Valuation Compliance Series

# Third Party Oversight

CRN

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## Table of Contents

**INTRODUCTION** 5
- a. Background and Purpose of Existing Regulations 6
- b. Regulatory Structure of the Valuation Process 6
- c. Primary Banking Regulations 7
- d. Oversight and Regulatory Agencies 7
- e. Appraisal Related Regulations 8
- f. Government Mortgage Insurance Programs 9

1. Third Party Arrangements / Oversight Requirements 10
   - a. Best Practices 12
   - b. Liability Risk Considerations 13

2. Appraisal and Evaluation Program Requirements 16
   - a. Best Practices 17
   - b. Liability Risk Considerations 18

3. Independence of the Valuation Program 19
   - a. Best Practices 20
   - b. Liability Risk Considerations 21

4. Selection of Appraisers or Persons Who Perform Evaluations 22
   - a. Approved Appraiser List 26
   - b. Liability Risk Considerations 27
   - c. Exclusionary List 27
   - d. Watch or Probation 27
   - e. Background Checks 28
   - f. Disciplinary Actions 28
   - g. Appraisal Subcommittee Registry 29
   - h. Education 29
   - i. Engagement Letters 29
   - j. Local Data Services 29
   - k. Identity Verification 29
   - l. Errors and Omissions Insurance 30
   - m. Foreign Languages 30
   - n. Minority and Women Owned Business 30
   - o. Sample Appraisal Reports 30
   - p. Competency Exam 31
   - q. Fee Schedules 31

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r. Areas of Expertise 31
s. Geographic Coverage 31
t. Photos of the Appraiser 32
u. Contractor Agreement between the AMC and Appraiser 32
v. Liability Risk Consideration 32

5. Customary and Reasonable Fees 33
a. Best Practices 35
b. Complex Assignments 37
c. Volume Discounts 37
d. Liability Risk Considerations 38

6. Mandatory Reporting 38
a. Best Practices 40

7. Minimum Appraisal Standards 41
a. Appraisal Development 42
b. Best Practices 43
c. Appraisal Content 43
d. Best Practices 43

8. Evaluations 44
a. Minimum Evaluation Standards 44
b. Best Practices 44
c. Minimum Evaluation Content 45
d. Best Practices 46
e. Property Condition Reports 46

9. Automated Valuation Models 47
a. Best Practices 47

10. Appraisal Report Portability 48
a. Best Practices 49

11. Reviewing Appraisals and Evaluations 49
a. Review Requirements 49
b. Best Practices 50
c. Reviewer Qualifications 51
d. Best Practices 52
e. Depth of Review 52
f. Best Practices 53
g. Resolution of Deficiencies 53
h. Best Practices 55

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i. Documentation of the Review 56
j. Best Practices 56
k. Best Practices 57

12. AMC State Registration 57
a. Definition of an AMC 58
b. AMC Services 59
c. Owner Criteria 59
d. Penalties 59
e. Key Provisions 59
f. Best Practices 60

13. Auditing Your Third Parties 61

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## Introduction

There is no question that “risk” and “third party oversight” are buzz words being spoken inside the walls of the regulators of financial institutions. This is in large part a result of the recent regulatory changes due to the financial crisis of a few years ago.

There are a number of types of risk. The goal of any institution is to manage risk by establishing processes, practices and procedures to ensure a safe and sound valuation program.

One risk, which is the focus of this paper, is outsourcing appraisal functions to one or more third parties.

Third Party Oversight is the term used to describe the process to ensure that an entity chosen to perform an operational process or to provide a service is performing adequately to minimize exposure to potential significant financial loss, reputational damage, and supervisory action. In addition, Third Party Oversight includes assessing the quality of the service, risk management practices, financial condition, conformance to policies and procedures, as well as applicable controls and reports.

While it is an acceptable practice, an institution should examine the purpose for outsourcing, part or all, of its valuation functions. It is not possible to outsource risk to a third party vendor. In fact Interagency and Evaluation Guidance states that an institution’s risk is increased with a decision to outsource.

With this increased attention and visibility into the operational aspect of a financial institution comes the inevitability of adverse commentary during exams from the regulators. The penalties for non-compliance range from recommendations, matters requiring attention and even significant financial penalties.

Since early 2010 there has been over 600 pages of new and/or proposed regulations related to the valuation process:

- The Dodd-Frank Act,
- The Interagency Appraisal and Evaluation Guidelines: changes to FIRREA, TILA, ECOA, USPAP, and
- The ever-growing list of state statutes and rules, to name a few.

The additional requirements to comply with Fannie Mae, Freddie Mac, FHA and VA requirements only add an additional layer of complexity and need for closer examination of policies and procedures to ensure compliance with regulations and guidance.

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This paper is written as an informative document that attempts to identify the regulatory standards, requirements and guidance with respect to valuation. It will suggest best practices for compliance with third party oversight requirements from the perspective of a financial institution or lender. It is important to consider that appraisal providers will be required to adhere to the same requirements as the financial institutions when engaged to perform services as a third party provider.

The objective is to simplify a very complicated maze of regulations and guidance by providing a clear road map. We examined all of the relative laws, guidelines, regulations, rules and suggestions contained in the guidance issued related to valuations. As part of this analysis, a checklist has been developed for use by financial institutions and others who may have an interest in assessing the compliance of a valuation program.

Please keep in mind the suggestions and recommendations in the paper are just that - recommendations and suggestions for compliance. It is not intended to be a replacement for sound and prudent legal advice. While there was every effort made to make this paper all-inclusive and an exhaustive analysis of the regulations and requirements, it is acknowledged that there may be some considerations that were not accounted for that could provide for a more compliant response to the regulations.

## Background and Purpose of Existing Regulations

Dating back to 1989, the federal agencies have issued guidance designed to promote the safe and sound practices related to establishing real estate appraisal and valuation programs. These began with FIRREA in 1989 and were expanded upon in the Interagency Appraisal and Evaluation Guidelines in 1994. A series of Bulletins followed, in addition to numerous changes to other regulations affecting the valuation process. Most recently, the introduction of Dodd-Frank and The Interagency Appraisal and Evaluation Guidelines in 2010 has elevated the importance of prudent third party vendor management to a new level of significance.

At times, Institutions and appraisal providers have struggled to identify and aggregate all of the rules, regulations, recommendations and guidance related to establishing safe, sound and compliant practices related to their real estate valuation programs. Where other regulations come with concise names such as Reg O, or Reg Z, appraisal and valuation related regulations are found in a number of areas. *(Note to the regulators, "Regulation A" for all things appraisal!)*

## Regulatory Structure of the Valuation Process

The following is an outline of the many different guidelines and regulations related to the appraisal and valuation process. Readers should identify the specific oversight regulatory requirements that are applicable to their own institution and build policies accordingly.

The paper will draw from a variety of sources to identify the primary banking regulations that should be considered for effective compliance.

## Primary Banking Regulations

- Financial Institutions Reform, Recovery and Enforcement Act- (FIRREA)
  Establishes:

  - Criteria for when appraisals are required.
  - Requirements for compliance with USPAP.
  - Appraiser licensing criteria.
  - State enforcement of appraisal standards.

- Fair Housing Act Title VIII
  Prohibits discrimination of persons in terms or conditions of a sale or rental.

- Equal Credit Opportunity Act Reg. B
  Defines "protected classes" for disparate treatment and disparate impact.

- Home Mortgage Disclosure Act Reg. C
  Effectively prohibits lending criteria based on zip code or neighborhood.

- Community Reinvestment Act
  Requires banks to invest in local communities through lending programs.

## Oversight and Regulatory Agencies

- Office of the Comptroller of the Currency – (OCC)
  The OCC's primary mission is to charter, regulate, and supervise all national banks and federal savings associations. They also supervise the federal branches and agencies of foreign banks. Their goal in supervising banks and federal savings associations is to ensure that they operate in a safe and sound manner and in compliance with laws requiring fair treatment of their customers and fair access to credit and financial products.

- Federal Depository Insurance Corporation – (FDIC)
  The Federal Deposit Insurance Corporation preserves and promotes public confidence in the U.S. financial system by insuring deposits in banks and thrift institutions for at least $250,000; by identifying, monitoring and addressing risks to the deposit insurance funds; and by limiting the effect on the economy and the financial system when a bank or thrift institution fails. The FDIC directly examines and supervises more than 4,500 banks and savings banks for

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operational safety and soundness, which includes more than half of the institutions in the banking system.

- Federal Reserve- (FRB)
  The Federal Reserve has supervisory and regulatory authority over a wide range of financial institutions and activities. It works with other federal and state supervisory authorities to ensure the safety and soundness of financial institutions, stability in the financial markets, and fair and equitable treatment of consumers in their financial transactions.

  National Credit Union Administration- (NCUA)
  National Credit Union Administration oversees all federally chartered credit unions. In recent years credit unions have seen healthy growth and have had very few failures as compared to the bank sector.

## Appraisal-Related Regulations

- Uniform Standards of Professional Appraisal Practice (USPAP)
  The Appraisal Foundation develops, interprets, and amends the Uniform Standards of Professional Appraisal Practice. The purpose of USPAP is to promote and maintain public trust in appraisal practice by establishing requirements for appraisers to develop and communicate their analyses, opinions, and conclusions to intended users in a manner that is meaningful and not misleading. Financial institutions are responsible for ensuring appraisals are developed in conformance with USPAP.

- Truth-in-Lending (TILA)
  Appraisal Independence regulations are enforceable under TILA along with payment of reasonable and customary fees to appraisers.

- Consumer Finance Protection Bureau (CFPB)
  The Interim Final rule (and subsequent rulemaking) applies to any creditor or person who provides settlement services in connection with an extension of consumer credit secured by the principal dwelling of the consumer. This is generally consistent with the scope of TILA, however, it is broader than the 2008 Home Valuation Code of Conduct (HVCC); those rules apply to closed-end loans but not to home-equity lines of credit (HELOC's).

- Interagency Appraisal & Evaluation Guidelines
  The FFIEC Agencies issued the Interagency Appraisal and Evaluation Guidelines to provide further clarification of the Agencies' appraisal regulations and

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supervisory guidance to institutions and examiners about prudent appraisal and evaluation programs.
The Guidelines, including their appendices, update and replace existing supervisory guidance documents to reflect developments concerning appraisals and evaluations, as well as changes in appraisal standards and advancements in regulated institutions' collateral valuation methods. The Guidelines clarify the Agencies' longstanding expectations for an institution's appraisal and evaluation program to conduct real estate lending in a safe and sound manner. Further, the Guidelines promote consistency in the application and enforcement of the Agencies' appraisal regulations and safe and sound banking practices.

## Government Mortgage Insurance Programs

- Federal Housing Finance Administration
  The Federal Housing Finance Administration mission is to provide effective supervision, regulation and housing mission oversight of Fannie Mae, Freddie Mac and the Federal Home Loan Banks to promote their safety and soundness, support housing finance and affordable housing, and support a stable and liquid mortgage market.

  - Fannie Mae
  The Selling Guide contains the current policies and procedures of Fannie Mae and all announcements issued to date. Fannie Mae updates the requirements periodically through bulletins, letters and updates to the Selling Guide.
  - Freddie Mac
  The *Single-Family Seller/Servicer Guide* contains Freddie Mac's selling and servicing requirements. Freddie Mac periodically publishes updates to the requirements in the form of Guide Bulletins and Industry Letters.

- Housing and Urban Development / Federal Housing Authority
  It is HUD's mission to promote non-discrimination and ensure fair and equal housing opportunities for all. In an ongoing effort to provide services and activities on a nondiscriminatory manner and to affirmatively further fair housing.

- Veterans Affairs
  VA helps Service members, Veterans, and eligible surviving spouses become homeowners. VA Home Loans are provided by private lenders, such as banks and mortgage companies. VA guarantees a portion of the loan, enabling the lender to provide loans with more favorable terms.

**NOTE:** The compliance requirements for loans sold to Fannie Mae, Freddie Mac, HUD/FHA or VA, are overlaid in addition to all of the other guidelines and requirements of a financial institution.

