that the GSEs, as well as the Office of Federal Housing Enterprise Oversight ("OFHEO"), will seriously evaluate TAVMA's comments and seriously consider making revisions to the Code prior to its implementation.

I. EXECUTIVE SUMMARY

The purpose of this letter is to comment on the practical effects of the Code and make drafting recommendations that TAVMA believes will assist the parties in their efforts to achieve appraisal independence without having unintended negative consequences for consumers or jeopardizing the financial integrity of the GSEs. While the Code will make sweeping changes to how mortgage lenders conduct their businesses and how appraisals are provided, and while various Code provisions will have different effects on different types of businesses, TAVMA defers to other trade associations to present their views of the Code and its likely impacts upon their memberships. TAVMA's comments and recommendations focus on the Code's potential exclusion of VMCs and AMCs from the appraisal business.

Initially, we note that **OFHEO's authority to obligate the GSEs to adopt the Code through Cooperation Agreements is questionable**. While TAVMA recognizes OFHEO's broad authority to regulate the safety and soundness of the GSEs and to issue related supervisory guidance, OFHEO must adhere to the procedural constraints set forth in the Administrative Procedure Act ("APA"), 5 U.S.C. §§ 551 et seq., in carrying out its duties. The Code is tantamount to a substantive rulemaking by OFHEO, and the mere fact that the Code is shrouded in Cooperation Agreements does not strip it of its nature or relieve OFHEO of its APA responsibilities. As a substantive rulemaking that significantly affects individual rights and obligations, the Code is subject to notice and comment procedures and its implementation should be delayed pending compliance with the APA.

Moreover, even assuming its legality, the Code is overly broad and clarifications are essential to ensure its proper implementation without risking devastating consequences to both consumers and the mortgage/appraisal industry. Of most concern to TAVMA is the issue of whether the Code effectively eliminates most VMCs and AMCs, as they exist today, from the appraisal business.

The express language of the Code does not prohibit VMCs and AMCs from engaging in the appraisal business. The Code's prohibitions apply to appraisers "employed by" the listed entities, not to entities that use independent contractors. VMCs and AMCs, however, do not employ appraisers and so would not be excluded under the Code. In fact, several provisions of the Code expressly state that a lender may obtain appraisals from AMCs. Nevertheless, **it has been suggested in the media that the term "employed by" was intended to include independent contractors and Freddie Mac issued a bulletin expanding the Code's language to cover entities that offer any other services other than appraisals**. Such interpretations would prohibit lenders from obtaining appraisals from VMCs and AMCs.

Vendor managers, including AMCs, have grown and evolved alongside mortgage lenders. During the last two decades, the lending industry began to outsource more of its settlement services to external providers. Due to specific lender requests, many external providers began to offer a broader array of services and products in order to offer "one-stop" solutions for lenders. The VMCs that now provide multiple services and products have grown to become major solution providers in the mortgage lending industry. The AMCs have improved the accuracy, efficiency and quality of the appraisal process. These improvements, in turn, have enhanced public trust in the real estate valuation industry. The Code, however, as interpreted by Freddie Mac, now threatens to force the appraisal industry to regress by reverting to less efficient and more costly business practices without improving the quality of appraisals. The potential ramifications of excluding VMCs and AMCs from the appraisal process are numerous and severe. As discussed in greater detail below:

- **Undue influence on appraisals will increase.** VMCs and AMCs are less susceptible to pressure than other providers of appraisals and actually mitigate lender pressure on appraisers by acting as true intermediaries between lenders and appraisers and protecting appraisers in their networks from manipulation or coercion. Statistical data based on appraiser surveys support these facts, and exclusion of VMCs and AMCs from the appraisal business would prevent appraisers from working through companies designed to protect their integrity and give greater control to those entities that are more likely to exert undue influence.

- **The likelihood of appropriate appraisal assignments, and thus the quality of appraisals, will decrease.** VMCs and AMCs not only ensure that their networks include licensed, insured, experienced and qualified appraisers, but also ensure that each appraisal assignment is directed to an appraiser possessing the qualifications to perform an appraisal in the particular market and on the particular type of property transaction. Exclusion of VMCs and AMCs may lead to a greater percentage of more haphazard assignments without consideration of individual appraiser qualifications, thereby threatening a decline in the number of quality appraisals.

- **Quality control will decline.** VMCs and AMCs perform unbiased quality control reviews of all appraisals both before and after loan closing. They are typically familiar with the complex federal and state laws and regulations that govern appraisals in the various states where they do business and are in a better position than lenders to ensure appraisers' compliance with them. Exclusion of VMCs and AMCs will leave the appraisal industry in the hands of entities that do not have the capability to achieve the same level of objectivity and stringency.

- **It will be more difficult to monitor appraisal activity.** VMCs and AMCs have invested millions of dollars in technology and recordkeeping practices that make it substantially easier to monitor appraisal activity and identify undue influence on property valuations. Exclusion of VMCs and AMCs therefore will result in even less information being available.

- **The market's ability to satisfy appraisal demands will be strained and costs to consumers will increase.** Due to their maintenance of advance technologies and efficiencies of scale, VMCs and AMCs are in a better position than other providers of appraisals to assure timely delivery of appraisals to consumers at reasonable prices. Their exclusion from the appraisal business would force smaller appraisal firms to assume their business portfolios (consisting of many millions of appraisals per year) and pass on the costs of doing so to consumers, despite the fact that such smaller providers may lack the workforce, capital, and technology to cover the increase in workload. The exclusion of VMCs and AMCs also would result in increased costs to lenders, which would be forced to bring appraisal functions in-house, as well as increased costs to appraisers, who would be forced to assume responsibility for marketing and client management that VMCs/AMCs otherwise do for them. Lenders and appraisers in turn would pass on their increased costs to consumers, who would suffer higher prices for ultimately slower and lower quality services.

- **The safety and soundness of the GSEs will be compromised.** The exclusion of VMCs and AMCs from the appraisal business ultimately would jeopardize the GSEs' financial safety and soundness. For the reasons discussed above, their exclusion would increase the risk of undue influence on appraisers and thus inflated property valuations, decrease the likelihood of appropriate appraisal assignments and thus the likelihood of quality appraisals, and impede quality control and appraisal monitoring, thereby reducing the overall quality of appraisals and thus the value of the mortgage loans sold to the GSEs. These effects would negatively impact the GSEs' credit risks and thus undermine the credit risk management aspect of their financial safety and soundness.

To overcome the foregoing obstacles and permit VMCs and AMCs to remain in business without compromising the Code's substantive requirements or threatening its ability to achieve the drafters' goals, **TAMVA makes the following recommendations**:

- **Delay implementation of the Code pending notice and comment pursuant to the APA and Congressional consideration of the Code's content during deliberations of various pending bills that will address the appraisal independence issue.**

- **Add a definitions section that includes definitions of at least the following terms – "affiliate", "vendor management company", "appraisal management company", and "employed by". Clarify other definitions, as described later herein.**

- **Add language at the beginning of Paragraph VI of the Code to clarify that the term "employed by" is to be interpreted by its plain meaning and does not include independent contractors.**

- **Withdraw Paragraph VI(5) altogether.**

- **Withdraw Paragraph VI(6) altogether.**

- **Revise and clarify the exception for lender ownership in Paragraph VI to extend it to affiliates of lenders and other settlement service providers, as well as to ownership of all appraisal providers and not just AMCs.**

As Fannie Mae and Freddie Mac are the largest purchasers of mortgage loans in the secondary market, the Code will have a colossal and unprecedented effect on the delivery of appraisals, lender operations, and corporate ownership of various entities. It will force countless entities to close their doors and others to divest their ownership interests, and will drive up costs to mortgage lenders, appraisers, and ultimately consumers without improving the quality of appraisals. All this will occur at a time when the mortgage industry is in crisis and cannot handle additional financial burdens. Clarification and revision of the Code to ensure the ability of VMCs and AMCs to continue participation in the appraisal business would assuage at least some of the unintended consequences that would ensue from the current draft of the Code and Freddie Mac's bulletin. It is absolutely imperative the GSEs ultimately implement a workable set of rules for which all parties to a mortgage transaction have a common understanding and that has as few unintended negative consequences as possible.

