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### APPRAISER INDEPENDENCE REQUIREMENTS

On Friday, October 15, 2010, FNMA issued its new Appraiser Independence Requirements which replace the Home Valuation Code of Conduct ("HVCC"), as of October 18, 2010, the date that HVCC has no further force or effect, pursuant to the Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). The new rules are effective immediately.

On Monday, October 18, 2010, pursuant to the mandatory requirements of the Dodd-Frank Act, the Federal Reserve Board published its Interim Rules amending Regulation Z (the implementing regulation for the Truth in Lending Act) in order to provide interim rules to implement Section 1472 of the Dodd-Frank Act which amended the Truth in Lending Act to establish new requirements for appraisal independence for consumer transactions secured by a consumer's principal dwelling.

#### FNMA Appraiser Independence Requirements.

The FNMA new Appraiser Independence Requirements are attached to this memo. As you will note, the new requirements are quite similar to the HVCC, which is no longer in effect as of October 18, 2010, the date the Interim Rules were published by the Federal Reserve Board. The new rules basically provide:

1. Only the Lender or its agent (the term "agent" includes, appraisal companies, appraisal management companies and Correspondent lenders) shall be responsible for selecting, retaining and providing for payment of all compensation to the appraiser. A lender may not accept an appraisal report completed by an appraiser **selected, retained or compensated** in any manner by any other third party (including Mortgage Brokers and Real Estate Agents).
2. An employee of the Lender in the sales or mortgage production functions shall have no involvement in the operations of the appraisal function.
3. A lender's production staff, any person who is compensated on a commission basis upon the successful completion of a mortgage transaction, or any person whose immediate supervisor is not independent of the mortgage production staff and process shall **NOT**:
  - a. Select, retain, recommend or influence the selection of any appraiser for a particular appraisal assignment or for inclusion on a list or panel of appraisers approved or forbidden to perform appraisals for the lender;
  - b. Have any substantive communications with an appraiser or appraisal

management company relating to or having an impact on valuation, including ordering or managing an appraisal assignment.

The above restrictions do not prohibit anyone from requesting that an appraiser provide additional information or explanation about the basis for a valuation, or correct objective factual errors in an appraisal report.

Additionally, if the “firewall” established above is not possible due to the small size of the Lender, the Lender must be able to clearly demonstrate that it has prudent safeguards in place to isolate its collateral evaluation process from influence or interference from its mortgage production process.

Lenders, both small and large, should consider the use of an appraisal management company in order to clearly remove its production department from the appraiser process.<sup>1</sup>

**Federal Reserve Board Regulation Z Interim Rules Implementing Amended Truth in Lending Regarding Appraiser Independence as set forth in the Dodd-Frank Act (Section 1472).**

As previously stated, on October 18, 2010, the Federal Reserve Board published its Interim Rules to implement the various Truth in Lending Amendments regarding Appraiser Independence included within the Dodd-Frank Act (Section 1472). The Interim Rules contain 132 pages and thus are not attached. They can be downloaded from the website [www.regulations.gov](http://www.regulations.gov).

The Interim Rules are effective 60 days from its publication; however mandatory compliance is not required until April 1, 2011. In that Truth in Lending was amended in 2008 by the Home Ownership and Equity Protection Act (HOEPA) to make it a Truth in Lending violation for a creditor or mortgage broker to coerce or influence an appraiser to misstate value, the Interim Rules specifically remove Section 226.36(b) from Regulation Z effective April 1, 2011 and replace it with a new Section series numbered as 226.42. The Interim Rules incorporate the provisions of the HOEPA rules and expand on the protections previously included under HOEPA. Voluntary compliance with the new rules will be deemed compliance with the HOEPA rules until they are removed effective as of April 1, 2011.

A summary of the provisions of the Interim Rules is as follows:

1. Violations of the appraisal independence rules are Truth in Lending Violations subjecting those covered by the Rule to substantial penalties (\$10,000.00 a day for the first violation and \$20,000.00 a day for each subsequent violation);
2. “Covered Persons” under the Rule subject to Truth in Lending now include not only lenders and mortgage brokers, but also any “settlement service provider” as that term is defined under the Real Estate Settlement and Procedures Act (“RESPA”). This is a significant change in that the scope of Truth in Lending compliance is now a matter of concern, responsibility and potential liability for real estate agents, title companies, attorneys, appraisers, appraisal management companies, appraisal companies and any other settlement service provider and their regulatory agencies.
3. “Covered Transactions” under the Rule include any consumer loan secured by the consumer’s principal dwelling, whether open end or closed end credit.