## 1. Third Party Arrangements

The need for program compliance and following the rules has never been stronger. The regulators have been clear in their guidance to banks and have basically said that if you choose to outsource your valuation program, you had better know what the third party or vendor is doing as well as if you are doing it yourself. In fact, IAEG states that an institution's risk is greater when a function is outsourced. Below are the regulatory references requiring the third party oversight. Banks will be examining valuation services providers to ensure compliance just as the regulators will be examining the banks to ensure compliance with the regulations.

| Regulatory Source | Requirement/Guideline |
| --- | --- |
| Dodd/Frank | The Consumer Finance Protection Bureau (CFPB) expects supervised banks and non-banks to oversee their relationships with service providers in a manner that ensures compliance with Federal consumer financial law, which is designed to protect the interests of consumers and avoid consumer harm. The CFPB's exercise of its supervisory and enforcement authority will closely reflect this orientation and emphasis.<br><br>The CFPB expects supervised banks and non-banks to have an effective process for managing the risks of service provider relationships. The CFPB will apply these expectations consistently, regardless of whether it is a supervised bank or non-bank that has a relationship with a service provider.<br><br>Supervised banks and non-banks should take steps to ensure that their business arrangements with service providers do not present unwarranted risks to consumers. These steps should include, but are not limited to:<br>• Conducting thorough due diligence to verify that the service provider understands and is capable of complying with Federal consumer financial laws.<br>• Requesting and reviewing the service provider's policies, procedures, internal controls, and training materials to ensure that the service provider conducts appropriate training and oversight of employees or agents that have consumer contact or |

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| | compliance responsibilities.<br>• Including in the contract with the service provider clear expectations about compliance, as well as appropriate and enforceable consequences for violating any compliance related responsibilities, including engaging in unfair, deceptive or abusive acts or practices.<br>• Establishing internal controls and ongoing monitoring to determine whether the service provider is complying with the Federal consumer financial laws.<br>Taking prompt action to address fully any problems identified through the monitoring process, including terminating the relationship where appropriate. |
| IAEG | An institution that engages a third party to perform certain collateral valuation functions on its behalf is responsible for understanding and managing the risks associated with the arrangement.<br><br>An institution should use caution if it engages a third party to administer any part of its appraisal and evaluation function, including the ordering or reviewing of appraisals and evaluations, selecting an appraiser or person to perform evaluations, or providing access to analytical methods or technological tools.<br><br>An institution is accountable for ensuring that any services performed by a third party, *both affiliated and unaffiliated entities*, comply with applicable laws and regulations and are consistent with supervisory guidance.<br><br>Therefore, an institution should have the resources and expertise necessary for performing ongoing oversight of third party arrangements. An institution should have internal controls for identifying, monitoring, and managing the risks associated with using a third party arrangement for valuation services, including compliance, legal, reputational, and operational risks.<br><br>While the arrangement may allow an institution to achieve specific business objectives, such as gaining access to expertise that is not available internally, the reduced operational control over outsourced activities poses additional risk.<br><br>Consistent with safe and sound practices, an institution should have a written contract that clearly defines the expectations and obligations of both the financial institution and the third party, including that the third party will perform its services in compliance with the Agencies' appraisal regulations and consistent with supervisory guidance.<br><br>Prior to entering into any arrangement with a third party for valuation services, an institution should compare the risks, costs, and benefits of |

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| | the proposed relationship to those associated with using another vendor or conducting the activity in-house. The decision to outsource any part of the collateral valuation function should not be unduly influenced by any short-term cost savings.<br><br>An institution should take into account all aspects of the long-term effect of the relationship, including the managerial expertise and associated costs for effectively monitoring the arrangement on an ongoing basis. If an institution outsources any part of the collateral valuation function, it should exercise appropriate due diligence in the selection of a third party. This process should include sufficient analysis by the institution to assess whether the third party provider can perform the services consistent with the institution's performance standards and regulatory requirements.<br><br>An institution should be able to demonstrate that its policies and procedures establish effective internal controls to monitor and periodically assess the collateral valuation functions performed by a third party.<br><br>An institution should document the results of ongoing monitoring efforts and periodic assessments of the arrangement(s) with a third party for compliance with applicable regulations and consistency with supervisory guidance and its performance standards. If deficiencies are discovered, an institution should take remedial action in a timely manner. |
| Fannie Mae | While Fannie Mae allows lenders to use third-party vendors, such as appraisal management companies (AMC), for appraisal services, neither the *Appraiser Independence Requirements* nor Fannie Mae requires their use. If lenders choose to rely on an AMC to review an appraiser's qualifications or select the individual to perform appraisals, lenders should establish appropriate procedures and qualifications, including compliance with the previously noted requirements, to ensure that qualified individuals are selected.<br><br>The lender delivering the loan to Fannie Mae is ultimately responsible for representations and warranties related to the value, condition, and marketability of the subject property. If a lender uses the services of an AMC, the lender must hold the AMC responsible for complying with Fannie Mae's requirements, including those of the Appraiser Independence Requirements, as if the lender had selected the appraiser. Imposing this requirement on the AMC does not relieve the lender of its warranties related to the appraisal or the value, condition, and marketability of the property. |

## Best Practices

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Banks and valuation services providers should have in place clear expectations in the form of contractual agreements. The services performed should be well defined by the bank. Clear expectations of compliance and the consequences for non-compliance should be covered within the contractual arrangement. The valuation services provider should be prepared to provide transparency into their internal controls, policies and procedures and be able to demonstrate an acceptable level of understanding of the requirements and compliance with the regulations.

This level of oversight is necessary whether the service provider is affiliated or unaffiliated with the bank. The financial institution should have knowledgeable, trained and experienced individuals to perform the oversight. The financial institution at all times will be responsible for the actions and compliance of their chosen third party valuation services providers. It is not acceptable or possible to abdicate responsibility for program compliance to a third party.

## Liability Risk Considerations

The oversight by lenders of third party providers of valuation services is not only a matter of technical regulatory compliance. To be sure, lenders are audited by regulators such as the FDIC for such compliance and are subject to regulatory orders and discipline, and there will likely be substantial future compliance efforts by the CFPB. Beyond that, however, the adequacy of a lender's oversight of third party valuation providers (namely, AMCs) significantly affects the lender's liability risk and, in some cases, the liability risk of its individual personnel, executive officers and directors. Inadequate oversight of outsourced valuation services has resulted in litigation against lenders and, in some cases, management involving:

- Loan repurchases demanded by GSEs and mortgage investors on the basis of alleged appraisal and valuation deficiencies.
- Legal actions filed by the FDIC as a receiver for failed lenders against bank officers and directors alleging gross negligence and breach of fiduciary duties.
- False Claims Act whistleblower litigation relating to appraisal independence violations and appraisal manipulation.
- Individual borrower and class actions against lenders relating to violations of appraisal independence and oversight of appraisals supplied by AMCs.
- Legal actions and regulatory complaints filed by appraisers and real estate agents/brokers relating to blacklisting and non-payment by the lender's AMC.

Minimizing the above types of liability risk relating to the use of AMCs involves:

- Having an appropriate appraisal and evaluation program in place as the foundation for the valuation services utilized by the lender.

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- Consistently following the adopted program.
- Having appropriate contractual arrangements with AMCs that address performance standards, legal and regulatory compliance, selection and payment of contracting appraisers and other vendors, risk shifting and insurance coverage.
- Recognizing that a lender will always have potential liability risk that cannot be shifted despite the use of third parties and contractual arrangements.
- Monitoring the performance and stability of AMCs.

With respect to a lender's engagement of an AMC to perform appraisal management, the lender must have a detailed written service agreement with the AMC for the purpose of minimizing its liability risk. The following elements of the service agreement should be carefully considered in connection with liability risk issues:

- Legal and Regulatory Compliance: Lenders should require AMCs to provide assurances that the appraisal services will be managed in a manner compliant with the applicable laws, regulations and guidelines discussed in this paper and also with privacy laws that apply.
- Selection of Appraisers: The service agreement, or ancillary agreements, should address the lender's qualification requirements for appraisers selected for assignments. The lender should then observe and verify the actual process used by the AMC to fulfill appraisal order assignments. For example, a lender who has agreed to pay a set charge for fulfillment of appraisal assignments may observe that the AMC then uses a broadcast system through which the AMC selects appraisers for assignments based on the lowest fee offered, thus maximizing the AMC's profit margin without regard to other appraiser qualification criteria. A lender may also observe that an AMC does not differentiate the qualifications required for assignments with higher levels of complexity.
- Payment of Appraisers: While a lender cannot avoid its own legal responsibility for payment of customary and reasonable appraisal fees for assignments under the jurisdiction of the Dodd-Frank Act, the lender must carry forward that responsibility into the service agreement with an AMC. In addition, a prudent lender should address an AMC's obligation to pay appraisers and other vendors on a timely basis to avoid the possible scenario of the lender having paid an AMC for services for which the AMC then fails to pay appraisers and other vendors. Along with that contractual obligation, the lender may want a mechanism to provide transparency into the AMC's payments.
- Representations and Warranties: It is common for lenders to require that AMCs provide contractual representations and warranties on such matters as compliance with laws and regulations as well as compliance of the managed appraisals with USPAP or GSE requirements. Some lenders further seek to impose on the AMC an obligation to pay for loan losses or mortgage repurchase liabilities insured by the lender as the result of appraisal deficiencies. The

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negotiation of such more extreme "reps and warranties" needs to be approached prudently, however, and a lender's expectations for financial and liability risk transfers should not be unrealistic. Some AMCs will agree to extreme risk transfer language essentially because they "have nothing to lose". They may be thinly capitalized and operated for short-term financial reward, or simply operated without regard to risk. More prudently operated AMCs will decline contractual relationships that transfer risk unreasonably. Yet, the lender would likely be better served in connection with its overall risk management by engaging the more responsible AMC and thus should not be steadfast in adherence to extreme provisions of transferring financial or liability risk.

- Insurance coverage of the AMC. Lenders are sometimes surprised to learn that many AMCs operate without any insurance coverage covering the negligent performance of appraisal management. Either the AMC maintains no insurance coverage at all or the insurance coverage of the AMC does not extend to the actual performance of appraisal management (*e.g.*, panel management and quality control) as differentiated from performing appraisals. The adequacy of an AMC's insurance coverage needs to be addressed in three manners:

    1. Assurance that the AMC will maintain types of policies appropriate for appraisal management activities on behalf of a lender. The most critical policy in this regard will be the AMC's professional liability (or E&O) policy. This is the policy intended to cover financial damage caused by an AMC's negligent performance of appraisal management activities. Other relevant coverage often required of AMCs in service agreements, but which are less likely to apply to actual claims, include: cyber/privacy liability coverage, general liability and property coverage, and crime/fidelity coverage.
    2. Assurance that the AMC's insurance coverage actually covers appraisal management, including the management of any non-appraisal products such as evaluations. In particular, it is critical that the AMC's professional liability policy actually be written to cover appraisal management because a policy written to cover, for example, "professional services as a real estate appraiser" cannot be assumed to cover appraisal management activities or the other types of services that an AMC may deliver.
    3. Assurance that the limits of the AMC's insurance coverage are adequate. In recent years, civil liability claims against AMCs have involved alleged damages exceeding $100 million in notable cases. When considering the adequacy of an AMC's insurance coverage, especially its professional liability coverage, a lender must recognize that an AMC will handle hundreds or thousands of appraisals for the lender. Thus, while an individual appraiser's negligence may result in a claim for losses on a single loan, an AMC's negligence may result in a claim involving multiple

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loans. For that reason, an AMC's limits of liability must be substantially higher than required for an individual appraiser. If an AMC is providing a high volume of services to a lender, the lender will often require the AMC to carry professional liability insurance covering a minimum of $5 million per claim and possibly as much as $10 million per claim. If an AMC is handling fewer assignments, a lower limit of $1 million or $2 million per claim may be adequate. In general, most AMCs will not have reasonable access to insurance coverage exceeding $10 million per claim.

## 2. Appraisal and Evaluation Program Requirements

A financial institution is required to have a real estate appraisal and evaluation program that develops and maintains policies and procedure to ensure an effective and compliant program. The following regulatory citations will address the critical elements that should be maintained within the program policies and procedures. When a financial institution outsources its valuation program or any portion of the program, these regulations pertain to the third party performing the services.

| Regulatory Source | Requirement/Guideline |
| --- | --- |
| IAEG | An institution's appraisal and evaluation policies should establish internal controls to promote an effective appraisal and evaluation program. The compliance process should:<br>1. Maintain a system of adequate controls, verification, and testing to ensure that appraisals and evaluations provide credible market values.<br>2. Insulate the persons responsible for ascertaining the compliance of the institution's appraisal and evaluation function from any influence by loan production staff.<br>3. Establish procedures to test the quality of the appraisal and evaluation review process.<br>4. Report appraisal and evaluation deficiencies to appropriate internal parties and, if applicable, to external authorities in a timely manner. |
| Fannie Mae / Freddie Mac | In support of [the GSEs'] efforts to improve the quality and accuracy of appraisals for the mortgages [they] purchase, effective appraisal management and underwriting processes within your organization is key. These best practices are based on [the GSEs'] analysis of practices used by many of [their] Sellers throughout their appraisal management and controls process. Based on [the GSEs] analysis, [they have] identified the following as key actions that support a strong collateral management process:<br>• Document and monitor compliance with, and effectiveness of, policies and procedures and implement necessary changes to policies and procedures in a timely fashion |

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| | • Monitor performance of appraisers, AMCs and appraisal reviewers. Proactively measure and manage these parties using specific appraisal quality benchmarks<br>• Conduct due diligence of AMC's policies, processes and key controls at the time of approval and on an ongoing basis thereafter<br>• Arrange for the governance and authority of collateral policies and procedures to be independent from production staff<br>• Conduct quality control tests on a randomly selected statistically significant percentage of appraisals |
| FIRREA | Title XI provides protection for federal financial and public policy interests in real estate related transactions by requiring real estate appraisals used in connection with federally related transactions to be performed in writing, in accordance with uniform standards, by appraisers whose competency has been demonstrated and whose professional conduct will be subject to effective supervision. |

## Best Practices

These requirements outline the need for the financial institution, and their valuation services provider, to have internal controls as well as programs to monitor the performance of the policies. These should be documented in policies and procedures to ensure compliance and independence.

The policies should be documented in writing and contain sufficient information to demonstrate an understanding of the regulations and requirements and a reasonable method for complying with each requirement relative to the service being performed. For example, if the service being provided is the delivery of appraisals, the financial institution and the service provider need to have policies that show compliance with that process.

Practices alone will not satisfy this requirement. Just because a service provider or a financial institution does something in a compliant manner, but it is not documented in a policy, it will not meet this requirement.

Note that the guidance suggests proactive measures. Abdicating responsibility for appraiser selection to a third party is likely the riskiest and most common failure point of an appraisal program. If your service level agreements are focused on turn times, the quality of your appraisal reports will suffer. Service is an important measure and is typically the focus of most audits because it is the easiest to quantify. Put appraiser selection first, followed by fee and turn times. Logic would dictate that if you engage the best appraiser, a quality report would result.

Specifically an appraisal program (internal as well as your third party) must:

1. Define a QC process including:
   a. Due diligence on appraiser selection and
   b. A quality control and review process of the appraisal report.
2. Appraisal Independence Policies.
3. Review policy and procedures.
4. Mandatory reporting.