II. INTRODUCTION – THE HOME VALUATION CODE OF CONDUCT

To approve mortgage financing in any given case, an appraiser usually is needed as an objective third party to evaluate the property and confirm its underlying value. All federally insured loans in excess of $250,000 are required to have an appraisal under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), 12 U.S.C. §§ 3331 et seq., and regulators, lenders, and others may require appraisals for loans that FIRREA does not cover. Alongside these requirements, standards for appraisals have been developed – most notably, the Uniform Standards of Professional Appraisal Practice ("USPAP"), a set of guidelines issued by The Appraisal Foundation to which appraisers must adhere – that address the issue of appraisal independence, and both state and federal legislatures and regulators have addressed the issue.[1]

Nevertheless, on March 3, 2008, based upon the results of his investigation into mortgage lenders' appraisal practices, New York Attorney General ("NYAG") Andrew M. Cuomo announced that his office had entered into Cooperation Agreements with OFHEO, Fannie Mae and Freddie Mac, under which the parties signed the Code into effect. The Cooperation Agreements require the GSEs, beginning January 1, 2009, to purchase loans only from those lenders that certify compliance with the Code.

There is no doubt that the Code will make sweeping changes to the appraisal process, affecting both the ways that most mortgage lenders currently handle their appraisal processes and the sources from which lenders may obtain appraisals. The Code will, among other things:

- forbid any attempt to influence appraisals through coercion, extortion, collusion, compensation, instruction, inducement, intimidation, bribery, or in any other manner;
- prohibit mortgage brokers and real estate agents from selecting, retaining, or compensating appraisers;

[1] More than a dozen states have enacted new laws, and all of the federal banking regulators have issued specific guidelines to address appraisal independence. See, e.g., AR HB 424 / SB 272; CA SB 223; SC HB 4596; see also, e.g., FIRREA, 12 U.S.C. §§ 3331 et seq.; 12 C.F.R. Part 34, subpart C; 12 C.F.R. § 208.18, Part 225, subpart G; 12 C.F.R. Part 323; 12 C.F.R. Part 564; OCC, FRB, FDIC, OTS, Interagency Appraisal and Evaluation Guidelines (Oct. 27, 1994), OCC, FRB, FDIC, OTS, NCUA, "Frequently Asked Questions on the Appraisal Regulations and the Interagency Statement on Independent Appraisal and Evaluation Functions" (March 22, 2005). There also currently are proposals in Congress for new federal laws to regulate the issue of appraisal independence. See, e.g., Mortgage Reform and Anti-Predatory Lending Act (H.R. 3915) (i.e., the Frank Bill); Homeownership Preservation and Protection Act (S.B. 2452) (i.e., the Dodd Bill); 73 Fed. Reg. 1672 (Jan. 9, 2008) (i.e., a proposed rule by the Federal Reserve Board offering amendments to regulations under the Truth in Lending Act).

- prohibit lenders from using "in-house" staff appraisers to conduct initial appraisals or using loan production staff and certain other employees to select, retain, recommend, or influence the selection of or otherwise communicate with appraisers;

- prohibit lenders from using appraisal providers that they own or control or that are owned in whole or in part by settlement service providers;

- impose certain quality control and reporting requirements on lenders; and

- require the GSEs to fund the creation of an "Independent Valuation Protection Institute" – an independent organization that will implement and monitor the Code, establish a complaint hotline for consumers to call with appraisal fraud concerns, and serve as a contact for appraisers who believe that their independence has been compromised.

The Code appears to have been designed specifically to prohibit three business segments from engaging or participating in the appraisal business: (1) VMCs and AMCs, as they exist today; (2) staff appraisers at lenders; and (3) mortgage brokers. TAVMA defers to the trade associations for the mortgage lenders and brokers to address their views of the Code and its likely impacts upon their memberships. Many VMCs and AMCs, however, are members of TAVMA and we are deeply concerned about the impact of the Code upon otherwise legal and compliant businesses. In short, the Code will require significant changes in the business practices and structural ownership of VMCs and AMCs throughout the entire settlement service industry.

Regional and national lenders have been using VMCs and AMCs with increasing frequency to meet their appraisal needs. Whether they are owned by a lender (e.g., Landsafe, which is owned by Countrywide), or by another type of settlement service provider (e.g., eAppraiseIt, which is owned by First American, or LSI, which is owned by Fidelity), VMCs and AMCs have become major providers and processors of appraisals. TAVMA's initial research indicates that approximately 500,000 appraisals per month (6 million per year) are completed through VMCs and AMCs. We understand that mortgage brokers order at least as many appraisals as VMCs/AMCs. Thus, if the GSEs ultimately exclude VMCs and AMCs from the appraisal process, lenders will incur the burden of handling not only the mortgage brokers' portfolio of roughly 500,000 appraisals per month, but the VMCs' and AMCs' portfolios of roughly 500,000 appraisals per month. Combining the two estimates, lenders will be forced to assume responsibility for ordering, processing, reviewing, and delivering one million additional appraisals per month, or 12 million additional appraisals per year. Lenders would be forced to expend substantial sums to hire the staff, obtain the technology, and implement the procedures necessary to handle the increased workload, which in turn would increase costs to consumers, and this is all assuming lenders are even prepared and able to subsume the extra work.

For these reasons, and other reasons discussed in greater detail below, implementation of the Code as currently drafted effectively will wipe out all current VMC/AMC and lender staff appraiser operations throughout the country without providing any alternative means of satisfying appraisal demands. There are no easy transition solutions to address this problem quickly or develop new corporate and/or ownership structures for VMCs/AMCs under the Code. The Code will create huge uncertainties in the lending marketplace: it will unfairly penalize businesses that have been in operation for decades and unfairly reward others, simply based upon the nature of their corporate structure or ownership. In sum, the Code's negative impacts upon VMCs/AMCs seem to far outweigh any new, positive benefits provided to lenders or consumers.

III. THE LEGALITY OF THE CODE'S ADOPTION IS QUESTIONABLE

OFHEO, as the entity responsible for the examination and financial regulation of Fannie Mae and Freddie Mac, is charged with ensuring that the GSEs are adequately capitalized and operating in a financially safe and sound manner. See 12 C.F.R. § 1700.1. To fulfill its role, OFHEO has broad authority "to make such determinations, take such actions, and perform such functions as" OFHEO deems necessary, including "the issuance of regulations to carry out" OFHEO's statutory responsibilities. 12 U.S.C. § 4513(b); see also 12 C.F.R. § 1720.1 (providing that OFHEO is "authorize[d] to take any action deemed appropriate by the Director of OFHEO to ensure that [Fannie Mae and Freddie Mac] are operated in a safe and sound manner, including by adopting supervisory policies and standards by regulation, guidance, or other process").

OFHEO's entry into the Cooperation Agreements with the NYAG and the GSEs presumably was intended to address the safety and soundness of Fannie Mae and Freddie Mac by attempting to improve the appraisal process, thereby more accurately capturing property valuations, enhancing the quality of mortgages that the GSEs purchase, and ultimately improving the GSEs' financial health. While TAVMA does not dispute OFHEO's broad authority to carry out such a mission, OFHEO is subject to the APA's procedural constraints in carrying out its duties. The fact that the Code's adoption is shrouded in Cooperation Agreements does not relieve OFHEO of its obligations in this regard. As a signatory to the Cooperation Agreements, OFHEO is effectively issuing the Code and forcing substantial modifications not only to the GSEs' operations, but to general mortgage and appraisal industry practices, without following the procedural safeguards that Congress designed to govern such substantive rulemaking. For all intents and purposes, the Code's adoption in this manner constitutes a circumvention of the APA requirements and thwarts Congressional mandates. As a result, OFHEO's failure to adhere to the APA as described below may result in litigation that will complicate the situation further and place additional strains on the already floundering real estate and mortgage industries.