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<sup>1</sup>In order to dismiss any appearance of impropriety, the author discloses ownership in an AMC.

4. The standard prohibitions against coercion, undue influence, bribery, extortion, etc. of an appraiser to cause the appraiser to provide a valuation not based on the appraiser's actual opinion of value. **Significantly, it is advised that in connection with purchase money transactions, the sales price should not be given to the appraiser independent of the sales contract. It is specifically allowed under the Interim Rules to provide the sales contract, but it is specifically prohibited to provide a value to the appraiser.** Also, withholding of payment from an appraiser is still allowed if the appraiser has breached the contract of engagement or has provided substandard services or substandard performance in connection with the services. Additionally, nothing in Interim Rules is intended to prohibit anyone with an interest in the transaction from asking an appraiser to undertake a review of additional comparables or additional property information in connection with an appraisal report or to require further detail, substantiation, or explanation as to the appraiser's value conclusion or to request that an appraiser correct errors in an appraisal report.
5. Prohibits conflicts of interest by disallowing an appraiser or an appraisal management company to prepare or manage the appraisal process if the appraiser or the appraisal management company has a financial or other interest in the property. The Interim Rules clarify that nothing prohibits a lender from using in-house appraisers or affiliated appraisal management companies.

The Interim Rules set up safe harbor rules, which, if followed, provide a rebuttable presumption that no violation exists under Truth in Lending as to conflicts of interest. The safe harbor rules distinguish institutions with assets greater than \$250 million ("large institutions") and those with assets less than \$250 million ("small institutions").

Large institutions who set up "firewalls" between the persons involved in "loan production functions" and those persons involved in the valuation management functions to assure that the person preparing a valuation or performing valuation management functions reports to a person who is not part of the creditor's loan production staff and whose compensation is not based on the closing of the transaction to which the appraisal relates. Further, no loan production staff may be involved in the selecting, retaining, recommending or influencing of the person who will prepare a valuation or a person who will perform valuation management functions **AND** no loan production person is involved in the selection of the panel of appraisers to be used by the creditor or its appraisal management company.

Small institutions should also set up firewalls. However, the Regulations provide some flexibility in the safe harbor in that it is recognized that staffing may be an issue. Thus, small institutions can still take advantage of the safe harbor so long as appraiser independence is maintained. For instance, an example is given that the bank officer involved in the loan production may be the only person competent to review the appraisal report and discuss the same with the appraiser. If that bank officer does not participate in loan approval, then the small institution can still fit within the safe harbor.

If a lender chooses to use an appraisal management company, it is important to remember that a non-loan production employee should be assigned to refer and/or suggest appraisers to be included on the appraisal panel managed by the appraisal management company and if the lender does not have an employee with knowledge and understanding of the Uniform Standards of Professional Appraisal Practice ("USPAP"), then the ultimate decision to include a new appraiser on the appraisal panel should be made by the appraisal management company who employs persons either knowledgeable in or certified by USPAP.

6. Prohibit a lender from extending credit if it has knowledge of a violation of the prohibitions on coercion or conflict of interest; provided, however, if the lender can demonstrate that the

violation did not affect the appraiser's opinion of value, it may still extend credit. As an example, if the loan officer contacted the appraiser to get a "bump" to the value, but the appraiser refused and the lender can document the refusal and the fact that the appraiser's opinion of value was not affected by the illegal contact, then the lender may extend the credit.

7. There is a **mandatory** requirement to report appraiser misconduct to the appraiser's regulatory agency. The Interim Rules require only **material** violations be reported. It defines "material" violations as only those which are likely to affect the value assigned to the property. The Interim Rules also limit reportable items to only those that the person has a reasonable basis to believe that a violation has occurred **AND** only if the person has actual knowledge or evidence of the violation that would lead a reasonable person to believe that a material failure to comply has occurred.
8. Mandates that appraisers must be paid reasonable and customary fees for the appraisals. Summarily, two safe harbors are included which, if followed, create a rebuttable presumption of compliance. One is to pay based on fee surveys conducted by independent parties to determine what the normal fee for appraisals has been over the past year in each geographical area, based on appraiser experience, certifications, property type and appraisal type, etc; provided however, payments to appraisers by appraisal management companies may not be taken into consideration in connection with the surveys. This is quite interesting in that approximately 90% of appraisals over the past year have been ordered and paid by appraisal management companies. This fact alone makes a survey somewhat questionable. The other is to pay based on existing agency rules such as the VA's Schedule of Fees for Appraisers. **These provisions are somewhat convoluted and only time will tell what is considered reasonable and customary. The Interim Rules do allow payment based on volume discounts. We will closely monitor this situation and provide additional guidance once the industry "digests" this provision.**
9. HVCC is no longer in effect as of October 18, 2010.