Automated scorecards have become increasingly popular. Scorecards are a way of identifying service levels and flags for items that should be further scrutinized. They are not a substitute for a review. They are merely a tool to assist a reviewer.

## Liability Risk Considerations

The most common liability issues faced by financial institutions with respect to their appraisal and evaluation programs have involved failures of the institution's management to actually follow the adopted program. Such failures not only pose liability risks to the institution itself but also pose personal liability risk to the management personnel who may be accused of failing to abide by the program. Most regulated institutions will have in place documentation that sets forth the elements of an acceptable appraisal and evaluation program on paper. The liability trap then is that the institution's personnel, particularly its ultimate lending decision makers (*e.g.*, the officers and directors who may sit on a bank's loan committee), will ignore either compliance with the elements required in the program or ignore the work product produced by the program.

Thus, in the recent wave of FDIC litigation against officers and directors of failed lenders, it has been very common for the FDIC to allege that while a failed bank had in place a program that required appraisals to meet specific parameters (such as the age of the appraisal at the time of loan funding or requiring both "as is" as well as "as completed" values for construction financing), the members of the bank's loan committee overlooked the requirements in approving a loan. When such loans have defaulted for the lender and the lender is now under an FDIC receivership, the FDIC has sued the individual officers and directors for gross negligence and breach of fiduciary duties, seeking monetary damages against them. In other cases, the FDIC has accused bank management personnel of ignoring the findings of appraisal reviews that have pointed out deficiencies in the appraisal upon which a proposed loan is based.

In a 2012 case, for example, the FDIC sued 10 former loan committee members of a failed California bank because they allegedly ignored the advice of the bank's chief appraiser with respect to his review of the appraisal performed by an independent appraiser for a proposed commercial construction loan. The chief appraiser had concluded that the appraisal did not include all costs necessary to complete the project

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because the appraiser had not been given complete information. For another construction loan, the chief appraiser had pointed out that the appraisal did not include a true “as is” valuation as required by the bank’s appraisal program policies and that the appraisal was based on a hypothetical condition that the land was vacant (the appraisal assumed that a mobile park and its tenants presently on the subject property were moved). These and similar issues were ignored by the bank’s loan committee and alleged by the FDIC to constitute violations of “safe and sound banking practices,” resulting in a claim for $100,600,000 in damages against the officers and directors.

## 3. Independence of the Valuation Program

There are few things as strongly reinforced as many regulations and laws as is independence of the valuation program. Independence is the cornerstone of the entire valuation program. Without independence, all other areas of the program are not in compliance. Independence reaches into almost every area and process associated with a valuation and appraisal program. The reporting structure of the organization, the individuals ordering the valuation product, selecting the service provider, the individual performing the service and those performing the review of the service provided are all impacted by this requirement.

| Regulatory Source | Requirement/Guideline |
|---|---|
| Dodd/Frank | It shall be unlawful, in extending credit or in providing any services for a consumer credit transaction secured by the principal dwelling of the consumer, to engage in any act or practice that violates appraisal independence.<br><br>The person preparing a valuation or performing valuation management functions may not report to a person who is part of the creditor’s loan production function<br><br>If the employee of the appraisal management company who is in charge of valuation management functions for that transaction is supervised by a person who earns a commission or bonus based on the percentage of closed transactions for which the appraisal management company provides valuation management functions, the condition under paragraph (d)(2)(ii) is not met. |
| IAEG | An institution should establish reporting lines independent of loan production for staff that administers the institution’s collateral valuation program, including the ordering, reviewing, and acceptance of appraisals and evaluations.<br><br>Appraisers must be independent of the loan production and collection processes and have no direct, indirect or prospective interest, financial or otherwise, in the property or transaction. |

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| | An institution should not directly or indirectly coerce, influence, or otherwise encourage an appraiser or a person who performs an evaluation to misstate or misrepresent the value of the property. |
| Fannie Mae/ Freddie Mac | 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. 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. |
| HUD/FHA | No members of a lender's loan production staff or any person<br>(i.) Who is compensated on a commission basis upon the successful completion of a loan or<br>(ii.) Who reports, ultimately, to any officer of the lender not independent of the loan production staff and process, shall have substantive communications with an appraiser relating to or having an impact on valuation, including ordering or managing an appraisal assignment. |
| FIRREA | If an appraisal is prepared by a staff appraiser, that appraiser must be independent of the lending, investment, and collection functions and not involved, except as an appraiser, in the federally related transaction, and have no direct or indirect interest, financial or otherwise, in the property.<br>If an appraisal is prepared by a fee appraiser, the appraiser shall be engaged directly by the regulated institution or its agent, and have no direct or indirect interest, financial or otherwise, in the property or transaction. |

## Best Practices

Again, appraisal independence is undeniably one of the most important components of a well-designed appraisal and valuation program. It is critical in the context of a compliant and prudent lending process. A financial institution and the service provider should be very cautious to draw clear lines of separation between production personnel and appraisers.

IAEG notes:

> "Loan Production Staff — Generally, all personnel responsible for generating loan volume or approving loans, as well as their subordinates and supervisors. These individuals would include any employee whose compensation is based on loan volume (such as processing or approving of loans). An employee is not considered loan production staff just because part of their compensation includes a general bonus or profit sharing plan that benefits all employees.

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> Employees responsible solely for credit administration or credit risk management are not considered loan production staff."

Policies and procedures should be in place to allow for the independent engagement and communication with the appraiser. Clear policies outlining appropriate and inappropriate communications with appraisers should be in place to avoid coercion and/or influence.

The valuation program should be isolated from influence by the institution's loan production staff, including the ordering, reviewing, and acceptance of appraisals and evaluations. Appraisers must be independent of loan production and have no direct, indirect or prospective interest, financial or otherwise, in the property or transaction.

Payment for appraisals cannot be determined by the consummation of the loan or a predetermined value. Withholding future appraisal assignments based on the evaluation of a property should not occur.

Communication with appraiser or person performing a valuation should not coerce, influence, or otherwise encourage an appraiser to misstate or misrepresent the value of the property and should not communicate a predetermined estimate of value, loan amount to the appraiser or person performing an evaluation.

It is acceptable to communicate to the appraiser to consider additional information about the subject property or about comparable properties, provide additional supporting information about the basis for a valuation and to correct factual errors in an appraisal.

An internal hotline and complaint process should be made readily available for the appraiser to file a complaint with supporting documentation. A resolution process should be swift and fair.

A financial institution should NOT consider if an AMC has a depository relationship with them. This financial relationship could be considered a vulnerability to coercion and may violate AIR guidance.

## Liability Risk Considerations

Alleged problems with the lack of separation between loan production and appraisers resulted in the New York Attorney General's well-known litigation against an AMC in 2007. That litigation ultimately led to Fannie Mae and Freddie Mac's forced adoption of the Home Valuation Code of Conduct (HVCC), which spawned many of the current regulations and guidelines now in place.

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Alleged violations of appraisal independence continue to threaten liability risk for financial institutions and AMCs. In the post-mortgage meltdown period, most appraisal independence problems are usually less obvious than before, such as:

- Communications from borrowers to appraisers that are guided by mortgage brokers or lending personnel in a manner to manipulate the appraiser's valuation.
- The handling of appraisal QC by an AMC in such a manner that appraisers are only questioned about reports when the valuation fails to meet values desired for loan closing.

Other instances are more easily discovered and prevented. For example, a review of the QC protocols of an AMC will sometimes uncover a step in the process with a label such as "If value is below contract price, contact appraiser." Such obvious missteps call attention to the fact that a lender does need to review the overall process used by the AMC to manage appraisals on the lender's behalf because the AMC is operating as the lender's agent for that purpose.

## 4. Selection of Appraisers or Persons Who Perform Evaluations

The quality of the valuation product is directly correlated to the selection of the service provider. When additional resources are applied to the selection and engagement of qualified, competent appraisers, the entire valuation process is impacted. Rate of acceptance, turnaround times, appraisal review and ultimately the impact on the default management process is affected by the selection of the right or wrong service provider.

| Regulatory Source | Requirement/Guideline |
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| IAEG | An institution's collateral valuation program should establish criteria to select, evaluate, and monitor the performance of appraisers and persons who perform evaluations. The criteria should ensure that:<br>• The person selected possesses the requisite education, expertise, and experience to competently complete the assignment.<br>• The institution periodically reviews the work performed by appraisers and persons providing evaluation services.<br>• The person selected is capable of rendering an unbiased opinion.<br>• The person selected is independent and has no direct, indirect, or prospective interest, financial or otherwise, in the property or the transaction.<br>• The appraiser selected to perform an appraisal holds the appropriate state certification or license at the time of the |

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| | assignment.<br><br>An institution's selection process should ensure that a qualified, competent and independent person is selected to perform a valuation assignment. An institution should maintain documentation to demonstrate that the appraiser or person performing an evaluation is competent, independent, and has the relevant experience and knowledge for the market, location, and type of real property being valued. |
| Fannie Mae/<br>Freddie Mac | Lenders are reminded that appraisers must have the requisite knowledge to perform a professional quality appraisal for the specific geographical location and particular property types.<br><br>The use of an appraiser who has the appropriate knowledge of specific geographical markets, access to the appropriate data sources, and experience in appraising specific property types within those markets will help to ensure that valuations are accurate and that appraisal practices are appropriate.<br><br>Although the Uniform Standards of Professional Appraisal Practice (USPAP) allows an appraiser who does not have the appropriate knowledge and experience to accept an appraisal assignment by providing procedures with which the appraiser can complete the assignment, Fannie Mae requires that lenders only use appraisers who have the appropriate knowledge and experience, and does not allow the USPAP flexibility. Consequently, the *Selling Guide* has been updated to state that appraisers who lack the requisite knowledge, experience, and access to appropriate data must not be utilized. Additional revisions have been made to clarify that the lender is responsible for the appraiser's qualifications and quality of the work, and to provide guidance for determining an appraiser's qualifications.<br>Lenders are responsible for the qualifications and quality of work provided by the appraisers they select. If a lender enters into a contract with any vendor, contractor, or third-party service provider, the lender is accountable for the quality of the work performed as if an employee of the lender performed it. In addition to knowledge, experience, access to the appropriate data sources, and geographical competence, the quality of appraisal work is a key criterion that the lender should use in selecting an appraiser. Before using an appraiser's services, lenders should be satisfied that the appraiser has demonstrated the ability to perform high quality appraisals. Lenders should review the appraiser's education and experience, sample appraisals, professional affiliations, and references from clients and employers. The requirement for an appraiser to produce a high quality work product must always outweigh fee or turnaround time considerations. See B4-1.1-01, General Information on Appraisal Requirements (07/26/2011), for additional information concerning the lender's responsibilities related to evaluating the quality |

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| | of the appraiser's work.<br>The *Selling Guide* has also been updated with regard to the lender's use of third-party vendors, such as appraisal management companies (AMC), to clarify that neither the Home Valuation Code of Conduct (HVCC) nor Fannie Mae requires the use of a third-party vendor; lenders are ultimately responsible for representations and warranties related to the value, condition, and marketability of the subject property; and lenders must hold the AMC responsible for complying with Fannie Mae's requirements.<br>Lenders must obtain an independent, disinterested examination and valuation of the property that secures a mortgage sold to Fannie Mae. Lenders must be aware of, and in full compliance with, state laws for licensing and certification of real estate appraisers.<br><br>Lenders must use appraisers who:<br><br>• Are state-licensed or state-certified in accordance with the provisions of Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989;<br><br>• Have the requisite knowledge required to perform a professional quality appraisal for the specific geographic location and particular property type;<br><br>• Have the requisite knowledge about, and access to, the necessary and appropriate data sources for the area in which the appraisal assignment is located.<br><br>Appraisers who are not familiar with specific real estate markets may not have adequate information available to perform a reliable appraisal. |
| HUD/FHA | The success of the FHA insurance program and HUD's ability to protect its financial interest begins with selecting qualified and knowledgeable appraisers. Mortgagees are reminded that they are responsible along with the appraiser for the quality and accuracy of the appraisal if the lender knew or should have known that there were problems with the integrity, accuracy and thoroughness of an appraisal submitted to FHA for mortgage insurance purposes and must select an appropriate appraiser for every assignment.<br><br>An appraiser who is primarily experienced in appraising detached, single family dwellings in one market may lack the knowledge, experience and/or sources for obtaining market data that will enable the appraiser to perform quality appraisals on condominiums or manufactured homes in the same market or detached, single family homes in another market a short distance away.<br><br>The valuation principles for appraising all residential properties are |

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| | essentially the same no matter the market in which a property is located, however not all appraisers are knowledgeable and experienced or have access to sources of data for all markets.<br><br>A lender must not assume, simply because an appraiser is state certified, that the appraiser is qualified and knowledgeable in a specific market area. It is incumbent upon the lender to determine whether an appraiser's qualifications, as evidenced by educational training and actual field experience, are sufficient to enable the appraiser to competently perform appraisals before assigning an appraisal to them. |
| FIRREA | All staff and fee appraisers performing appraisals in connection with federally related transactions must be state certified or licensed, as appropriate.<br><br>However, a state certified or licensed appraiser may not be considered competent solely by virtue of being certified or licensed. Any determination of competency shall be based upon the individual's experience and educational background as they relate to the particular appraisal assignment for which he or she is being considered. |

The significance of selecting the appropriate appraiser for each assignment cannot be overstated. The regulations clearly ask that competent, professional appraisers provide USPAP compliant appraisals. Being licensed in a geographic area alone is not the determination of competence. Evidence of a license is a minimum standard and denotes neither competence nor ethics.

Once again, the regulations are clear in stating that the financial institution is responsible for the selection of the service provider, even when the process is outsourced to a third party provider such as an Appraisal Management Company.