A. THE APA's PROCEDURAL REQUIREMENTS

The APA requires each federal agency, including OFHEO, to publish in the Federal Register any amendment or revision to any "substantive rules of general applicability adopted as authorized by law, and statements of general policy or interpretations of general applicability formulated and adopted by the agency." 5 U.S.C. § 552(a)(1)(D)-(E). In addition, an agency must publish notice of a proposed rule in the

Federal Register at least 30 days before the effective date of the rule. Id. § 553. The notice must include: the time, place, and nature of any rulemaking proceedings open to the public; the legal authority under which the rule is being proposed; and the terms or substance of the rule, or a description of the subjects and issues involved in the rule. Id. After providing notice, the agency must give interested persons an opportunity to submit comments, arguments, or other responses. Id. The agency must include in the final rule "a concise general statement of [its] basis and purpose." Id.

B. THE CODE IS SUBJECT TO THE APA'S NOTICE AND COMMENT REQUIREMENTS

The Code constitutes a substantive rule that is subject to the APA. Courts have held that a proclamation constitutes a substantive rule when it (1) prescribes substantive standards, not interpretive rules, general statements of policy or rules of agency organization, procedure or practice, and (2) conforms to certain procedural requirements. See, e.g., United States v. Alameda Gateway, 213 F.3d 1161, 1168 (9th Cir. 2000) (citing United States v. Fifty-Three Eclectus Parrots, 685 F.2d 1131, 1136 (9th Cir. 1982)). An agency's labeling of a regulation in a certain way "is not dispositive" as to its proper characterization. Id. (citing Mt. Diablo Hosp. Dist. V. Bowen, 860 F.2d 951, 956 (9th Cir. 1988)).

Although the APA does not define a "substantive rule," courts have held that a rule is substantive rather than interpretive if it is "'legislative in nature, affecting individual rights and obligations'." Chrysler Corp. v. Brown, 441 U.S. 281, 301-302 (1979); Alameda Gateway, 213 F.3d 1168 (citing James v. United States Parole Comm'n, 159 F.3d 1200, 1206 (9th Cir. 1998)). A court should look to the text of a regulation to determine whether it was "intended to create substantive rights." Id. Courts have noted that a substantive rule, as compared to an interpretive rule or policy statement, is "primarily concerned with policy considerations for the future rather than the evaluation of past conduct, and looks not to the evidentiary facts but to policy-making considerations to be drawn from the facts" and "effect[s] a change in existing law or policy…". Coalition for Common Sense in Gov't Procurement v. Sec'y of Veterans Affairs, 464 F.3d 1306, 1317 (Fed. Cir. 2006) (citing Paralyzed Veterans of Am. v. Sec'y of Veterans Affairs, 308 F.3d 1262, 1264 (Fed. Cir. 2002); Paralyzed Veterans of Am. v. West, 138 F.3d 1434, 1436 (Fed. Cir. 1998)). By contrast, an interpretive rule "simply indicates an agency's reading of a statute or rule. It does not intend to create new rights or duties, but only reminds affected parties of existing duties." Id. Compared to a general statement of policy, which "provides guidance to agency officials in exercising their discretionary power while preserving their flexibility and opportunity to make 'individualized determinations'," a substantive rule "narrowly limits administrative discretion". Mada-Luna v. Fitzpatrick, 813 F.2d 1006, 1013-14 (9th Cir. 1987).

Here, while TAVMA recognizes that OFHEO has broad discretion to issue policy guidances to effectuate the specific standards it has outlined for ensuring the GSEs' financial safety and soundness, the Code goes far beyond interpreting or effectuating any of OFHEO's existing rules or regulations. Significantly, OFHEO's regulations do not set forth any underwriting or appraisal requirements for the GSEs. OFHEO has issued only a limited number (i.e., 15) of policy guidances related to its general supervisory requirements for the safety and soundness of the GSEs; of those, only a few provide specific standards related to the minimum supervisory requirements OFHEO outlined in the Code of Federal Regulations, and OFHEO has not issued any policy guidance or other regulation specifically addressing underwriting standards. The only discussion of underwriting standards appears in language included in a 2000 policy guidance, now included as Appendix B to the final regulation at 12 C.F.R. § 1720.2. To this end, the policy guidance requires Fannie Mae and Freddie Mac to "adopt and implement prudent underwriting procedures commensurate with the type of loan or loans and the markets in which the loan or loans were made that include consideration of the borrower's and any guarantor's financial condition and ability to repay as well as the type and value of any collateral or credit enhancement." 12 C.F.R. § 1720.2, App. B(I). The policy guidance, however, does not dictate procedures that the GSEs must adopt to implement the foregoing requirement. The identification and adoption of appropriate procedures is within the GSEs' discretion.

In fact, OFHEO itself has recognized that its policy guidances are intended to lay out general policies without dictating the management or operation of the GSEs or mandating the adoption of specific operational requirements. In this regard, OFHEO has stated in Federal Register notices explaining the agency's issuance of policy guidances as appendices to rules that:

> The minimum standards set forth in OFHEO's policy guidances are designed to identify key safety and soundness concerns regarding operation and management of an Enterprise, and to ensure that conduct and practices of the Enterprises reasonably avoid the emergence of problems that might entail serious risks. The minimum standards also reflect the need for internal policies and procedures in particular areas that, if not appropriately addressed by the Enterprises, may warrant supervisory action by OFHEO in order to reduce risks of loss and corresponding capital impairment. The minimum standards set out in such guidances are intended to effect these purposes **without dictating how the Enterprises must be operated and managed**; moreover, **the guidances do not purport to set out detailed operational and managerial procedures that an Enterprise must have in place**. **Rather, the guidances identify the ends that proper operational and management policies and procedures are to achieve, while leaving the means to be devised by each Enterprise as it designs and implements its own policies and procedures.** To the limited extent that OFHEO does specify particular requirements, each Enterprise's management is left with substantial flexibility to fashion and implement those requirements.

67 Fed. Reg. 42200 – 42202, *42201 (June 21, 2002) (emphasis added); see also, e.g., 67 Fed. Reg. 55691 – 55699, * 55692 (Aug. 30, 2002).

Despite OFHEO's explicit statements that its policy guidances are not intended to mandate detailed operational and managerial procedures, thereby implicitly recognizing that the institution of such requirements would necessitate public notice and comment, the agency seeks to impose substantive rules on the GSEs through Cooperation Agreements that not only will dictate specific operational requirements, but will have monumental effects on the mortgage and appraisal industries, result in increased costs to consumers, and adversely affect competition, investment, and real estate productivity. The Code establishes a lengthy and complex set of specific appraisal requirements that clearly alter individual rights and obligations, especially to the extent they restrict who may furnish appraisals. They do not evaluate past conduct or rely on evidentiary facts, but rather establish policy for the future and effectuate substantial change in the GSEs' existing operations, as well as require significant alteration of business practices for lenders and other entities across the nation. The Code does much more than merely provide guidance. It prescribes specific standards that will govern evaluation of the GSEs' conduct and that will affect an entire industry, and thereby constitutes a substantive rule for which notice and comment under the APA is both required and essential.

Given that the Code constitutes a substantive rulemaking by OFHEO, OFHEO was obligated to follow the APA's notice and comment procedures set forth above before contractually obligating Fannie Mae and Freddie Mac to adopt it. OFHEO, however, failed to do so. While the Code will have sweeping effects on the appraisal industry and the way in which mortgage lenders conduct their business, there was no public notice about the proposals and the Code's drafters did not seek any meaningful industry comment or feedback prior to its adoption. Freddie Mac acknowledged in one of its recent press releases that "…the Code … will require significant changes in appraisal practices … and may require a change in some lenders' business models." In fact, the proposals will: require dozens of large lenders to eliminate or re-deploy their staff appraiser operations; restrict the use of outside VMCs and AMCs; and require many of the larger VMCs and AMCs to be divested by their parent organizations, which are settlement services providers that also deliver non-appraisal products to lender customers. As discussed below, effectuating these types of consequences without providing the notice and comment that the APA requires could be disastrous for both consumers and the mortgage industry.

For these reasons, TAVMA respectfully submits that implementation of the Code should be delayed pending notice and comment under the APA. Moreover, as discussed below in Section VI, there are various bills pending in Congress that will address the appraisal independence issue, and it would be useful to delay implementation of the Code so as to allow prior discussion of its content in Congress.