## Appraiser Independence Requirements

### I. Appraiser Independence Safeguards

- A. An “appraiser” must be, at a minimum, licensed or certified by the State in which the property to be appraised is located.
- B. No employee, director, officer, or agent of the Seller, or any other third party acting as joint venture partner, independent contractor, appraisal company, appraisal management company, or partner on behalf of the Seller, shall influence or attempt to influence the development, reporting, result, or review of an appraisal through coercion, extortion, collusion, compensation, inducement, intimidation, bribery, or in any other manner including but not limited to:
- (1) Withholding or threatening to withhold timely payment or partial payment for an appraisal report;
  - (2) Withholding or threatening to withhold future business for an appraiser, or demoting or terminating or threatening to demote or terminate an appraiser;
  - (3) Expressly or impliedly promising future business, promotions, or increased compensation for an appraiser;
  - (4) Conditioning the ordering of an appraisal report or the payment of an appraisal fee or salary or bonus on the opinion, conclusion, or valuation to be reached, or on a preliminary value estimate requested from an appraiser;
  - (5) Requesting that an appraiser provide an estimated, predetermined, or desired valuation in an appraisal report prior to the completion of the appraisal report, or requesting that an appraiser provide estimated values or comparable sales at any time prior to the appraiser’s completion of an appraisal report;
  - (6) Providing to an appraiser an anticipated, estimated, encouraged, or desired value for a subject property or a proposed or target amount to be loaned to the Borrower, except that a copy of the sales contract for purchase transactions may be provided;
  - (7) Providing to an appraiser, appraisal company, appraisal management company, or any entity or person related to the appraiser, appraisal company, or appraisal management company, stock or other financial or non-financial benefits;
  - (8) Removing an appraiser from a list of qualified appraisers, or adding an appraiser to an exclusionary list of disapproved appraisers, in connection with the influencing or attempting to influence an appraisal as described in Paragraph B above (this prohibition does not preclude the management of appraiser lists for bona fide administrative or quality-control reasons based on written policy); and

- (b) Having any substantive communications with an appraiser or appraisal management company relating to or having an impact on valuation, including ordering or managing an appraisal assignment.

These parties are:

- (i) All members of the Seller's Mortgage production staff;
- (ii) Any person who is compensated on a commission basis upon the successful completion of a Mortgage; and
- (iii) Any person whose immediate supervisor is not independent of the Mortgage production staff and process.

Seller personnel not described in Section IV.B (1)(i) through (iii) above are not subject to the restrictions described above, and may engage in communications with an appraiser. In addition, any party, including the parties described in Section IV.B (1)(i) through (iii) above, may request that an appraiser provide additional information or explanation about the basis for a valuation, or correct objective factual errors in an appraisal report.

- (2) If absolute lines of independence cannot be achieved as a result of the Seller's small size and limited staff, the Seller must be able to clearly demonstrate that it has prudent safeguards to isolate its collateral evaluation process from influence or interference from its Mortgage production process.

- C. Any employee of the Seller (or if the Seller retains an appraisal company or appraisal management company, any employee of that company) tasked with selecting appraisers for an approved panel or substantive appraisal review must be:

- (1) Appropriately trained and qualified in the area of real estate appraisals; and
- (2) In the case of an employee of the Seller, wholly independent of the Mortgage production staff and process.

## **V. Use of Appraisal Reports by In-House Appraisers or Affiliated Appraisers**

- A. In underwriting a Mortgage, the Seller may use an appraisal report:

- (1) Prepared by an appraiser employed by:
  - (a) The Seller;
  - (b) An affiliate of the Seller;
  - (c) An entity that is owned, in whole or in part, by the Seller; or

- (9) Any other act or practice that impairs or attempts to impair an appraiser's independence, objectivity, or impartiality or violates law or regulation, including, but not limited to, the Truth in Lending Act (TILA) and Regulation Z, or the Uniform Standards of Professional Appraisal Practice (USPAP).