A compliant process will allow the financial institution or valuation service provider to know the appraiser very well. Their experience, education, knowledge, work samples, license qualifications, professional designations, previous disciplinary actions, any background history and the quality of their work should all be considered as criteria for selecting an appraiser for an assignment. In addition, the service provider should have access to data sources necessary and relevant to the geographic area where the service is being performed.

The individuals selecting the service provider should be free from influence and not part of the production environment. Service providers selected should be free from independence issues and have no direct or indirect interest in the transaction.

The institution or its agent should select the appraiser. Clearly this would indicate a financial institution that outsources its ordering process to an appraisal management

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company would need to know that the appraisal management company is directly engaging the appraiser and is doing so consistent with the regulations. Therefore, an appraisal management company that assigns an order to another appraisal management company is inconsistent with the requirements of the regulations.

The borrower cannot select, recommend or have any influence in the selection of the service provider. An appraisal provided by the borrower is not acceptable, regardless of how independently it was engaged.

A financial institution or a service provider should not allow lower cost or speed of delivery time to inappropriately influence its appraisal ordering procedures or the appraisers' determination of the scope of work.

The Interagency Appraisal and Evaluation Guidelines stress that a financial institution or a service provider "should not select a valuation method or tool solely because it provides the highest value, the lowest cost, or the fastest response or turnaround time."

## Best Practices

### Approved Appraiser List

A financial institution or a service provider should have an approved appraiser list and an exclusionary list. There should be a clear, well-defined process for qualifying an appraiser for initial placement on an approved appraiser list. These lists should be socialized across the institution to ensure that each department is aware of any violations of policy. If an appraiser was found to have committed fraud for example on a purchase transaction, that appraiser should be prohibited from doing business with other departments within the financial institution. If the financial institution does business with correspondent lenders it would be especially important to manage and publish these lists in real time.

The financial institution or service provider should have a process in place to ensure periodic monitoring of appraiser's performance and credentials as well as to assess whether to retain on the appraiser on the list.

It is critical that loan production personnel not have input into the development or maintenance of the list. Loan production may not nominate appraisers to be placed on the fee panel.

While broadcasting orders can be compliant, it would be difficult to be compliant. The AMC must prove that for each assignment they have selected the best appraiser. If the purpose of the broadcast is to obtain the cheapest fee at the quickest acceptance that is

not a compliant process. Acceptance of a fee by an appraiser is not a guarantee that the fee is customary and reasonable.

### Liability Risk Considerations

Lenders have been subject to liability for either maintaining themselves or dictating to their AMCs lists of favored appraisers who have been selected based on the appraisers' previous delivery of appraisals that meet or exceed the values needed to close loans. While actual work quality is certainly an important consideration with respect to the selection of appraisers, a lender obviously should not evaluate or select appraisers based on the degree to which appraisers deliver opinions of value enabling loans to be closed. Input or comments from loan production personnel about this factor should not be permitted to be considered by a lender's personnel in charge of supervising an AMC or should not provide to an AMC information about the lender's appraiser lists.

### Exclusionary List

Equally important and perhaps more important is the development of exclusionary lists. For obvious reasons it is responsible policy to remove an appraiser from an approved status for violations of policy and practices as well as service level agreements. It is vitally important to have clearly established Appraisal Policies that are readily available to appraisers for reference. A process to remove appraisers should be transparent and should provide a rebuttal process. Many institutions establish a committee to review these cases on a weekly basis. A matrix should be established to determine which files are to be reported to the state agency, what requires a Suspicious Activity Report, SARS, and what remedial actions may be in order.

### Watch or Probation

An institution may move an appraiser to a watch list if the appraiser's quality rating or service levels decline. It is advisable to notify the appraiser so they can take whatever action necessarily to maintain their relationship. An appraiser can also be asked to take remedial training and education.

Due diligence of your appraiser panel may include:

- Background checks
- Verification of any disciplinary actions with the State agency, VA or FHA
- ASC.gov verification
- Education
- Local data sources

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- Identity verification
- E & O insurance
- Foreign languages
- Minority and Women Owned Business Entities
- Sample appraisal reports
- Competency exams
- Fee schedules
- Areas of expertise
- Geographic coverage
- Photos for identity verification (for the consumer's benefit)
- Signed engagement letter

### Background Checks

Background checks are important to maintain and should be monitored on an annual basis. There is a misconception that due diligence has been done at the state licensing authority. Some states do allow felons to maintain a license. Civil cases by consumers and financial institutions to recover losses can also be found in a background check. It would also put the financial institution at extreme risk to allow a sex offender into a consumer's home.

With this knowledge each institution must establish policies around what is considered behavior that would exclude them from the privilege to do business. A common question is DUIs. If one DUI does not exclude, does a pattern of 3 DUIs and loss of a driver's license elevate the risk? Write policies around what is an automatic placement on an exclusionary list versus what would be reviewed by your committee.

### Disciplinary Actions

Many lenders and AMCs use the Appraisal Subcommittee registry at www.asc.gov as their entire due diligence process. This process does nothing more than verify, at the time of the appraisal, that the appraiser had a valid license. The registry lists Revocations, Voluntary Surrender and Suspensions. The suspensions only appear in the registry when they are active. After the suspension period has expired, no history is made available on www.asc.gov.

Over half of the disciplinary actions meted out by the States do NOT appear in the registry. The States have created other categories of actions that they do not report to the ASC. Unfortunately one cannot assume that these are minor infractions as some are serious. Enforcement at the state level is quite uneven. The consent orders are not available from the ASC.

Not all disciplinary actions are created equally. There is virtually no standardization in the actions taken. It is imperative that each consent order is reviewed on a case-by-case basis. An affirmative response to a disciplinary action can mean something as innocuous as they didn't complete their continuing education on time to incarceration for murder.

### Appraisal Subcommittee Registry

A check of the ASC registry will verify if the appraiser's credentials were valid at the time of the search. There is no history available. The practice of having an appraiser include a copy of their license with each appraisal report is a meaningless activity as they are easily photo shopped. The evidence of a valid credential in no way denotes that the appraiser is qualified for any given assignment. A license is a minimum criteria for practice and should not be solely used as the basis for due diligence.

### Education

The appraiser's educational background and affiliation with professional trade associations can be considered but not solely relied upon.

### Engagement Letters

The use of engagement letters is encouraged by Agencies. Engagement letters facilitates communication with appraiser and documents the expectations of each party. The appraiser should not begin the appraisal process until the engagement letter has been received. The financial institution should retain a copy of the engagement letter in the credit file. Master engagement letters are suggested.

Your policies and procedures should be clear and accessible to appraisers for reference. Policies and procedures are dynamic and should be communicated in real time.

### Local Data Sources

It is incumbent on the client, during the onboarding process, that the appraiser identifies and confirms access to their local data sources. If there is a local MLS and the appraiser does not belong that would be one failure point in the geographic competence test.

### Identity Verification

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It would be advisable to verify the identity of the appraiser. This can be done by submission of their driver's license. Appraisers have, in the past, had their identity stolen. It is easy for someone to go to the ASC registry and create a copy of their license and steal a license number.

It would also be valuable to have a photo of the appraiser. Too often the appraiser who was engaged is not the party who appears for the inspection. This is often revealed when the homeowner files a complaint and the physical description doesn't match.

It is important to note your requirement in all policies and in your engagement letter that the appraiser to whom the order is assigned is the party who must perform a physical inspection.

### Errors and Omissions Insurance

The practice of asking an appraiser to submit a copy of their binder with each appraisal report would signify an illusion of compliance with an E & O requirement. Appraisers can easily Photoshop their binder. It is not unheard of for appraisers to initiate a policy only to quickly cancel it. Typical requirements are for $500,000 in coverage but for complex properties policies of $1,000,000 should be considered.

A certificate of insurance obtained directly from the E&O Provider is the only safe way to ensure that a policy is in force.

### Foreign Languages

While not a regulatory compliance issue, it would be pragmatic to be aware of the foreign language skills of your panel. From time to time financial institutions encounter customers who do not speak English.

### Minority and Women Owned Businesses

Many financial institutions have proactive policies to engage Minority and Women Owned Businesses. A certificate should be collected as confirmation of the credential.

### Sample Appraisal Reports

While it may be presumed that a lender will only receive pristine sample appraisals, which has not proven to be the case. If submitted samples are not the appraiser's best

work then it would seem logical that the expectation of credible appraisal reports after engagement, are nil. Reviews of sample work files are considered a prudent practice.

### Competency Exams

An appraiser's ability to appraise specific types of properties, such as REO or FHA for example, require specific education and skill set. Guidelines dictate that lenders must engage a competent, ethical appraiser. Practically speaking, it is costly for a lender to engage an appraiser who is not competent due to potential repurchase exposure and loan losses. Competency is never defined in any of the guidance. The most practical method to determine competency is to test appraisers in specific areas. Lenders and their agents should direct appraisers who are not able to pass exams to approved education programs.

Any measure that an institution can take to prophylactically avoid engaging an appraiser who is not qualified is a best practice.

### Fee Schedules

There are three considerations when engaging an appraiser: quality, service and fees. There have been arguments made that fees do not dictate quality. There is no profession where engaging the cheapest vendor would be considered a best practice for consistent quality and service. Appraisals are not a commodity. Having a fair compensation plan and an adherence to best practices will attract the most professional vendors.

The premise that quality and fees are not correlated typically involves a service provider stating that giving their fee panel a raise would not increase quality. That is likely true. A service provider may have excluded the best appraisers from their pool based upon fees. The importance of establishing customary and reasonable fees is crucial to the success of any appraisal program. It is important to establish financial incentives that attract the best appraiser.

### Areas of Expertise

Experience and educational background are tied to specialty areas of expertise. Some appraisers specialize in a given niche such as relocation. Other appraisers, especially in rural markets, do not have the luxury to specialize. Education, experience and competency exams in each specialty would help to identify competency.

### Geographic Coverage

When assigning an appraisal report the client should consider the location of the appraiser and the distance to the subject. Appraisers who are distant should not be automatically excluded. For example, an appraiser may live in one state but appraise in the next state and travel to a resort area because of the density and volume of work. That appraiser's entire work history may be in that market area. Distance from subject would just be one measure. There are many counties in the US with a thin number of appraisers who reside in that county. It is helpful to overlay general population with the appraiser population in that county.

### Photos of the Appraiser

There are numerous instances when the appraiser, who was assigned the order, is not the party who physically inspects the property.. Make it clear in your engagement that this is an unacceptable practice. One way to derail this practice is to collect a photo of the appraiser. If a complaint is received from the consumer, you can discern who was responsible and proceed accordingly.

### Contractor Agreement between the AMC and Appraiser

In general, AMCs must use contractor agreements with panel appraisers to govern the details of the relationship between the AMC and appraiser and to confirm agreed upon compliance with appraisal-related requirements. An AMC's contractor agreement will typically address:

- Compliance with legal and regulatory requirements, including USPAP and applicable privacy laws.
- Compliance with applicable Fannie Mae, Freddie Mac, FHA or other third party-imposed appraisal requirements, and compliance with any additional specific lender-client requirements.
- Expectations with respect to completion and delivery of appraisals.
- Terms of payment from the AMC to the appraiser.
- Insurance requirements to be met by the appraiser.
- Processes for appraisal reconsiderations or appeals.
- Indemnification and liability.
- Ownership of appraisal work product and intellectual property.
- Duties with respect to maintenance of work files.

### Liability Risk Considerations

The AMC's contractor agreement with a panel appraiser serves as the foundation for an AMC's ordering of appraisal services on behalf of the lender-client. Yet, few lenders take the initiative to review their AMC's form contractor agreement. For the purpose of liability risk prevention, it is important that lenders review the form agreements for the following purposes:

- Follow through on lender requirements. The lender should determine if the terms and conditions it negotiated in its service contract with the AMC are being carried through in the AMC's contractor agreement with appraisers (and also in the engagement letters for individual assignments). Frequent issues of concern are: obligations with respect to timely payment of appraisers, privacy law adherence, and ownership of appraisal work product.
- Unreasonable contract terms. It is very common for AMC contractor agreements to be highly one-sided in favor of the AMC. One of the most common provisions handled in a very one-sided manner is indemnification of the AMC by the appraiser. AMCs will often seek to transfer any and all liabilities relating to appraisal work – regardless of fault – to the appraiser based on an unrealistic view that the AMC will be able to avoid ultimate monetary responsibility itself. Very one-sided agreements in favor of AMCs, however, actually cause AMCs to lose access to many qualified and financially stable appraisers because such appraisers more often are able to choose the AMCs with whom they do business and more often will choose against doing business with those AMCs that have unreasonable contractual provisions. Thus, lenders should review AMC form agreements with an eye toward whether the agreements will detract from the AMC's ability to retain such qualified appraisers on its behalf. Higher quality appraisers reduce a lender's liability risk.