IV. VENDOR AND APPRAISAL MANAGEMENT COMPANIES

A VMC is an entity that manages a group of independent, licensed and certified third-party service providers that offer products and services necessary to close a mortgage loan to mortgage lending institutions. It often is a licensed title agency that provides additional ancillary services to title insurance, such as title abstracts, appraisals, building inspections, closings, flood reports, and other products and services. VMCs that provide appraisals often are referred to as AMCs. AMCs may focus entirely on appraisals or may provide a broader array of settlement services.

VMCs, which date back nearly 50 years, were created to counteract typical industry delays and poor service by responding to consumers' desire for less expensive, faster, and better quality service. Over the years, VMCs and AMCs have grown from a small resource for lending institutions seeking an alternative to branch manager controlled services to a nationwide industry aimed at establishing greater control over product quality and uniformity. As the mortgage industry has relied on new technologies such as the Internet to move from local and regional business to nationwide lending, VMCs and AMCs simultaneously have grown and evolved to allow lenders to focus on their larger scale operations by outsourcing the job of identifying, contracting with, and arranging for vendors to provide the numerous products and services required in every real estate transaction. VMCs and AMCs have become an integral part of real estate transactions. Their centralized processes offer significant benefits to all parties involved and have improved lender performance and loan quality. As discussed below, their continued participation in the appraisal process is essential to safeguard appraisal independence and is critical to an efficient mortgage market.

VMCs and AMCs act as centralized appraisal sources for mortgage lenders that operate on a wide geographic basis. Rather than contacting individual appraisers in each jurisdiction, a lender may obtain appraisals directly through a VMC or AMC. The VMC or AMC contracts with a local appraiser who performs the physical inspection of the property and issues an appraisal report containing an estimated property valuation. VMCs and AMCs generally have invested substantial sums in automating the appraisal process. Lenders submit orders for appraisals electronically, the appraiser selection process is often automated and designed to ensure the unbiased selection of qualified vendors, and completed appraisals are transmitted electronically back to lenders. Moreover, the automated systems enable efficient review of individual appraisers for quality, turnaround time, and responsiveness. The introduction of such technologies to the appraisal process has produced tangible benefits; namely, high quality appraisals can be obtained in a matter of days (rather than weeks) at reasonable prices.

VMCs and AMCs typically offer services on a wide scale regional or national basis and thus operate from large regional or national processing centers. They not only manage and control networks of independent, third-party service providers, but they manage all of the ordering, tracking, and delivery tasks associated with the vendors' offerings. Specifically, in return for a management fee from their mortgage lender clients, VMCs and AMCs, among other things:

- recruit and qualify vendors for the networks, as well as verify their licensure and/or certification, check references and audit work samples;

- negotiate fee and service level expectations with individual vendors;

- assume loan-level administrative duties for the large numbers of transactions in their pipelines, including
  - order entry and assignment,
  - tracking order status,
  - updating clients on delays,
  - performing both pre- and post-delivery quality control,
  - transmitting preliminary and final hard copies of appraisal reports to clients,
  - handling accounts payable and receivable,
  - engaging in dispute resolution between lenders and appraisers,
  - providing and administering warranties and E&O Insurance, and
  - ensuring proper record retention;
- provide a single point of contact for lenders and uniformity across jurisdictions; and
- offer technology interfacing that permits auto assigning, tracking, and reviewing and the electronic delivery of reports.

In essence, a lender client hires a VMC or AMC to act on its behalf to engage a real estate appraiser and perform the administrative functions involved in the appraisal ordering, tracking, and delivery process. The primary difference between a VMC or AMC and an appraisal company or firm (hereinafter an "appraisal shop") is that a VMC or AMC does not engage in the practice of appraising (i.e., it neither performs appraisals nor supervises appraisers in the conduct of their business). At an appraisal shop, each appraisal report is reviewed by a certified appraiser who signs the report as the supervisory appraiser. In contrast, a VMC or AMC receives the report from the network appraiser and, after performing a quality control review, transmits it to the client.

The vendor management model has streamlined the appraisal process. VMCs and AMCs understand the perspective of each interested party in the transaction and have experience meeting each party's needs while preserving the integrity of the appraisal process. For example, they meet the lender's need to manage a multi-state business in a professional and cost-effective manner by providing, among other things, electronic portal connections, expertise in multi-state laws and regulations governing the products and services they manage, and a single point of contact. They meet appraisers' needs by marketing the appraisers' services, generating work, managing client relations, collecting fees from lenders, offering continuing education, and acting as a buffer between the lender and appraiser so as to reduce the risk of undue pressure. Finally, and most importantly, VMCs and AMCs meet consumers' needs by reducing the time required for appraisals and improving their quality while keeping costs down. If lenders are forced to forego their use of VMCs and AMCs and bring appraisal functions back in-house, they will have to invest in new technologies, acquire appraisal monitoring capabilities, and hire competent staff to handle the appraisal functions that VMCs/AMCs otherwise would handle, ultimately resulting in increased costs to consumers for appraisals.

V. DOES THE CODE EXCLUDE VMCs AND AMCs?

Paragraph VI of the Code prohibits a lender from utilizing any appraisal report prepared by an appraiser who is "employed by" a number of different types of entities, including:

(1) the lender;

(2) an affiliate of the lender;

(3) an entity that is owned, in whole or in part, by the lender;

(4) an entity that owns, in whole or part, the lender;

(5) a real estate "settlement services" provider, as that term is defined in the Real Estate Settlement Procedures Act of 1974, 12 U.S.C. §§ 2601 et seq. ("RESPA"); or

(6) an entity that is owned, in whole or in part, by a "settlement services" provider.

While VMCs and AMCs that have no affiliation whatsoever with mortgage lenders do not fall into any of the first four categories above, they do constitute settlement service providers under RESPA, regardless of whether they offer any products or services other than appraisals, and they often are affiliated with other settlement service providers such as title insurance companies or agencies. The question therefore arises whether they are excluded from the appraisal process under subsections (5) and (6) above.

By its language, Paragraph VI of the Code excludes reports only from appraisers "employed by" any of the listed entities. Neither VMCs nor AMCs, however, "employ" appraisers; rather, they maintain networks of independent contractor appraisers. Thus, according to the express terms of Paragraph VI, neither VMCs nor AMCs would be excluded from the appraisal process. This analysis is supported by the language in Paragraphs III and V, as well as by other language in Paragraph VI, all of which expressly acknowledge that AMCs are a permissible source of appraisals under the Code. Specifically, Paragraph III states that a "lender or any third-party specifically authorized by the lender (including, but not limited to, appraisal management companies and correspondent lenders) shall be responsible for selecting, retaining, and providing for payment of all compensation to the appraiser." (Emphasis added). Similarly, Paragraph

V states that an "employee of the lender (or, if the lender retains an appraisal management company, any employee of that company) tasked with selecting appraisers for an approved panel or substantive appraisal review must" satisfy certain requirements. (Emphasis added). Finally, Paragraph VI lays out an exception to the prohibition on lender ownership of appraisal providers where the lender owns only 20% or less of an "appraisal management company" and satisfies certain other criteria. (Emphasis added). Thus, Paragraphs III, V, and VI of the Code all presume the use of AMCs, which is a clear indication that the drafters did not intend to exclude them from the appraisal business.

Nevertheless, it has been suggested by some reporters and others that the term "employed by" was intended to include **independent contractors**, which would bring both VMCs and AMCs within the reach of Paragraph VI, again regardless of whether they offer other services besides appraisals. Moreover, on March 5, 2008, Freddie Mac sent an e-mail bulletin to its seller-servicers in which it voiced its intent not to purchase loans from lenders containing appraisal reports ordered from an entity that offers any other services besides appraisals. Specifically, the bulletin states that, as a result of the Code's requirement "that the appraisal process be independent from the lender in all respects . . . : a lender will no longer be allowed to sell Freddie Mac a loan if the appraisal was … ordered by a mortgage broker, or an entity that offers any other services other than appraisals" (emphasis added). This exclusion covers VMCs and AMCs that also offer title or other closing services, which has become a fairly common practice in the industry. Such interpretations effectively would ban appraisals: (1) from lender-owned or lender-controlled entities; (2) from VMCs and AMCs if they are also licensed title agencies or providers of other settlement services; and (3) from other companies owned in whole or in part by non-lender settlement service providers such as title companies or agencies. For the reasons set forth below, TAVMA submits that such a broad prohibition would have severe and unintended consequences for consumers, as well as undermine the safety and soundness of the GSEs.