## **II. Acceptability of Subsequent Appraisals**

A Seller must not order, obtain, use, or pay for a second or subsequent appraisal in connection with a Mortgage financing transaction unless: (i) there is a reasonable basis to believe that the initial appraisal was flawed or tainted and such basis is clearly and appropriately noted in the Mortgage file, or (ii) such appraisal is done pursuant to written, pre-established bona fide pre- or post-funding appraisal review or quality control processes or underwriting guidelines, and so long as the Seller adheres to a policy of selecting the most reliable appraisal, rather than the appraisal that states the highest value, or (iii) a second appraisal is required by law.

## **III. Borrower Receipt of Appraisal**

The Seller shall ensure that the Borrower is provided a copy of any appraisal report concerning the Borrower's subject property promptly upon completion at no additional cost to the Borrower, and in any event no less than three days prior to the closing of the Mortgage. The Borrower may waive this three-day requirement if such waiver is obtained at least three days prior to the closing of the Mortgage. The Seller may provide the Borrower at closing, a revised copy of an appraisal and information as to the nature of any revisions, so long as the revisions had no impact on value.

The Seller may require the Borrower to reimburse the Seller for the cost of the appraisal.

## **IV. Appraiser Engagement**

- A. The Seller or any third party specifically authorized by the Seller (including, but not limited to, appraisal companies, appraisal management companies, and Correspondent lenders) shall be responsible for selecting, retaining, and providing for payment of all compensation to the appraiser. The Seller will not accept any appraisal report completed by an appraiser selected, retained, or compensated in any manner by any other third party (including Mortgage Brokers and real estate agents).
- B. There must be separation of a Seller's sales or Mortgage production functions and appraisal functions. An employee of the Seller in the sales or Mortgage production function shall have no involvement in the operations of the appraisal function.

(1) Certain parties are prohibited from:

- (a) Selecting, retaining, recommending, or influencing the selection of any appraiser for a particular appraisal assignment or for inclusion on a list or panel of appraisers approved or forbidden to perform appraisals for the Seller; and

- (d) An entity that owns, in whole or in part, the Seller.
  - (2) Prepared by an appraiser employed, engaged as an independent contractor, or otherwise retained by an appraisal company or any appraisal management company affiliated with, or that owns or is owned, in whole or in part, by the Seller or an affiliate of the Seller, provided that the Seller complies with the provisions of these Appraiser Independence Requirements.
- B. The Seller also may use in-house staff appraisers to:
- (1) Order appraisals;
  - (2) Conduct appraisal reviews or other quality control, whether pre-funding or post-funding;
  - (3) Develop, deploy, or use internal Automated Valuation Models; or
  - (4) Prepare appraisals in connection with transactions other than Mortgage origination transactions (e.g., Mortgage workouts), if the Seller complies with the provisions of these Appraiser Independence Requirements.

## **VI. Transfer of Appraisals**

A Seller may deliver to Fannie Mae a conventional Mortgage with an appraisal prepared by an appraiser selected by another lender, including where a Mortgage Broker has facilitated the Mortgage application (but not ordered the appraisal). The Seller delivering the loan to Fannie Mae makes all representations and warranties to Fannie Mae regarding the appraisal set forth in the Mortgage Selling and Servicing Contract, the Selling Guide and related documents, including the representation that the appraisal is obtained in a manner consistent with these Appraiser Independence Requirements.

## **VII. Referrals of Appraisal Misconduct Reports**

Any Seller that has a reasonable basis to believe an appraiser or appraisal management company is violating applicable laws, or is otherwise engaging in unethical conduct, shall promptly refer the matter to the applicable State appraiser certifying and licensing agency or other relevant regulatory bodies.

## **VIII. Compliance**

Sellers must adopt written policies and procedures implementing these Appraiser Independence Requirements, including, but not limited to, adequate training and disciplinary rules on appraiser independence, including the principles detailed in Section I. Additionally, Sellers must ensure that any third parties, such as appraisal management companies or Correspondent lenders, used in conjunction with the sale and delivery of a Mortgage to Fannie Mae are also in compliance with these Appraiser Independence Requirements.