## 5. Customary and Reasonable Fees

There has been much discussion about how to achieve compliance with the Customary and Reasonable provision within The Dodd-Frank Act. This regulation provides for two approaches to compliance, both very different and unique in their approach.

| Regulatory Source | Requirement/Guideline |
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| Dodd/Frank Act<br>Original Law | Customary and Reasonable Fee<br>In General - Lenders and their agents shall compensate fee appraisers at a rate that is customary and reasonable for appraisal services performed in the market area of the property being appraised. Evidence for such fees may be established by objective third-party information, such as government agency fee schedules, academic studies, and independent private sector surveys. Fee studies shall exclude assignments ordered by known appraisal management companies. |

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| | Exception for Complex Properties<br>In the case of an appraisal involving a complex assignment, the customary and reasonable fee may reflect the increased time, difficulty, and scope of the work required for such an appraisal and include an amount over and above the customary and reasonable fee for non-complex assignments. |
| Dodd/Frank Act Interim Final Rule | First presumption of compliance (§ 226.42(f)(2)). A creditor and its agent are presumed to compensate a fee appraiser at a customary and reasonable rate if the amount of compensation is reasonably related to recent rates for appraisal services performed in the geographic market of the property. The creditor or its agent must identify recent rates and make any adjustments necessary to account for specific factors, such as the type of property, the scope of work, and the fee appraiser's qualifications. In addition, the creditor and its agent must not engage in any anticompetitive actions in violation of state or federal law that affect the rate of compensation paid to fee appraisers such as price-fixing or restricting others from entering the market.<br><br>Second presumption of compliance (§ 226.42(f)(3)). A creditor and its agent are also presumed to comply if the creditor or its agent establishes a fee by relying on rates in the geographic market of the property being appraised established by objective third-party information, including fee schedules, studies, and surveys prepared by independent third parties such as government agencies, academic institutions, and private research firms. The interim final rule follows the statute in requiring that fee schedules, studies, and surveys, or information derived from them, used to qualify for this presumption of compliance must exclude compensation paid to fee appraisers for appraisals ordered by appraisal management companies (defined in § 226.42(f)(4)(iii)).<br><br>Complex Assignments - the statute provides that if an appraisal involves a "complex assignment," the customary and reasonable fee may reflect "the increased time, difficulty, and scope of the work required for such an appraisal and include an amount over and above the customary and reasonable fee for non-complex assignments." TILA Section 129E(i)(3). The statute does not define "complex" and "non-complex" assignments. |
| HUD/FHA | FHA does not require the use of AMCs or other third party organizations for appraisal ordering, but recognizes that some lenders use AMCs and/or other third party organizations to help ensure appraiser independence. To address several questions that have already been raised regarding compensation, this mortgagee letter corrects and expands existing fee requirements set forth in Mortgagee Letter 1997-46.<br>FHA-approved lenders must ensure that:<br>• FHA Appraisers are not prohibited by the lender, AMC or other third party from recording the fee the appraiser was paid for the performance of the appraisal in the appraisal report. |

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| | • FHA Roster appraisers are compensated at a rate that is customary and reasonable for appraisal services performed in the market area of the property being appraised.<br>• The fee for the actual completion of an FHA appraisal may not include a fee for management of the appraisal process or any activity other than the performance of the appraisal.<br>• Any management fees charged by an AMC or other third party must be for actual services related to ordering, processing or reviewing of appraisals performed for FHA financing.<br>• AMC and other third party fees must not exceed what is customary and reasonable for such services provided in the market area of the property being appraised. |

## Best Practices

Presumption #1 allows for recent rates (within the past year) paid to appraisers over the past twelve months for comparable appraisal services prepared in the geographic market that the property is located. In addition, there must be consideration given to the factors below and any adjustments to recent rates made to ensure the rate paid is reasonable. The additional criteria are as follows:

- The type of property.
- The scope of work.
- The time in which the appraisal services are required to be performed.
- Fee appraiser qualifications.
- Fee appraiser experience and professional record.
- Fee appraiser work quality.

To ensure the six criteria are being considered on a case-by-case basis would involve a very manual process and may not allow for the needed efficiency in the appraisal assignment process. To consider the six factors would require much diligence upfront in the assignment process. A more manual process may allow for opportunities for the financial institution or valuation provider staff to confirm competency and acceptance of the assignment with the appraiser at the time of assignment. This could ultimately yield considerable improvement in the selection process but would most likely require more resources to fulfill order assignments. It would be risky to attempt to remain in compliance with the IEAG requirement to engage the best appraiser, not the fastest and not the cheapest.

Presumption #2 allows for rates paid to appraisers to be determined by objective third party information. This can be determined by fee schedules, surveys, studies and information gained by independent parties such as governmental agencies, academic institutions and private research firms. The information must be based on the

geographic location of the property to be appraised and must exclude the compensation made to appraisers through AMC's.

If either presumption of compliance is chosen, the financial institution and the appraisal management company should be prepared to defend or prove that the rates paid to the appraisers are consistent with the guidance.

Considerable analysis should be performed on the fees paid to appraisers on at least a county-by-county geographic level. The analysis should produce a median, mode, and a range of high and low fees paid to appraisers at a county level. The financial institution and appraisal management company should be prepared to defend any differences in the data and how the fees were determined.

To say, "that's what the appraiser says the fee is" may not satisfy the requirements in this presumption. The financial institution and appraisal management company must also be prepared to articulate how they considered the six criteria when assigning the appraisal orders if Presumption #1 is chosen. It is difficult for the individual selecting the appraiser to know what the type and complexity of property is being assigned so considering the six criteria may be difficult to demonstrate compliance with in a higher volume, automated process.

A more defendable and perhaps ultimately more compliant process would include the Presumption #2 approach using fee surveys, fee studies and governmental agency information. Establishing a customary and reasonable fee by a geographic area can be achieved by acquiring fee surveys and other existing fee information already available in the market and updating it on a regular basis. Fees paid to appraisers would be more consistent using this approach and ultimately less deviation between the high and low fees paid to appraisers.

A "Cost-Plus" approach to compliance would include a Presumption #2 pricing approach for the fees paid to appraisers and a fixed fee for the administrative services paid to the appraisal management company. This approach may become more common and may be seen as a more desirable and compliant approach. The Interim Final Rule has been a highly controversial rule. What was clear in Dodd Frank, Title 14 language became uncertain with the Interim Final Rule. The penalties for noncompliance are steep. The Consumer Finance Protection Bureau will be issuing Final Rules on appraisals in January 2014. It is anticipated that the roadmap on this issue becomes clearer. (Note to regulators- lack of guidance on this topic is disruptive to the market.)

Best practices on how to establish a national C&R fee schedule would include a grid of every county in the US. There are over 3000 counties in the US. Overlay population by county. Go to www.asc.gov and overlay the number of appraisers in each county. (Note these are by location of the appraiser, not necessarily their coverage areas.) Then

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calculate the ratio of appraisers to population to establish supply and demand. The next step would be to take the VA Fee Schedule, the only government fee schedule, and include their fees in your grid as one of the benchmarks.

Dodd Frank states that government fee schedules, fee surveys, and academic studies may be used. There are several sources for fee surveys. Prior to HVCC (Home Valuation Code of Conduct) lenders performed and established fee schedules based upon a survey of appraisers in each geographic area. Those historical practices need to be reinstated. Allowing your Appraisal Management Companies to establish fees paid to appraisers creates a misaligned incentive for the engagement of the cheapest appraiser, not the best appraiser.

Once appraisers are surveyed, or readily available surveys are referenced, you can establish a mean, median and mode for a "typical" fee assignment. Obviously scope of work and complexity of the assignment will affect the range of fees.

Once the financial institution has established their C&R fee schedule they should audit their AMCs to ensure that these schedules have been adhered to.

## Complex Assignments

A complex 1-to-4 unit single family residential appraisal means an appraisal for which the property to be appraised is atypical due to its form of ownership, certain property characteristics, or specific market conditions. In the case of an appraisal involving a complex assignment, the customary and reasonable fee may reflect the increased time, difficulty, and scope of the work required for such an appraisal and include an amount over and above the customary and reasonable fee for non-complex assignments.

Complex assignments should be assigned using additional care and diligence to ensure the appraiser is qualified and has the requisite knowledge, experience and qualifications to competently complete the appraisal assignment. This can be achieved by individual interviews with appraisers in the geographic area of the property and assigning the appraisal assignment to the most qualified appraiser.

*Additionally, FIRREA requires that a* state certified appraiser complete all complex residential property appraisals if the transaction value is $250,000 or more.

## Volume Discounts

When considering customary and reasonable fees, Section 226.42(f)(1) does not prohibit a fee appraiser and a financial institution or the valuation service provider from agreeing to compensation based on transaction volume, so long as the compensation is

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customary and reasonable. An example is given in The Interim Final Rule that states "For example, assume that a fee appraiser typically receives $300 for appraisals from creditors with whom it does business; the fee appraiser, however, agrees to reduce the fee to $280 for a particular creditor, in exchange for a minimum number of appraisals performed within a specified period of time." This guidance is very vague and allows for many interpretations. It should be noted that the example provided is a less than 10% "discount" and the requirement for paying customary and reasonable fees remains.

It would be difficult to defend Presumption 1 if a lender directly engages an appraiser for a fee of $400 and in the same week, on the same street, same property type their AMC engages the same appraiser for $250. While there is always a range of Customary and Reasonable fees the disparity would be problematic. Both the lender and the AMC would appear to be out of compliance and subject to fines of $10,000 per incident. Note both the lender and their third party are subject to these fines.

### Liability Risk Considerations

Lenders have not yet been subject to regulatory penalties or civil liability for failing to pay appraisers customary and reasonable fees pursuant to the requirements of the Dodd-Frank Act. Such actions, however, are certainly a future threat. As of this date, what has resulted in actual civil litigation against lenders is the failure of a lender's AMC to pay appraisers on a timely basis or failing to pay them when the AMC ceases business due to financial failure. A lender needs to be able to monitor and assure that its AMCs are paying appraisers on a timely basis.

## 6. Mandatory Reporting

Mandatory reporting is widely agreed upon by the regulatory agencies and their requirements are basically consistent with a few minor variations.

| Regulatory Source | Requirement/Guideline |
|---|---|
| Dodd/Frank | Mandatory reporting requires reporting of a failure to comply with USPAP or of an ethical or professional requirement under applicable state or federal statute or regulation only if the failure to comply is material, that is, likely to significantly affect the value assigned to the consumer's principal dwelling.<br><br>Requires reporting only if there is a "reasonable basis to believe" that an appraiser has materially failed to comply with USPAP or ethical or professional requirements if the bank has actual knowledge or information that would lead a reasonable person to believe that the appraiser has materially failed to comply with USPAP or such |

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| | requirements.<br>Examples of material failures to comply.<br>1. Materially mischaracterizing the value of the consumer's principal dwelling, in violation of § 226.42(c)(2),<br>2. Performing an appraisal in a grossly negligent manner, in violation of a USPAP rule; and<br>3. Accepting an appraisal assignment on the condition that the appraiser will assign a value equal to or greater than the purchase price to the consumer's principal dwelling, in violation of a USPAP rule. |
| IAEG | An institution should file a complaint with the appropriate state appraiser regulatory officials when it suspects that a state certified or licensed appraiser failed to comply with USPAP, applicable state laws, or engaged in other unethical or unprofessional conduct.<br><br>An institution must file a complaint with the appropriate state appraiser certifying and licensing agency under certain circumstances. An institution also must file a suspicious activity report (SAR) with the Financial Crimes Enforcement Network of the Department of the Treasury (FinCEN) when suspecting fraud or identifying other transactions meeting the SAR filing criteria. |
| Freddie Mac | In accordance with the Appraisal Independence Requirements, when there is a reasonable basis to believe an appraiser or Appraisal Management Company is violating applicable laws, or is otherwise engaging in unethical conduct, the matter must be promptly referred to the applicable state appraiser certifying and licensing agency or other relevant regulatory bodies. |
| Fannie Mae | 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. |
| HUD/FHA | Allowing the removal of an appraiser from a list of qualified appraisers or the addition of an appraiser to an exclusionary list of qualified appraisers, used by any entity, without prompt written notice to such appraiser, which notice shall include written evidence of the appraiser's illegal conduct, a violation of the Uniform Standards of Professional Appraisal Practice (USPAP) or state licensing standards, improper or unprofessional behavior or other substantive reason for removal. |
| FIRREA | Institutions and institution-affiliated parties, including staff appraisers and fee appraisers, may be subject to removal and/or prohibition orders, cease and desist orders, and the imposition of civil money penalties pursuant to the Federal Deposit Insurance Act,12 U.S.C. 1811 *et seq.*, as amended, or other applicable law. |

## Best Practices

Despite its long-standing existence in regulation dating back to 1989 with FIIRREA, financial institutions and valuations provides have, for the most part, ignored Mandatory Reporting. A very clear policy and a transparent process ensuring appropriate due diligence should be developed by the financial institution and the valuation provider. Many state laws require appropriate notification and opportunity for response to be given to the appraiser before action is taken.

Financial institutions and valuation providers should be careful when choosing to no longer use an appraiser without appropriate cause. Clear expectations for performance and quality of work should be communicated to the appraiser and a well-defined and objective process should be followed prior to removing anyone from the assignment process. Simply "scoring" and moving an appraiser to the bottom of the rotation may not rise to the level of many state laws. In some states it is necessary to notify the appraiser if they are removed from the rotation and/or will no longer receive appraisal assignments.

An objective exclusionary process that includes a well-documented approach that allows appraiser participation in the process is well advised. It is good practice to have many perspectives involved with the decision to eliminate an appraiser from the approved appraiser list. An exclusionary committee that makes a determination would remove any subjectivity from a single source making the determination.

An excellent objective third party resource is the Appraisal Foundations Disciplinary Matrix. The Disciplinary Matrix outlines violations to USPAP and provides suggested disciplinary actions depending on the severity of the offence. A policy that identifies varying levels of offenses as either a training opportunity or a reporting opportunity can aid in developing the quality of the appraiser panel while meeting the regulatory obligation.

Appraisers that do not meet expected customer service expectations should be given multiple opportunities to comply and notification when they do not meet predetermined expectations. A process that has a "three strike" approach could allow for elimination of appraisers in a well-documented and open process but not result in a referral to the state regulatory authorities.

An exclusionary list should be developed and maintained to ensure appraisers that have been reported are not assigned subsequent orders.