VI. THE RAMIFICATIONS OF EXCLUDING VMCs AND AMCs

Given that Fannie Mae and Freddie Mac are the largest purchasers of whole loans in the secondary market and the changes that the Code thus ultimately will require of most participants in the real estate industry, it is crucial that the final Code contain clear guidelines with as few unintended consequences as possible. As currently drafted, however, the Code contains a number of provisions that, when read literally, conflict with one another or are open to interpretation.[2] TAVMA's focus here is on the controversy surrounding whether or not the Code excludes participation by VMCs and AMCs, and the ramifications of any such exclusion.

Specifically, an expansion of the term "employed by" in Paragraph VI to include independent contractors and Freddie Mac's position (as stated in its March 5th bulletin)

[2] For example, various terms used in Paragraphs I (e.g., influence, coercion, instruction, inducement, intimidation) and III (e.g., correspondent lenders) are undefined and have raised questions among industry professionals regarding their meanings.

are contrary to the language in the Code and are wholly unnecessary. They would prohibit a lender from obtaining appraisal reports from either VMCs or AMCs, even if such entities are not owned or otherwise affiliated in any way with mortgage lenders, merely because they are owned by (or themselves constitute) settlement service providers or because they offer products or services besides appraisals. The Code itself clearly does not exclude AMCs given the statements in Paragraphs III, V, and VI that lenders indeed may obtain appraisals from AMCs. Moreover, there is no reason to exclude a VMC or AMC from the appraisal business simply because it is affiliated with a non-lender settlement service provider or because it offers other products or services in addition to appraisals. There is no evidence to suggest that such affiliations or offerings increase the likelihood of undue influence on appraisals, and, as explained below, statistical data actually supports the opposite conclusion.

For the following reasons, VMCs and AMCs actually serve to protect appraisers from undue influence and are in a strong position to assist Fannie Mae and Freddie Mac, as well as state and federal regulators, in protecting the integrity of the appraisal process and enforcing the Code. The exclusion of VMCs and AMCs would serve only to undermine appraisal independence, jeopardize the safety and soundness of the GSEs, and strain the appraisal market at a time when the mortgage industry cannot bear any additional crisis. As described below, the following are just some of the unintended consequences of a VMC/AMC exclusion:

A. Undue influence on appraisals will increase.

B. The likelihood of appropriate appraisal assignments, and thus the quality of appraisals, will decrease.

C. Quality control will decline.

D. It will be more difficult to monitor appraisal activity.

E. The market's ability to satisfy appraisal demands will be strained and costs to consumers will increase.

F. The safety and soundness of the GSEs will be compromised.

A. UNDUE INFLUENCE ON APPRAISALS WILL INCREASE

1. <u>VMCs and AMCs are Less Susceptible to Pressure</u>

The primary goal underlying the Code is to eradicate pressure on appraisers and thereby ensure independence and accurate home valuations. Notably, VMCs and AMCs are less susceptible to pressure than other providers of appraisals. Unlike small mono-line appraisal firms that typically operate in only a handful of regions or states, VMCs and AMCs have undergone decades of managed growth so that they now operate nationally. Moreover, unlike mortgage brokers or loan officers and branch managers of lenders, these entities receive flat fees for appraisal services rendered, regardless of whether any given loan closes and regardless of loan volume. VMCs and AMCs therefore have less motivation to obtain inflated appraisals.

In addition, the mere fact that a VMC or AMC offers services other than appraisals or is affiliated with a non-lender settlement service provider in no way suggests an increase in the potential for pressure or undue influence. VMCs and AMCs typically offer appraisals through divisions or departments that are separate and distinct from other divisions and departments, such as title and closing divisions, and the transactions in which a VMC or AMC provides appraisals do not necessarily overlap with transactions in which the entity provides other products or services. Often, a lender may obtain less than all of the services that a VMC or AMC offers so that it is not unusual for a VMC or AMC to have title-only and appraisal-only customers.

2. VMCs and AMCs Mitigate Lender Pressure

Not only are VMCs and AMCs less susceptible to pressure than other providers of appraisals, but they actually mitigate lender pressure on appraisers by acting as intermediaries between lenders and appraisers and protecting appraisers in their networks from manipulation or coercion. To this end, a VMC or AMC ensures that only a licensed, qualified appraiser with appropriate experience and education is selected to perform a particular appraisal (without any consideration in the selection of whether an appraiser has furnished values equaling or exceeding sales prices in the past), that the lender has no contact with the appraiser, and that the appraiser remains independent and free of undue influence throughout the entire appraisal process. In fact, a VMC or AMC typically instructs appraisers to refer a lender to the VMC or AMC should a lender contact the appraiser directly during the appraisal process, thereby mitigating any risk of lender pressure on the appraiser. As an objective third party, the VMC or AMC also is able to identify and filter out information or data from a lender that the appraiser may need during the appraisal process and communicate such information or data to the appraiser appropriately.

By requiring that all communications between a lender and a network appraiser be handled by the VMC or AMC, vendor managers are able to police the appraisal independence issue and ensure appraisers' ability to generate autonomous and professional reports free from improper outside influence. In fact, research data evidence that the primary benefit of working with a VMC or AMC is the appraiser's ability to escape pressure.

3. Statistical Data Confirm that VMCs and AMCs Protect Appraisers from Undue Pressure and Influence

While there are few statistics available concerning the roles of VMCs and AMCs in the appraisal process, the October Research Corporation, an independent publisher and research firm based in Richfield, Ohio, recently conducted a study of the real estate valuation industry, which includes a survey of residential real estate appraisers representing all 50 states, the District of Columbia, and Puerto Rico. See 2007 October Research National Appraisal Survey, A Snapshot of the Real Estate Valuation Industry, Volume II – Customer Relationships with Appraisers ("October Research Survey"). According to the October Research Survey, 63% of appraisers in the United States work with VMCs/AMCs, and on average receive 17% of their business from such entities.[3] Those appraisers who do not work with VMCs/AMCs generally reported low pay, not undue pressure, as the reason, which is in stark contrast to appraiser statements that undue pressure from mortgage brokers is the primary reason why brokers tend to be appraisers' least favorite clients. Notably, 21% of appraisers surveyed agreed that VMCs/AMCs do not exert pressure on appraisers regarding property valuation and condition, and 25% of appraisers surveyed claimed that a real benefit of working with VMCs/AMCs is less pressure to overstate property values.

The October Research Survey results suggest that, unlike appraiser relationships with mortgage brokers and others, undue pressure on appraisers is not of great concern with respect to VMCs/AMCs. Quite the contrary, these entities' business models are predicated on maintaining appraisal independence and providing an impartial and essential safeguard against undue influence on appraisers. Their exclusion from the appraisal industry would prevent appraisers from working through companies designed to protect their integrity and give greater control over appraisal assignments and communications to lenders, which are more likely to exert undue influence on the process. It would have the unintended effect of reducing appraisal independence and rejecting an important part of the solution to the ongoing mortgage crisis.

B. THE LIKELIHOOD OF APPROPRIATE APPRAISAL ASSIGNMENTS, AND THUS THE QUALITY OF APPRAISALS WILL DECREASE

VMCs and AMCs play a crucial role in ensuring appraisal assignments to experienced appraisers who are qualified to handle the particular orders. Initially, they ensure that their networks include licensed, insured, experienced and qualified appraisers to perform appraisals for the entities' clients. They require appraisers to satisfy qualification criteria and provide business references before admitting them to the networks, and they may offer ongoing continuing education courses that keep appraisers informed of changes in the market and current federal, state, and lender guidelines. Some VMCs and AMCs also provide free technologies to their vendors that facilitate appraisers' workflow and enhance the quality of their work. These types of benefits contribute to enhanced quality control as described below.