A watch list of appraisers who do not consistently demonstrate competency in performing appraisal assignments, but that do not rise to the level of mandatory reporting, can be used to monitor performance of these appraisers and apply an

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additional level of appraisal review due to the increased risk associated with the appraisers quality of work.

Many lenders have avoided this practice fearful that it would attract lawsuits. The risk and cost associated with engaging known fraudsters, sex offenders, and appraisers with a history of disciplinary actions or consumer complaints is behaving both irresponsibly and beyond measure. Managing an Exclusionary List is not only the right thing to do, it is the prudent thing to do.

## 7. Minimum Appraisal Standards

Financial institutions are required to accept only real estate appraisals that are performed by licensed, competent appraisers that are in writing and in accordance with USPAP.

| Regulatory Source | Requirement/Guideline |
|---|---|
| Dodd/Frank | A “valuation” is an estimate of value prepared by a natural person, such as an appraisal report prepared by an appraiser or an estimate of market value prepared by a real estate agent. The term includes photographic or other information included with a written estimate of value. A “valuation” includes an estimate provided or viewed electronically, such as an estimate transmitted via electronic mail or viewed using a computer. |
| IAEG | Although the Agencies’ appraisal regulations exempt certain real estate-related financial transactions from the appraisal requirement, most real estate-related financial transactions over the appraisal threshold are considered federally related transactions and, thus, require appraisals. The Agencies also reserve the right to require an appraisal under their appraisal regulations to address safety and soundness concerns in a transaction. |
| Fannie Mae/ Freddie Mac | All manually underwritten mortgage loans sold to Fannie Mae require an appraisal based on an interior and exterior property inspection and must be completed on the appropriate form depending on the property type, unless the specific product guidelines permit a less than full appraisal. |
| HUD/FHA | Except for certain streamline refinance transactions, FHA requires an appraisal of all properties to establish an estimated value for mortgage insurance purposes. All individual properties, whether proposed construction, under construction, or existing construction, must meet MPS( Minimum Property Standards or MPR( Minimum Property Requirements. The appraisal process is the lender's tool for determining if a property meets the minimum requirements and eligibility standards for a FHA insured mortgage. |
| FIRREA | *Transactions requiring a state certified appraiser - All transactions of $1,000,000 or more.* All federally related transactions having a transaction value of $1,000,000 or more shall require an appraisal |

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| | prepared by a state certified appraiser. All federally related transactions having a transaction value of $250,000 or more, other than those involving appraisals of 1 to 4 family residential properties shall require an appraisal prepared by a state certified appraiser. |

Financial institutions and valuation providers should be careful when selecting appraisers to complete assignments for federally related transactions to ensure the appraisers are appropriately licensed and are competent to complete the appraisal. While there is a requirement of the appraiser to produce a USPAP compliant appraisal there is also a requirement for a financial institution to only utilize USPAP compliant appraisals. If an appraiser does not perform a compliant appraisal, there needs to be controls in place to identify the weaknesses and resolve the deficiencies.

Financial institutions and valuation providers should be careful to assign appraisals with transaction values above $250,000 to only licensed appraisers and to those over $1,000,000 to only certified appraisers

## Appraisal Development

All appraisals must be developed consistent with USPAP and include certain information and be based on a specific definition of market value.

| Regulatory Source | Requirement/Guideline |
|---|---|
| IAEG | The Agencies' appraisal regulations require appraisals for federally related transactions to comply with the requirements in USPAP. Consistent with the USPAP Scope of Work Rule, the appraisal must reflect an appropriate scope of work that provides for credible assignment results. |
| FIRREA | For federally related transactions, all appraisals shall, at a minimum:<br>a. Conform to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP) promulgated by the Appraisal Standards Board of the Appraisal Foundation, unless principles of safe and sound banking require compliance with stricter standards;<br>b. Be written and contain sufficient information and analysis to support the institution's decision to engage in the transaction;<br>c. Analyze and report appropriate deductions and discounts for proposed construction or renovation, partially leased buildings, non-market lease terms, and tract developments with unsold units;<br>d. Be based upon the definition of market value as set forth in this part; and<br>e. Be performed by state licensed or certified appraisers in accordance with requirements set forth in this part. |

## Best Practices

Financial institutions and valuation providers must produce appraisals for federally related transactions that comply with the requirements in USPAP. The appraisal must contain the appropriate scope of work to provide credible assignment results. The appraiser's scope of work should reflect the extent to which the property is identified and inspected, the type and extent of data researched, and the analyses applied to arrive at opinions or conclusions.

While the appraiser must comply with USPAP, it is important that financial institutions and valuation providers obtain an appraisal that contains sufficient information to support the credit decision.

## Appraisal Content

Appraisals must contain certain information and be completed to certain standards to be acceptable. An appraisal that shows only a value estimate is not acceptable.

| Regulatory Source | Requirement/Guideline |
|---|---|
| IAEG | The appraisal also should include a discussion on market conditions, including relevant information on property value trends, demand and supply factors, and exposure time. Other information might include the prevalence and effect of sales and financing concessions, the list-to-sale price ratio, and availability of financing. In addition, an appraisal should reflect an analysis of the property's sales history and an opinion as to the highest and best use of the property. |
| Fannie Mae/ Freddie Mac | Fannie Mae requires the appraiser to provide complete and accurate reports; to report neighborhood and property conditions in factual and specific terms; to be impartial and specific in describing favorable or unfavorable factors; and to avoid the use of subjective, racial, or stereotypical terms, phrases, or comments in the appraisal report. The opinion of market value must represent the appraiser's professional conclusion, based on market data, logical analysis, and judgment. |
| HUD/FHA | The Uniform Standards of Professional Appraisal Practice (USPAP) apply to all appraisals performed for properties that are security for FHA insured financing including the Competency Rule. |

## Best Practices

Financial institutions and valuation providers should clearly engage the appraiser and communicate the expectations. The appraiser must analyze and reconcile the market conditions information and any relevant trends in the property's geographic market area, other influences such as demand and supply, exposure time and marketing time,

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all applicable approaches to value, financing concessions, highest and best use, and the subject's sales history. There must be a reconciliation of the data that allows for the appraisers professional judgment and analysis of the information contained in the appraisal.

It would be a prudent practice to make your institution's policies web accessible. If policies are easily accessible and clearly communicated, they become a resource to the appraiser.

## 8. Evaluations

### Minimum Evaluation Standards

In some instances, for low risk loans under $250,000, it is acceptable to have an evaluation performed. An evaluation can be an automated valuation model (AVM), BPO or an estimate considering factors that affect market value including an inspection of the property.

| Regulatory Source | Requirement/Guideline |
|---|---|
| Dodd/Frank | Broker price opinions may not be used as the primary basis to determine the value of a piece of property for the purpose of a loan origination of a residential mortgage loan secured by such piece of property. |
| IAEG | Policies and procedures should address the process for selecting the appropriate valuation method for a transaction rather than using the method that renders the highest value, lowest cost, or fastest turnaround time.<br><br>The institution should establish criteria for determining the level and extent of research or inspection necessary to ascertain the property's actual physical condition and the economic and market factors that should be considered in developing an evaluation.<br><br>An institution should consider performing an inspection to ascertain the actual physical condition of the property and market factors that affect its market value. When an inspection is not performed, an institution should be able to demonstrate how these property and market factors were determined |

### Best Practices

An AVM or BPO alone may not be used to determine the value of a property for the origination of a residential mortgage. If an institution or valuation services provider would like to complete evaluations for use in their programs they should augment the

evaluation with other market data and analysis of the information contained in the evaluation.

## Minimum Evaluation Content

The Interagency Appraisal and Evaluation Guidelines have very clear guidance related to the contents of an evaluation.  Financial institutions should be careful when engaging an individual to perform and evaluation and be clear on the expectations and content of the evaluation.

| Regulatory Source | Requirement/Guideline |
|---|---|
| IAEG | An evaluation should contain sufficient information detailing the analysis, assumptions, and conclusions to support the credit decision. An evaluation's content should be documented in the credit file or reproducible. The evaluation should, at a minimum:<br>1. Identify the location of the property.<br>2. Provide a description of the property and its current and projected use.<br>3. Provide an estimate of the property's market value in its actual physical condition, use and zoning designation as of the effective date of the evaluation (that is, the date that the analysis was completed), with any limiting conditions.<br>4. Describe the method(s) the institution used to confirm the property's actual physical condition and the extent to which an inspection was performed.<br>5. Describe the analysis that was performed and the supporting information that was used in valuing the property.<br>6. Describe the supplemental information that was considered when using an analytical method or technological tool.<br>7. Indicate all source(s) of information used in the analysis, as applicable, to value the property, including:<br>– External data sources (such as market sales databases and public tax and land records);<br>– Property-specific data (such as previous sales data for the subject property, tax assessment data, and comparable sales information);<br>– Evidence of a property inspection;<br>– Photos of the property;<br>– Description of the neighborhood; or<br>– Local market conditions.<br>Include information about the preparer when an evaluation is performed by a person, such as the name and contact information, and signature (electronic or other legally permissible signature) of the preparer. |

## Best Practices

Financial institutions and valuation providers should be very careful to only accept evaluations that contain the required content. There are many products, both automated and completed by humans, which claim to be compliant but do not rise to the level of meeting the requirements of the Interagency Appraisal and Evaluation Guidelines.

Information in the evaluations should reflect the property's specific zoning, the property description, what analysis was performed in determining the property's value estimate in its actual physical condition, photos of the property and an analysis of the local market conditions. An assumption that the property is in average condition is not acceptable. The evaluation should contain a description of the method for determining the property's actual physical condition.

Performance monitoring of the providers of evaluations should be maintained along with all contact information. The standards of independence also apply to persons who perform evaluations, who select the individual for performing the evaluation, and for those reviewing the evaluations.

## Property Condition Reports

Property condition reports can be combined with AVM's and evaluations to provide a compliant and acceptable solution for valuing transactions less than $250,000.

It is important that a property condition report not only addresses the property's actual physical condition and characteristics but also the economic and market conditions that affect the estimate of the property's market value. The market conditions may take on the look of the 1004MC and show relevant market data. This information should not just report but should be considered in the decision along with the evaluation. Other relevant information to be considered is the proximity to adverse influences such as railroad tracks, freeways, noxious odors, incompatible land uses and if the property is listed for sale or is a foreclosure, to name just a few.

As a practical matter the mash-up of AVMs, BPOs, and PCRs does not meet the level of a compliant evaluation. There are emerging desktop appraisal products that are practical from a risk perspective and operational efficiencies point of view.

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# 9. Automated Valuation Models

## AVM Program Requirements

An AVM is a valuation report that can be obtained in a matter of seconds. It is a technology driven report. The product of an automated valuation is an estimate of a probable selling price of a residential property that could be based on property records and MLS data which uses mathematical algorithms to obtain it's estimated value conclusion.

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| Dodd/Frank | Automated Valuation Models - Validation<br>Shall adhere to quality control standards designed to:<br>1. Ensure a high level of confidence in the estimates produced by automated valuation models.<br>2. Protect against the manipulation of data.<br>3. Seek to avoid conflicts of interest.<br>4. Require random sample testing and reviews.<br>5. Account for any other such factor that the agencies listed in subsection (b) determine to be appropriate. |
| IAEG | Institutions may employ AVMs for a variety of uses such as loan underwriting and portfolio monitoring.<br><br>**An institution may not rely solely on the results of an AVM to develop an evaluation unless the resulting evaluation is consistent with safe and sound banking practices and these Guidelines.**<br><br>For example, to be consistent with the standards for an evaluation, the results of an AVM would need to address a property's **actual** physical condition, and therefore, could not be based on an unsupported assumption, such as a property in average condition.<br><br>Institutions should establish policies and procedures that govern the use of AVMs and specify the supplemental information that is required to develop an evaluation. |

## Best Practices

Like evaluations, AVM's should only be used in conjunction with a compliant property condition report that includes a physical inspection of the property. If a physical inspection is not included, the methods of determining the actual physical condition of the property should be explained.

If AVM's are used, the financial institution should have very clear policies and procedures to ensure a high level of confidence in the model and provide for regular testing to ensure data integrity and accuracy.

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AVM's and evaluations, like other evaluations, should not be used to value transactions over $250,000. When ordering valuation products, financial institutions and valuation providers should have adequate controls in place to ensure against an evaluation being relied upon for the credit decision.

## 10. Appraisal Report Portability

It is acceptable for a financial institution to use an appraisal ordered by another financial institution when certain precautions are met.

| Regulatory Source | Requirement/Guideline |
| --- | --- |
| Dodd/Frank | The Board and the other agencies may jointly issue regulations that address the issue of appraisal report portability, including regulations that ensure the portability of the appraisal report between lenders/brokers for a consumer credit transaction secured by a 1-4 unit single family residence that is the principal dwelling of the consumer. |
| IAEG | The Agencies' appraisal regulations specify that an institution may use an appraisal that was prepared by an appraiser engaged directly by another financial services institution, provided the institution determines that the appraisal conforms to the Agencies' appraisal regulations and is otherwise acceptable. Among other considerations, an institution should confirm that:<br>1. The appraiser was engaged directly by the other financial services institution.<br>2. The appraiser had no direct, indirect, or prospective interest, financial or otherwise, in the property or transaction.<br>3. The financial services institution (not the borrower) ordered the appraisal. For example, an engagement letter should show that the financial services institution, not the borrower, engaged the appraiser.<br>4. An institution must not accept an appraisal that has been readdressed or altered by the appraiser with the intent to conceal the original client. Altering an appraisal report in a manner that conceals the original client or intended users of the appraisal is misleading, does not conform to USPAP, and violates the Agencies' appraisal regulations.<br><br>An institution generally should not rely on an evaluation prepared by or for another financial services institution because it will not have sufficient information relative to the other institution's risk management practices for developing evaluations. |
| Fannie Mae | Lenders must order and receive the appraisal report for each mortgage transaction. Lenders may not use appraisals ordered or received by borrowers or other parties with an interest in the transaction, such as |

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| | the property seller or real estate broker. |
| FHA | In cases where a borrower has switched lenders, the first lender must, at the borrower's request, transfer the case to the second lender. FHA does not require that the client name on the appraisal be changed when it is transferred to another lender. In accordance with the Uniform Standards of Professional Appraisal Practice (USPAP), the second lender is not permitted to request that the appraiser change the name of the client within the appraisal report unless it is a new appraisal assignment. |

### Best Practices

An institution may use an appraisal that was prepared by an appraiser that was engaged by another financial institution provided the appraisal is found to be acceptable and compliant with the regulations. A higher level of review should be performed to ensure compliance and independence in the appraisal process.