Significantly, VMCs and AMCs not only ensure the integrity of their networks, but they also consider each individual network vendor's qualifications to perform appraisals in particular markets and on particular types of property transactions before identifying any particular appraiser for a specific project assignment. Accordingly, there is a greater

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[3] The October Research Survey indicates that 54% of appraisers working with VMCs/AMCs receive between 10% and 100% of their business from such entities and that appraisers receive 38% of their business from lenders, 4% from real estate agents, 25% from mortgage brokers, and 16% from unspecified sources.

likelihood that the appraiser assigned to any given loan will have the qualifications and experience necessary to evaluate the subject property when the appraisal is ordered through a VMC or AMC that considers such qualifications and experience in the selection process than when an appraisal is ordered through another channel where the assignment may be made less precisely. Therefore, exclusion of VMCs and AMCs from the appraisal process likely will result in poorer quality appraisals in many cases.

C. QUALITY CONTROL WILL DECLINE

VMCs and AMCs are in a better position to resist undue pressure and influence, and to attract and retain top quality appraisers. They ensure appropriate appraisal assignments to qualified appraisers; provide unbiased quality control; and are typically familiar with the complex federal and state laws and regulations that govern appraisals. Thus, they are in a better position than lenders to ensure appraisers' overall compliance. VMCs and AMCs provide ongoing, independent quality control reviews of appraisers to ensure adherence to the myriad of applicable federal and state laws, as well as to the USPAP. They usually perform quality control reviews of appraisals to ensure the integrity of each transaction and the provision of independent, unbiased, quality appraisal reports. They also have a strong incentive to ensure their networks include only appraisers who consistently provide reliable property evaluations in compliance with all pertinent rules and regulations. A failure to do so would jeopardize the VMC's or AMC's reputation and risk a loss of business. For these reasons, they are in a strong position to perform objective reviews of appraisal reports In fact, VMCs' and AMCs' quality control efforts have proved successful over the years insofar as they have resulted in the removal of a number of appraisers from the networks each year due to substandard performance.

Exclusion of VMCs and AMCs from the appraisal process would remove an important check on the system and turn responsibility for quality control entirely over to appraisal shops that have a more direct and personal stake in the outcome of reviews. Compared to VMCs and AMCs, smaller appraisal shops depend on a relatively narrow universe of clients to generate appraisal orders and a relatively small group of appraisers to fulfill those orders. VMCs and AMCs, however, have broad client bases and large networks of appraisers capable of handling appraisal work, thereby assuring objective and stringent quality control that cannot be achieved in the alternative setting.

D. IT WILL BE MORE DIFFICULT TO MONITOR APPRAISAL ACTIVITY

In addition to performing unbiased and stringent quality control, VMCs and AMCs have invested in technology and recordkeeping practices that make it substantially easier to monitor appraisal activity and identify undue influence on property valuations. For example, VMCs and AMCs generally create a permanent record of each transaction that includes all correspondence with the lender and the results of monitoring and pre- and post-closing quality control reviews. Some VMCs and AMCs even maintain detailed historic ratings of all of their appraisers, including metrics focused on timeframes for scheduling appointments with consumers, meeting pre-set appointments with consumers, delivering final appraisal reports, and resolving any concerns or deficiencies identified in appraisal reports. Some VMCs and AMCs also maintain detailed historic vendor logs throughout each network appraiser's tenure that record communications and provide one place to identify any issues the companies have experienced with the appraiser.

Unlike VMCs and AMCs, smaller appraisal shops have not invested millions of dollars in technology and recordkeeping practices that enable them to monitor the appraisal process both before and after closing with the same degree of precision and reliability. To our knowledge, it is not their practice to create permanent records of all transactions and communications or to establish ongoing review criteria based on which appraiser ratings are generated and updated over time. Thus, exclusion of VMCs and AMCs will result in even less information being available regarding the qualifications, productivity, and professionalism of individual appraisers and their relationships with mortgage broker and lender clients.

E. THE MARKET'S ABILITY TO SATISFY APPRAISAL DEMANDS WILL BE STRAINED AND COSTS TO CONSUMERS WILL INCREASE

In addition to adding value to individual real estate transactions, VMCs and AMCs are in the best position to assure the timely delivery of appraisals to consumers at reasonable prices, and their exclusion would increase costs to consumers and delay the appraisal process and time to close. VMCs and AMCs have invested millions of dollars in information technology services and products that have enabled them to automate the appraisal process. Such automation in turn has shortened the time frame between loan application and closing for consumers by achieving a system of more rapid order placement, property profile delivery, communication of updated and additional information needed to complete an appraisal, and product delivery. Through their automated systems, appraisal managers provide almost immediate appraiser confirmations for consumers and real-time information and updates to lenders on the status of orders, which in turn enable the entities to offer consumers a faster time to close with reasonable market fees and consistency in delivery and pricing without compromising appraisal independence or quality control. In contrast, we understand that most smaller appraisal shops have not invested in comparable technology to offer all of the foregoing services and achieve the same results. If lenders are prohibited from obtaining appraisals through VMCs and AMCs, the result will be a less organized appraisal process that relies heavily on the manual performance of back-office tasks, which necessarily will result in increased costs, lower quality, and delayed closings.

Moreover, smaller appraisal shops are not in a position to assume current VMC/AMC business portfolios, which include many millions of appraisals per year. If the Code is interpreted to cover such entities, then surviving providers will be unable to fill the incoming orders. Smaller providers lack the workforce, capital, and technology that would be essential to assume VMCs'/AMCs' business, acquire the knowledge and expertise necessary to conduct business in different markets, monitor and track orders, perform adequate quality control, protect consumers' privacy, and implement all of the safeguards necessary to operate an independent appraisal business free from undue lender influence. To achieve such goals and satisfy the demand for hundreds of thousands of appraisals each month, surviving entities would be forced to raise their prices in an effort to meet market demands and cover the associated costs.

In addition, real estate related VMCs and AMCs were formed in large part to allow mortgage lenders to shift the appraisal function from lenders' staff appraisers to vendor managers and avoid the branch manager controlled model. This shift allowed lenders to replace the fixed costs to consumers resulting from the use of lender employees to the variable costs charged by VMCs and AMCs as a result of contracting out the appraisal function. By relying on VMCs and AMCs to manage the process, lenders no longer needed to maintain the staff necessary to monitor individual appraisers' compliance with the varying license, insurance, and other requirements in different states. The elimination of current VMCs and AMCs from the appraisal process likely would force lenders to bring some or all of the appraisal management function back in-house, which again would drive up costs to consumers and delay the appraisal and closing processes. It would reverse the appraisal efficiencies that have been gained during the last few decades and require lenders to hire staff to monitor individual vendors' compliance with varying state license, insurance and other requirements and to increase prices to consumers to cover the new staffing and other appraisal-related demands.

Finally, it is important to note that individual appraisers also receive a number of benefits by entering into relationships with one or more VMCs and/or AMCs without which they too would be forced to increase prices. For example, these relationships reduce the time and costs that appraisers otherwise must expend in, among other things: soliciting clients for appraisal work; scheduling appraisal assignments and property evaluations; obtaining property profiles from title companies or real estate agents to secure the base information from which an appraisal assignment may begin; reviewing appraisal reports to determine if they are in appropriate form and free from errors when delivered to the lender; engaging in customer service; delivering preliminary and final reports to clients; and billing clients and collecting fees. These benefits constitute tangible economic gains to appraisers. If appraisers have to perform these functions and incur these costs themselves, then their overall charges may be higher than those charged by VMCs and AMCs because individual appraisers cannot achieve the same efficiencies and economies of scale.

For all of the foregoing reasons, the exclusion of VMCs and AMCs would have the unintended consequence of increasing both the turn time for appraisals and costs to consumers. The Code will seriously damage the modern delivery of appraisals and increase costs to lenders at a time when lenders can ill-afford to take on the additional staff, create new software and other internal systems, and assume of all the appraisal duties that VMCs and AMCs have been handling for them. Therefore, it is essential that the Code be as narrowly tailored as possible to achieve the underlying goals with as few negative consequences for the industry as possible.