A financial institution should not accept an appraisal that has been readdressed or altered to misrepresent the original client. This practice is misleading and does not conform to USPAP.

For practical reasons many institutions do not accept appraisals ordered by others. The appraiser would have to be properly vetted. Also the accepting lender would need assurance that the appraiser was engaged in a compliant manner. It is doubtful that the original lender would warrant the appraisal.

## 11. Reviewing Appraisals and Evaluations

### Review Requirements

All appraisal and evaluations should be reviewed to ensure compliance with program requirements, policies and procedures, and the regulations and requirements of the agencies.

| Regulatory Source | Requirement/Guideline |
|---|---|
| Dodd/Frank | Requires appraisals shall be subject to appropriate review for compliance with the Uniform Standards of Professional Appraisal Practice. |
| IAEG | As part of the credit approval process and prior to a final credit decision, an institution should review appraisals and evaluations to ensure that they comply with the Agencies' appraisal regulations and are consistent with supervisory guidance and its own internal policies.<br><br>This review also should ensure that an appraisal or evaluation contains |

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| | sufficient information and analysis to support the decision to engage in the transaction. |
| Fannie Mae | Lender Responsibilities Pertaining to Appraisal Report Review<br>When a new appraisal is required for a mortgage that a lender delivers to Fannie Mae, the lender must perform an underwriting analysis of:<br>• The appraisal report to ensure that the report is of professional quality and is prepared in a way that is consistent with Fannie Mae's appraisal standards. See B4-1.4-21, Appraisal Report Review: Valuation Analysis and Final Reconciliation (06/30/2010), for guidance on addressing appraisal deficiencies;<br>• The property based on the appraisal;<br>• The property's acceptability as security for the mortgage requested in view of its value and marketability;<br>• The current contract for sale for the subject property for purchase money transactions;<br>• The current offering or listing for sale for the subject property for both purchase and refinancing transactions, if applicable;<br>• The current ownership for the subject property for both purchase and refinance transactions;<br>• The sale or transfer history of the subject property, and comparable sales for both purchase and refinance transactions;<br>• The sale(s) of the subject property and the sale price trend in relation to the appraiser's opinion of value to confirm that they are reasonable and representative of the market. |
| HUD/FHA | Underwriters must<br>• Review appraisal reports and compliance inspections, and<br>• Document all analyses performed and/or obtained by fee and staff personnel. Doing so ensures reasonable conclusions, sound reports and compliance with FHA requirements |

## Best Practices

It is essential that financial institutions and valuation providers have policies and procedures in place that describe the process for reviewing appraisals.

The review process should be able to ensure compliance with USPAP and compliance with the agencies' appraisal regulations.

When using a third party, an institution remains responsible for the quality and adequacy of the review process, including the qualification standards for reviewers.

## Reviewer Qualifications

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Reviewers should possess the education, expertise, and competence to perform the review commensurate with the complexity of the transaction, type of real property, and market.

| Regulatory Source | Requirement/Guideline |
|---|---|
| IAEG | An institution should establish qualification criteria for persons who are eligible to review appraisals and evaluations. Persons who review appraisals and evaluations should be independent of the transaction and have no direct or indirect interest, financial or otherwise, in the property or transaction, and be independent of and insulated from any influence by loan production staff.<br><br>Reviewers should be capable of assessing whether the appraisal or evaluation contains sufficient information and analysis to support the institution's decision to engage in the transaction.<br><br>An institution should assess the level of in-house expertise available to review appraisals for complex projects, high-risk transactions, and out-of-market properties. An institution may find it appropriate to employ additional personnel or engage a third party to perform the reviews.<br><br>When using a third party, an institution remains responsible for the quality and adequacy of the review process, including the qualification standards for reviewers. |
| FIRREA | Effective July 1, 2013, requirements established by a State for licensed appraisers, as well as for trainee and supervisory appraisers, must also meet or exceed the AQB Criteria, as required by the Dodd-Frank Act. |
| HUD/FHA | The underwriter must have a minimum of three years fulltime recent experience (or equivalent experience) reviewing both credit applications and property appraisals. This experience should have been with an institutional investor originating for their own portfolio or purchasing these types of mortgage loans, or an originator selling these types of mortgage loans to investors. Experience related solely to either mortgage credit or appraisal review counts for one half of the total requirement. Other experience may include quality control reviews for investors, or other similar experiences. |

Policy statements issued by the Appraisal Subcommittee were revised and adopted on June 1, 2013.

With respect to the qualifications of the reviewer the ASC has stated that "any State or Federal agency may impose additional appraisal standards if they consider such standards necessary to carry out their responsibilities, so long as additional standards do not preclude compliance with USPAP or the Federal financial regulatory agencies' appraisal regulations for work performed for federally related transactions".

This Policy Statement # 5 written in 1997 was removed:

> Finally, some State agencies have sought to require that an appraiser register for temporary practice if the appraiser is certified or licensed in another State, performs a technical review of an appraisal in that other State and changes, or is authorized to change, a value in the appraisal. The ASC, however, has concluded that for federally related transactions the review appraiser need not register for temporary practice or otherwise be subjected to the regulatory jurisdiction of the State agency in which the appraisal was performed, so long as the review appraiser does not perform the technical review in the State within which the property is located.

From Fannie Mae's Appraisal Independence Guidelines:

**Guidance on Addressing Appraisal Deficiencies**

If the lender considers an appraisal deficient, the lender has the following options for addressing the deficiencies:

- contacting the appraiser to address deficiencies contained in the appraisal report,
- obtaining a desk review or a field review of the original appraisal, or
- obtaining a new appraisal of the subject property.

The lender can return the appraisal report to the appraiser who completed the assignment, identify the deficiencies found, and provide justification for requesting correction of the deficiencies the lender believes make the report unreliable.

If the lender is unable to obtain a revised appraisal that adequately addresses its concerns, a desk or field review of the report may be obtained. The review must be completed in accordance with the USPAP. Because the Scope of Work for either type of review allows for a change of the opinion of market value for something other than a mathematical error, the appraiser completing the appraisal review must be licensed in the state in which the property is located, and he or she must have access to the appropriate data sources and must possess the knowledge and experience to appraise the subject property with respect to both the specific property type and geographical location.

The lender may forego either type of review and obtain a new appraisal. The new appraisal must, at a minimum, be based on the same level of inspection that was required for the original appraisal. For example, if the original appraisal was based on an

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interior and exterior inspection of the property, then the new appraisal must, at a minimum, also be based on an interior and exterior inspection of the property.
When a review appraisal or new appraisal is obtained, the lender must use the opinion of market value as stated in the review or new appraisal because the lender has, at that point in time, rejected the original appraisal. It is not acceptable for the lender to exercise blanket discretion by arbitrarily changing the opinion of market value from a report for use in the lending process. For example, it is not within the lender's discretion to simply average the two opinions of market value in order to arrive at a final value conclusion.

## Best Practices

There are a number of states that have written laws requiring that the review appraiser must be licensed and geographically competent to perform a review appraisal. Since this is a best practices document it would be considered prudent practice to have even policy from state to state. Since there are some states that do require that the review appraiser must be licensed in the state of the subject property many valuation departments have established staff reviewers in the states where they do business. IAEG requires that the lender must abide by USPAP and comply with state laws.

This does not preclude lenders from using automated tools to identify files that need to be reviewed by an appraiser who is geographically competent and appropriately licensed. It also does not preclude lenders from using non appraisers to review files for completeness. It would be a best practice to have policy in place that allows for a tiered escalation based upon risk such as an automated tool, administrative staff, desk reviews followed by field reviews.

The review process should address the independence, education and training qualifications, and the role of the reviewer.  Financial institutions and valuation service providers should ensure that the qualifications of the reviewers are adequate to provide compliance with the guidelines.  Reviewers should be well versed in the requirements of USPAP and be familiar with the requirements of the Interagency Appraisal and Evaluation Guidelines, as well as the GSE guidelines and unacceptable appraisal practices.

The review process should be able to assess the reasonableness of the appraisal or evaluation, including whether the valuation methods, assumptions, and data sources are appropriate and well supported. The review findings can be a good indicator of an appraiser's competency and qualifications and should be used to evaluate the ongoing performance of appraisers.

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## Depth of Review

The depth of the review should be sufficient to ensure that the methods, assumptions, data sources, and conclusions are reasonable, well supported, and appropriate for the transaction, property, and market.

| Regulatory Source | Requirement/Guideline |
|---|---|
| IAEG | An institution should implement a risk-focused approach for determining the depth of the review needed to ensure that appraisals and evaluations contain sufficient information and analysis to support the institution's decision to engage in the transaction. This process should differentiate between high-risk and low-risk transactions so that the review is commensurate with the risk.<br><br>The review also should consider the process through which the appraisal or evaluation is obtained, either directly by the institution or from another financial services institution.<br><br>The reviews for residential real estate transactions should reflect a risk-focused approach that is commensurate with the size, type, and complexity of the underlying credit transaction, as well as loan and portfolio risk characteristics. Risk factors could include debt-to-income ratios, loan-to-value ratios, level of documentation, transaction dollar amount, or other relevant factors.<br><br>With prior approval from its primary federal regulator, an institution may employ various techniques, such as automated tools or sampling methods, for performing pre-funding reviews of appraisals or evaluations supporting lower risk residential mortgages.<br><br>When using such techniques, an institution should maintain sufficient data and employ appropriate screening parameters to provide adequate quality assurance and should ensure that the work of all appraisers and persons performing evaluations is periodically reviewed. |

## Best Practices

Not all appraisals need the same level of review and the financial institution and valuation providers review program should reflect a risk-focused approach to the appraisal review process.

Supplemental data sources and analytics included in the appraisal report can aid in initially determining the complexity of the appraisal report. This can be used, along with additional data such as loan-to-value percentage, loan amount, market trends, default

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rates and foreclosure rates to ensure the appropriately qualified reviewer reviews the appraisal.

There should be a process in place to ensure the appraisal was obtained in an independent and compliant manner.

If the financial institution of the valuation provider does not have the required experience or competence to appropriately review the appraisal, they should engage a qualified resource outside of their organizations to perform the review.

## Resolution of Deficiencies

Financial institutions and valuation providers should have policies and procedures in place to identify and resolve deficiencies in appraisals. These policies should address appraiser independence and when to replace deficient valuations prior to the credit decision.

| Regulatory Source | Requirement/Guideline |
| --- | --- |
| IAEG | An institution should establish policies and procedures for resolving any inaccuracies or weaknesses in an appraisal or evaluation identified through the review process, including procedures for:<br>1. Communicating the noted deficiencies to and requesting correction of such deficiencies by the appraiser or person who prepared the evaluation. An institution should implement adequate internal controls to ensure that such communications do not result in any coercion or undue influence on the appraiser or person who performed the evaluation.<br>2. Addressing significant deficiencies in the appraisal that could not be resolved with the original appraiser by obtaining a second appraisal or relying on a review that complies with Standards Rule 3 of USPAP and is performed by an appropriately qualified and competent state certified or licensed appraiser prior to the final credit decision.<br>3. Replacing evaluations prior to the credit decision that do not provide credible results or lack sufficient information to support the final credit decision. |
| Fannie Mae/<br>Freddie Mac | If the lender considers an appraisal deficient, the lender has the following options for addressing the deficiencies:<br>• Contacting the appraiser to address deficiencies contained in the appraisal report,<br>• Obtaining a desk review or a field review of the original appraisal, or<br>• Obtaining a new appraisal of the subject property.<br>The lender can return the appraisal report to the appraiser who completed the assignment, identify the deficiencies found, and provide |

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| | justification for requesting correction of the deficiencies the lender believes make the report unreliable.<br><br>If the lender is unable to obtain a revised appraisal that adequately addresses its concerns, a desk or field review of the report may be obtained. The review must be completed in accordance with the USPAP. Because the Scope of Work for either type of review allows for a change of the opinion of market value for something other than a mathematical error, the appraiser completing the appraisal review must be licensed in the state in which the property is located, and he or she must have access to the appropriate data sources and must possess the knowledge and experience to appraise the subject property with respect to both the specific property type and geographical location.<br><br>The lender may forego either type of review and obtain a new appraisal. The new appraisal must, at a minimum, be based on the same level of inspection that was required for the original appraisal. For example, if the original appraisal was based on an interior and exterior inspection of the property, then the new appraisal must, at a minimum, also be based on an interior and exterior inspection of the property.<br><br>When a review appraisal or new appraisal is obtained, the lender must use the opinion of market value as stated in the review or new appraisal because the lender has, at that point in time, rejected the original appraisal. It is not acceptable for the lender to exercise blanket discretion by arbitrarily changing the opinion of market value from a report for use in the lending process. For example, it is not within the lender's discretion to simply average the two opinions of market value in order to arrive at a final value conclusion. |
| HUD/FHA | FHA prohibits "appraiser shopping", where lenders order additional appraisals in an effort to assure the highest possible value for the property, and/or the least amount of deficiencies or repairs are noted and required by the appraiser.<br><br>However, in the case where a borrower switches from one FHA lender (first lender) to a second lender, and an appraisal was ordered by and completed for the first lender, a second appraisal may be ordered by the second lender if the:<br>• First appraisal contains material deficiencies, as determined by the Direct Endorsement underwriter for the second lender<br>• Appraiser performing the first appraisal is on the second lender's exclusionary list of appraisers, or<br>• Failure of the first lender to provide a copy of the appraisal to the second lender in a timely manner would cause a delay in closing, posing potential harm to the borrower, which includes events outside the borrower's control such as<br>– Loss of interest rate lock |

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|---|---|
| | – Purchase contract deadline<br>– Foreclosure proceedings, and/or<br>– Late fees.<br>For the first two scenarios above, the lender must ensure that copies of both appraisals are retained in the case binder. For the third scenario, the appraisal from the first lender must be added to the case binder when it is received. |

## Best Practices

Appropriate communication between the appraisal reviewer and the appraiser is critical. Independence in the appraisal process **can be** compromised if the reviewer suggests or demands inappropriate revisions to an appraisal report. Communication to the appraiser that asks for clarifications or corrections of factual data and additional information is appropriate. Financial institutions and valuation providers should have policies and procedures in place to address the proper way to communicate and resolve any inaccuracies or deficiencies with appraisers.