F. THE SAFETY AND SOUNDNESS OF THE GSEs WILL BE COMPROMISED

Lastly, and of obvious concern to Fannie Mae, Freddie Mac and OFHEO, the exclusion of VMCs and AMCs from the appraisal process ultimately would jeopardize the financial safety and soundness of the GSEs. Pursuant to its responsibility to monitor the safety and soundness of Fannie Mae and Freddie Mac, OFHEO aims to ensure that the GSEs are adequately capitalized and operating safely. To further those purposes, OFHEO establishes minimum supervisory requirements and standards intended to "avoid the emergence of problems that might entail serious risks" to either GSE, reducing the risk of impairment or destruction of the entities' financial stability. 12 C.F.R. § 1720, App. A(I)(i)-(ii). The GSEs have discretion to implement policies and procedures that fulfill the goals of the supervisory requirements, which apply to eight principal areas of concern: (1) asset underwriting and credit quality; (2) balance sheet growth and risk management; (3) market risk; (4) information technology; (5) internal controls; (6) audits; (7) information reporting and documentation; and (8) board and management responsibilities and function. Id. § 1720.2. Compliance with the requirements, however, does not guaranty that the GSEs' activities will satisfy the safety and soundness requirements, and OFHEO may take action to address the GSEs' engagement in any activity that OFHEO considers to be an unsafe or unsound practice or a failure to comply with the minimum requirements for any of the aforementioned areas. Id. § 1720, App. A(I)(i).

Within each of the aforementioned principal areas, OFHEO has identified specific concerns that the GSEs must take into account when developing and implementing policies and procedures. The relationship between the safety and soundness of the GSEs and the appraisal process is best categorized as an "asset underwriting and credit quality" issue. To address related concerns, OFHEO requires the GSEs to have policies and procedures in place "to adequately assess credit risks before they are assumed, and monitor such risks subsequent. . .". Id. Here, as explained above, the exclusion of VMCs and AMCs from the appraisal process would increase the risk of undue influence on appraisers and thus inflated property valuations, decrease the likelihood of appropriate appraisal assignments and thus the likelihood of a quality appraisal, and impede quality control and appraisal monitoring, thereby reducing the overall quality of appraisals and thus the value of the mortgage loans sold to the GSEs. This chain of events clearly impacts the credit risks that Fannie Mae and Freddie Mac undertake in purchasing loans in the secondary market. The GSEs' ability to implement effective risk management strategies to address their credit risks depends in part on their ability to rely on the independence and quality of the appraisals that help to determine the prices of mortgage loans that the GSEs purchase or that are collateralized as securities.

VII. RECOMMENDATIONS

For the reasons discussed above, the Code is overly broad and can achieve its purposes without the wholesale removal of VMCs and AMCs from the appraisal business, which would be a disservice to both consumers and the entire mortgage market. TAVMA therefore makes several recommendations below for modifications to the Code's language that would enable VMCs and AMCs to remain in business without compromising the Code's substantive requirements or threatening its ability to achieve the drafters' goals. Initially, however, TAVMA suggests delaying the Code's implementation.

A. DELAY IMPLEMENTATION

The current draft of the Code will require significant changes not only to the way that lenders currently manage and receive appraisals, but to the corporate structure and ownership of countless entities. Many questions and uncertainties exist, however, as to the Code's wording, intent and actual long-term impacts.

Some of the Code's requirements already are embedded in the existing regulatory framework for appraisals. For example, Congress enacted FIRREA in 1989, in response to the fallout of the savings and loan crisis of the 1980s, which instituted a complex scheme of appraisal reforms designed to enhance the quality and integrity of appraisals for mortgage loans, including establishment by the federal banking agencies of federal appraisal standards that meet the USPAP. 12 U.S.C. §§ 3331-3351. Subsequent banking agency regulations and guidelines prescribed rules concerning, among other things, the selection and monitoring of appraisals, market value approaches that an appraiser should use, when a lender may engage an appraiser to perform a limited as opposed to a complete appraisal, and which transactions do not require an appraisal. See, e.g., 12 C.F.R. Part 34, subpart C; 12 C.F.R. § 208.18, Part 225, subpart G; 12 C.F.R. Part 323; 12 C.F.R. Part 564; OCC, FRB, FDIC, OTS, Interagency Appraisal and Evaluation Guidelines (Oct. 27, 1994), OCC, FRB, FDIC, OTS, NCUA, "Frequently Asked Questions on the Appraisal Regulations and the Interagency Statement on Independent Appraisal and Evaluation Functions" (March 22, 2005).

Given the existing rules and regulations for appraisals, it is likely that the lending and appraisal management industries will be able to comply with most of the Code's substantive provisions. Some of the Code's requirements, however, are unprecedented and unsupported by the facts in today's lending market. As proposed, the Code will effectively "preempt the field" with its broad requirements, and TAVMA is concerned that a litigation settlement by a state attorney general is not an appropriate way to regulate the federally mandated appraisal process. As noted above, the lack of consultative discussions, industry research and any type of public comment are perceived as weaknesses in the development of the Code. At best, the Code represents a good faith effort that lacked critical input and industry expertise. At worst, the Code is an arbitrary mandate, forced upon the GSEs and the lending industry, that will have adverse effects on hundreds of lenders and VMCs/AMCs and effectively amount to a "taking" of their operational value without due process.

The NYAG's announcement of the Code was surprising in light of its secrecy and apparent swiftness, especially given the enormous impact it will have. As discussed above in Section II, the legality of the Code's adoption through Cooperation Agreements is questionable and implementation should be delayed pending notice and comment under the APA. In addition, perhaps the perceived "rush to judgment" could be lessened by allowing Congress to incorporate the Code into its review of the whole appraisal process. There are various bills pending in Congress that will address the appraisal independence issue. See, e.g., Mortgage Reform and Anti-Predatory Lending Act (H.R. 3915) (i.e., the Frank Bill); Homeownership Preservation and Protection Act (S.B. 2452) (i.e., the Dodd Bill); 73 Fed. Reg. 1672 (Jan. 9, 2008) (i.e., a proposed rule by the Federal Reserve Board offering amendments to regulations under the Truth in Lending Act). TAVMA believes that the Code's implementation date should be delayed and its content included in the discussions of the issue in Congress. Such an approach would be the logical and proper way to address federal appraisal issues and changes to FIRREA.

B. PROPOSED DRAFTING MODIFICATIONS

Assuming the Code's implementation as scheduled in January 2009, given the industry confusion and concern that already have arisen in response to the Code, and in view of the substantial tangible benefits that VMCs and AMCs offer to all parties to a real estate transaction, TAVMA offers the following recommendations for revisions to the Code's language. We believe that adoption of these suggestions would promote appraisal independence while avoiding at least some of the pitfalls created by the current draft and interpretations.

First, TAVMA recommends the addition of a definitions section that includes definitions of various terms used throughout the Code. Many of the terms are ambiguous and can be interpreted differently by different market participants. From TAVMA's perspective, the Code should define explicitly at least the following terms: "affiliate"; "vendor management company"; "appraisal management company"; and "employed by". Specifically, we recommend the following definitions:

- *Affiliate* should be defined 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"[4] of such person, has an "affiliate relationship"[5] with, or a direct or beneficial ownership interest of

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4 RESPA defines an "associate" as, among others, a spouse, parent, child, parent company, employer, employee, officer, director, partner, franchisor, or franchisee of such person, as well as anyone who has an agreement, arrangement, or understanding with such person, the purpose or substantial effect of which is to enable the person in a position to refer settlement business to benefit financially from the referrals. See 12 U.S.C. § 2602(8).

5 Under RESPA, an "affiliate relationship" "means the relationship among business entities where one entity has effective control over the other by virtue of a partnership or other agreement or is under common control with the other by a third entity or where an entity is a corporation related to another corporation as parent to subsidiary by an identity of stock ownership." 24 C.F.R. § 3500.15(c)(2). A person who is a general partner, officer, director, or employer of another person is deemed in "control" of the other person. "Control" also is deemed to exist where a person directly or indirectly owns, holds with power to vote, or holds proxies representing more than 20% of the voting interests of another person, where a person affirmatively influences the election of a majority of the directors of another person, or where a person has contributed more than 20% of another person's capital. See id. § 3500.15(c)(4).

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. <u>See</u> 12 U.S.C. § 2602(7).

- *Vendor Management Company* should be 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.