It is acceptable for an appraiser to perform a review consistent with USPAP Standard 3 and for the reviewer to develop an alternate opinion of value. If an alternate opinion of value is developed, this is an appraisal. The review appraiser must have geographic competence and appropriate state appraiser licensing or certification when developing an opinion of value. If deficiencies in an original appraisal report are unable to be resolved, it is best to obtain a new appraisal from a different appraiser and use the opinion of value from that appraisal.

## Documentation of the Review

Financial institutions and valuation providers should have policies and procedures in place that require the documentation of the appraisal review process in either a checklist or narrative format.

| Regulatory Source | Requirement/Guideline |
|---|---|
| IAEG | An institution should establish policies for documenting the review of appraisals and evaluations in the credit file.<br><br>Such policies should address the level of documentation needed for the review, given the type, risk and complexity of the transaction. The documentation should describe the resolution of any appraisal or evaluation deficiencies, including reasons for obtaining and relying on a second appraisal or evaluation.<br><br>The documentation also should provide an audit trail that documents |

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| | the resolution of noted deficiencies or details the reasons for relying on a second opinion of market value. |

## Best Practices

All appraisal reviews should be documented to the degree necessary to demonstrate the appropriate level of review was performed commensurate with the complexity of the appraisal. It should show that the reviewer has determined the methods, assumptions and conclusions contained in the appraisal were appropriate and that the results of the appraisal are credible.

Any communication with the review appraiser and the appraiser should be documented and any deficiencies should be noted along with the steps taken to resolve the deficiencies.

| | |
|---|---|
| FIRREA | The Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency and the Bureau of Consumer Financial Protection shall jointly by rule, establish minimum requirements to be applied by a State in the registration of appraisal management companies. Such requirements shall include a requirement that such companies:<br>(1) Register with and be subject to supervision by a State appraiser certifying and licensing agency in each State in which such company operates;<br>(2) Verify that only licensed or certified appraisers are used for federally related transactions,<br>(3) Require that appraisals coordinated by an appraisal management company comply with the Uniform Standards of Professional Appraisal Practice; and<br>(4) Require that appraisals are conducted independently and free from inappropriate influence and coercion pursuant to the appraisal independence standards established under section 129E of the Truth in Lending Act |

## Best Practices

If a financial institution uses an appraisal management company to obtain appraisals, there should be a program in place to ensure compliance with the regulations by both the financial institution and the valuation provider.

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Individual states have unique laws that have varying impact on the operations of the appraisal management company. Financial institutions should be aware of these laws and monitor the appraisal management company's compliance.

Appraisal management companies should have policies and procedures in place that address the need to abide by state laws related to supervision, use only licensed or certified appraisers for federally related transactions, that appraisals comply with USPAP, and that the appraisals were conducted independently and free from influence and coercion.

## 12. State AMC Registration

It is incumbent upon a financial institution to ensure that their third party Appraisal Management Companies are registered in states where they do business and that they are in compliance with state laws.

Dodd Frank mandates that each state agency shall have an AMC registration program in place 36 months after the final rules have been issued.

While Dodd Frank defines an AMC and also establishes minimum requirements, states may have established definitions and minimum requirements unique to their state. The challenge for the financial institution is to ensure that each AMC is compliant with federal and state laws as they pertain to appraisal management services. This can be done by executing comprehensive Service Level Agreements and regularly monitoring and auditing the activities of their third parties. Oversight of third party activities is not optional. Financial institutions cannot abdicate compliance and risk.

While there are 56 jurisdictions to which an AMC must comply, we have attempted to organize and summarize these laws into the following categories:

Definition of an AMC
AMC Services
Owner Criteria
Penalties
Key provisions

At the present time there are 497 registered AMCs. There are over 3200 registrations nationally. Forty nine percent of all AMCs are registered in just one state. Less than 1% of all AMCs are registered in 25 states. The total cost of registrations in just these states is $49,724. Once all jurisdictions have enacted state AMC registration laws, the costs are estimated to approximate $100,000 annually. These costs exclude the expense of surety bonds and other requirements such as background checks.

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## Definition of an AMC

The federal definition of an AMC is based on size—"oversees a panel of 15 appraisers in a state or 25 appraisers nationally".

Some states have written very broad definitions that encompass "any appraisal activity". Some lenders may find that the software platform that they use is subject to state AMC registrations. Some states have also defined an AMC based upon size rather than activities. These definitions sweep in large appraisal companies who employ staff appraisers and are not, by the common definition of an AMC, a true AMC.

Conversely, a local appraisal company who engages independent contractors and does not classify their appraisers as employees could be considered an AMC regardless of their size.

AMCs owned by financial institutions are exempt from registration in most, but not all, states.

## AMC Services

The importance of having in place a well-crafted Service Level Agreement (SLA) to establish the level of services to be performed by the AMC cannot be understated.

State agencies have recognized the following as appraisal management services:

- Recruit, select and retain appraisers.
- Contract appraisers to perform assignments.
- Manage the appraisal process-ordering, administrative duties, collecting fees, reimbursing appraisers.
- Review and verify.

## Owner Criteria

Most states have an ownership criterion that dictates that no owner of an AMC may have ever had an appraisal license denied, revoked or voluntarily surrendered. Some states require a resident agent. Some states require background checks on AMC owners. Some states require that the owners have lawfully paid their debt obligations including taxes.

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## Penalties

Penalties for noncompliance can be as high as $250,000 per incident. Penalties for failure to register can be considered a felony in some states subject to fines and potentially incarceration.

## Key Provisions

While there is no national standard for AMC registrations and other appraisal laws there are some common threads:

- Review
- Surety bonds
- Fee Panel Management
- Record keeping
- Timely payment to appraisers.
- Customary and Reasonable Fees

## Best Practices

While compliance can be achieved by overlaying unique state requirements, any AMC operating nationally would be better served to develop best practices whereby they are compliant in all states at all times. The following is a summary and checklist to serve as a best practices benchmark for state compliance. Please note that we defaulted to the highest standard to ensure compliance in all jurisdictions.

- Appraisal Review is defined as the process of developing and communicating an opinion about the quality of work. It does not include a general examination for grammar, typographical or other errors or a completeness process. An automated scorecard is not a substitute for review by a licensed or certified appraiser in the subject state.
- Timely payment to the appraiser within 30 days.
- Must verify that the appraiser is competent to perform the assignment.
- Removal of an appraiser from a fee panel requires that the appraiser be notified in writing and a rebuttal process is in place.
- BPOs may only be ordered if the lender owns the property and is seeking to sell it or list it.
- AMC is subject to the same record keeping as the appraiser.
- Failure of an AMC to register can be a Class D felony and subject to 6 years in prison and/or a $10,000 fine.

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- AMC owners may not have a revoked or suspended appraisal (or any related real estate or lending activity) license or certification.
- AMC owners may not be convicted felons.
- AMC owners and their appraisers may not have a DUI while in the act of performing an appraisal or have a cumulative 3 DUIs.
- AMCs may not charge a background check fee, or credit report fee to the appraiser.
- AMCs may not charge appraisers for software, connection fees, and panel application fees.
- AMC owners may not evade lawful obligations to pay debts.
- AMCs may not require the appraiser to sign indemnity agreements that hold harmless the AMC that does not include the services performed by the appraiser.
- AMCs must be able to prove that the appraiser is competent to perform appraisal services for which they are engaged, prior to engagement.
- AMC must pay appraisers a Customary & Reasonable fee (no presumptions or safe harbors).
- Appraiser must disclose their fee in the body of the appraisal. AMC must disclose their fee from the client.
- AMC must place their registration number on the front page of the appraisal.
- Mandatory reporting required for violations of USPAP.
- Appraiser must sign a certification that they are geographically competent.

There is a growing trend for AMCs to engage other AMCs. This is most likely being done without the knowledge of the client. In order for a financial institution to be compliant it must know with whom it is doing business. If one of your approved AMCs is outsourcing to yet another AMC, you must follow all of the procedures to ensure you have properly vetted that AMC. Needless to say the multiple degrees of separation require greater, not lesser controls as the risk is further enhanced absent a Service Level Agreement.

If the motivation of outsourcers outsourcing is to avoid registration fees these AMCs are at risk of the wrath of the state regulators. Headline risk is increased as these AMCs are likely operating on razor thin margins. With the AMC operating as the agent for the lender, the risk falls to the lender/client.

## 13. Auditing Your Third Parties

Financial Institutions may choose to manage the audit function themselves or outsource to a company that specializes in audits or even better both. Audits can take many forms with some managed remotely coupled with periodic onsite extensive examinations.

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Audits should be performed to ensure that the Appraisal Management Companies with whom the financial institution does business is compliant with state and federal laws. Audits are also essential to ensure that the institution does not put itself at increased risk because of the decision to outsource. Some lenders have chosen to concentrate the business with only a few large national AMCs. This, of course, is easier to manage from an audit perspective but could potentially put the institution at risk if one fails or chooses to cease operations. A recent trend would indicate that some lenders have chosen to select a broader number of small regional AMCs to spread the risk and to seek better quality and service.

Audit best practices fall into the following broad categories identified as the 5 "P"s:

- PEOPLE - review the fee panel to ensure that the AMC is selection the best appraiser, not the fastest and not the cheapest.
- POLICY - review the policies. Audit payment policies and fee schedules to ensure compliance.
- PRACTICES - does the AMC actually follow the policies they have in place?
- PRODUCT - independently review a sampling of appraisals. Review the reviews.
- PENALTIES - what corrective measures will you take if the AMC fails any part of an audit?

## Summary

There is no doubt that the regulatory maze is difficult at best as there are multiple jurisdictions affecting every phase of the appraisal process. In addition to all of the benefits to being in regulatory compliance, there are operational benefits to adopting a "best practices" approach to the appraisal process. Creating a corporate culture of "doing the right thing" spares all parties unnecessary risk. Well-documented practices and well-crafted policies are the "means and not the ends" to creating an optimal appraisal program.

This is an oversight paper. Oversight includes both initial onboarding of vendors and constant monitoring. The Appraisal Management Company is acting as the agent of the lender. The lender is responsible for the actions of their third party vendors. It is therefore incumbent upon the financial institution to have complete transparency into the practice, policies and procedures of their third party vendors.

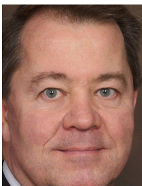
## Biography

Joan N. Trice is the founder and CEO of Clearbox LLC. Clearbox was formed as a response to compliance with Interagency & Evaluation Guidelines and Dodd Frank. Clearbox maintains an appraiser credentialing database and aggregates background checks and disciplinary actions. The Clearbox suite of products offers solutions to many of the challenges presented in this paper.

Allterra Group, LLC was founded in 2002. Joan is also the publisher of Appraisal Buzz, an email newsletter circulated to over 100,000 subscribers. In addition to the Buzz, Joan hosts the annual Valuation Expo, the largest conference for the valuation community.

The Collateral Risk Network founded in 2003 currently boasts membership over 400 comprised of Lenders, Government Agencies, Wall Street, Vendor Management Companies and Appraisers.

Allterra Group recently launched Allterra Online, an online continuing education venture with a focus on emerging issues in the valuation space. Third Party Oversight will be the first in a series of compliance topics offered on Allterra Online.



Tony Pistilli, is EVP and Chief Appraiser of Axios Valuation Solutions, a Fort Worth, Texas based national valuations provider. Tony is responsible for all aspects of the operations and compliance for the organization. Tony has over 25 years of real estate appraising and lending experience. He has previously worked at large national banks, mortgage companies, a federal agency and as a self-employed fee appraiser. He has provided compliance and regulatory assessments to financial institutions, regulatory agencies and appraisal management companies. Tony is a member of several appraisal industry organizations and was a subject matter expert for the Appraisal Foundation in the area of declining markets. Tony is an AQB certified USPAP instructor and holds a certified residential appraisers license.

Peter Christensen is general counsel of LIA Administrators & Insurance Services. LIA provides insurance and bond products to appraisers, appraisal firms and management companies in all 50 states. As general counsel, Peter assists and advises LIA's 24,000+ insureds with regard to liability threats, lawsuits, and administrative complaints and discipline. He graduated with a law degree from the University of

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California at Berkeley (Boalt Hall School of Law) in 1993 and previously worked for the law firms Latham & Watkins LLP and Irell & Manella LLP in Orange County, California.

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