- *Appraisal Management Company* should be defined 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.

- *Employed by* should be defined expressly to exclude independent contractors and to mean under an employer-employee contract where, consistent with both general legal principles (<u>see</u>, <u>e.g.</u>, 53 Am. Jur. 2d, <u>Master and Servant</u>, § 2) and the Internal Revenue Service description of an employee versus an independent contractor (<u>see</u> IRS Revenue Ruling 87-41, 1987-1 C.B. 296), the "employer" has the right to select and engage the appraiser, pay his or her wages, and terminate his or her employment and the appraiser, among other things: is subject to the employer's supervision and control, maintains a presence at the entity's office, uses the entity's office supplies and equipment, attends staff meetings, and receives pay checks and W-2 forms with appropriate withholdings from wages for income and FICA taxes.

- *Appraisal report* should be clarified to mean any document which follows USPAP standards 1 or 2 and includes a value opinion.

- *List,* as used in Section 1, Part 6, should be clarified. VMCs/AMCs 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.

- *Instruction*, as used in the preamble of Section I, 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".

Second, TAVMA recommends that the drafters add language in the beginning of Paragraph VI that the term "employed by" (1) is to be interpreted by its plain meaning in accordance with the above definition and (2) does not include independent contractors. The first line of Paragraph VI of the Code states that a "lender shall not utilize any appraisal report prepared by an appraiser **employed by**" any of the entities listed in subsections (1) through (6) (emphasis added). Most VMCs and AMCs do not "employ" the appraisers they use, but hire them as independent contractors. Thus, the recommended addition would clarify that VMCs and AMCs are not covered by the prohibitions in Paragraph VI, although they of course would have to comply with the remaining provisions of the Code. VMCs and AMCs should (at least) be allowed to continue to utilize independent contractors as appraisers if they meet the other requirements under the USPAP and the Code. Any other interpretation of the phrase "employed by" would be unworkable and counter-productive.

Third, TAVMA recommends withdrawing Paragraph VI(5) altogether. This provision prohibits a lender from obtaining an appraisal report from an appraiser employed by a real estate settlement service provider, as that term is defined in RESPA. Significantly, RESPA defines the term "settlement service" broadly to include "any services provided in connection with a real estate settlement including, but not limited to, . . . title searches, title examinations, the provision of title certificates, title insurance, . . . the rendering of credit reports or appraisals, . . .". 12 U.S.C. § 2602(3). HUD's regulations expand the definition to include, among other things, the "[p]rovision of any other services for which a settlement service provider requires a borrower or seller to pay." 24 C.F.R. § 3500.2(b). Accordingly, every entity that provides real estate appraisals is a settlement service provider under RESPA. Given this fact, Paragraph VI(5) would lead to bizarre and unanticipated results, not just by eliminating the use of VMCs and AMCs entirely (to the extent they even are covered by Paragraph VI), but by effectively prohibiting any type of appraisal company, whether owned directly by appraisers or otherwise, from providing appraisal reports.

Fourth, in order for dozens of VMCs and AMCs to continue to operate under their current parent organizations, Paragraph VI(6) should be extracted, and Freddie Mac should withdraw its statement in the March 5th bulletin that it will no longer purchase loans based on appraisals obtained from entities that provide any other products or services besides appraisals. There has been no finding of fact whatsoever to suggest that the potential for undue influence or pressure on appraisers is higher when a VMC or AMC is owned in whole or in part by another settlement service provider or offers other products or services in addition to appraisals. Despite this lack of factual data or a factual basis, however, this section of the Code would severely impact such operations.

Finally, TAVMA recommends clarifying the exception for lender ownership in Paragraph VI. As currently drafted, Paragraph VI states that a lender may not use a report obtained by or through an AMC that is owned by a lender or an affiliate of the lender, but that this prohibition does not apply where the lender has an ownership interest in the AMC of 20% or less and certain other conditions are met. The language suggests that the exception to the prohibition against lender ownership is available only to lenders, and not to affiliates of lenders or to other types of settlement service providers. The language further suggests that the 20% exception applies only to lender ownership of AMCs, and not to lender-ownership of other types of appraisal providers, such as independent appraisal shops or VMCs. The exception's limitation to lenders and AMCs would appear to be unintended. There is no plausible reason to permit a lender to have a 20% ownership interest in an AMC while prohibiting other types of settlement service providers that are even less likely to exert any undue influence over the appraisal process from having any ownership interest whatsoever. It likewise seems counterintuitive to permit an affiliated AMC, but not to permit affiliations by any other type of appraisal provider.

For these reasons, if the drafters ultimately withdraw Paragraph VI(6), TAVMA recommends that the drafters revise Paragraph VI to extend the 20% exception to affiliates of lenders and to ownership of all appraisal providers and not just AMCs. If the drafters ultimately retain Paragraph VI(6), TAVMA recommends that the drafters at least revise Paragraph VI to extend the 20% exception to both affiliates of lenders and all other settlement service providers, as well as to ownership of all appraisal providers and not just AMCs.

VIII. <u>CONCLUSION</u>

If the GSEs implement the Code as currently drafted, it will cause a major disruption in the lending community due to a serious interruption in appraisal services. Such a disruption ultimately will increase consumers' closing costs and their ability to obtain financing in a timely manner, or at all. TAVMA supports the parties' efforts to craft a solution to the appraisal independence problem and recognizes that many of the Code's provisions will further these efforts. The Code, however, including Freddie Mac's extension of the language to cover entities that provide services other than appraisals, is overly broad to the extent it would exclude VMCs and AMCs from the appraisal business.

VMCs and AMCs are an integral part of the mortgage industry. They are crucial to the market's ability to process the large numbers of appraisal orders for many lenders, and their exclusion would result in a restraint of trade that effectively drives all of the nation's appraisal business to a handful of operations that, even assuming they are able to meet market demands and comply with the Code, would have an unprecedented and unfair strangle-hold on the entire appraisal market in terms of both service and pricing that could prove dangerous to appraisers, lenders, and consumers alike. In addition, VMCs and AMCs are in a strong position to aid the GSEs and regulators in their endeavors to promote appraisal independence. They can and do provide the best protection against lender pressure because they act as a buffer or "middle manager" between the lender and the appraiser and thereby have a positive influence on property valuations. Moreover, VMCs and AMCs actually help appraisers improve the quality of their work and deliver better service to lenders. Years of industry experience, as well as the latest appraiser surveys, support this position. VMCs/AMCs play an important and irreplaceable role in safeguarding appraisal independence. Their continued operation in no way would increase the potential for undue pressure on appraisers, but instead would be an indispensable tool in aiding solutions to the ongoing mortgage crisis.

Accordingly, the most critical changes to the Code are the deletion of Paragraphs VI(5) and VI(6). At minimum, clarification of the phrase "employed by" – and specifically its limitation to the plain meaning of the term as discussed above – is essential. Such clarification would ensure the GSEs' ability to implement the substantive provisions of the Code without allowing an overly broad interpretation that sweeps in a wider array of providers than is necessary to achieve the Code's purposes. The final version of the Code should allow VMCs' and AMCs' continued participation in the appraisal business.

Given the potential ramifications of excluding VMCs and AMCs from the appraisal market, an objective discussion of appraisal independence among industry participants, regulators, and the GSEs is essential to view the problem of appraisal independence in its proper perspective and develop clear, unambiguous solutions. Both the industry and the public deserve a workable set of rules that will be understood by all parties and have as few unforeseen consequences as possible. The adoption of vague standards that are impractical in the current mortgage lending industry will serve only to complicate the problem further. TAVMA therefore hopes that the GSEs and OFHEO will reconsider the intended timeframe for implementing the Code, as well as TAVMA's suggested revisions to the language, which would reduce significantly the risks associated with the Code while still establishing a framework to reduce undue influence on appraisers and ensure appraisal independence.

We appreciate your consideration of TAVMA's comments.

Sincerely,

Jeff Schurman

Jeff Schurman, Executive Director
TAVMA

cc: William Sussman, TAVMA President
TAVMA Board of Directors
Fannie Mae
OFHEO
Federal Reserve
Office of the Comptroller of Currency
Federal Trade Commission
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