

LENDERS UPDATE™

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AN ALT & ASSOCIATES NEWSLETTER

Main Office:
2102 BUSINESS CENTER DRIVE
SUITE 130
IRVINE, CA 92612

Mailing Address:
P.O. BOX 4125
IDY, CA 92549-4125

DAVID JEROME ALT

Attorney at Law

David.j.alt@altandassociates.com

TELEPHONE 949.253.5755

FACSIMILE 949.253.5756

www.altandassociates.com

October 20, 2010

SUMMARY OF NEW FEDERAL APPRAISAL RULES

Earlier this week the Federal Reserve Board published, for public comment, an Interim Final Rule amending Regulation Z. The new Rule implements an amendment to the Truth in Lending Act ('TILA') included in the Dodd-Frank Wall Street Reform and Consumer Protection Act. These revisions establish new requirements for appraisal independence in consumer credit transactions secured by the consumer's principal dwelling.

The Rule is effective in 60 days however, compliance with the Rule is optional until April 1, 2011.

In normal circumstances, the Board would publish a proposed Rule and solicit comments prior to writing and publishing a Final Rule. However, due to several factors, the Board

decided to publish this Interim Rule. Even without public comment this Rule is effective according to the scheduled just mentioned above. It is however, also subject to change based on comments received by the Board.

Therefore, to repeat, the Interim Final Rule is effective in 60 days and compliance with the Rule is mandatory for all applications received by a creditor on or after April 1, 2011. The new Rule effectively “sunsets” the Home Valuation Code of Conduct (“HVCC”) which governs loans made by FANNIE MAE and FREDDY MAC. In addition, the Rule replaces the Board’s Appraisal Independence Rules adopted in 2008 as Section 226.36(b) of Regulation Z and its related staff commentary.

The Dodd-Frank Act amended the Truth in Lending Act to specifically establish new requirements for appraisal independence. The Act:

- ✚ Prohibits coercion, bribery and similar actions which cause an appraiser to base the value of the property on factors other than the appraiser’s independent judgment.
- ✚ Prohibits appraisers and appraisal management companies from having a financial or other interest in the property or in the credit transaction.
- ✚ Prohibits a creditor from extending credit if it knows of a violation of the prohibitions against coercion or conflict of interest.
- ✚ Requires that parties report appraiser misconduct to appropriate licensing authorities.
- ✚ Requires the payment of reasonable and customary compensation to a fee appraiser.
- ✚ Provides that when the Board (as it has now done) promulgates the Interim Final Rule, the HVCC which is the standard for appraisals for loans made by FANNIE MAE and FREDDY MAC, will have no other force or effect.

Scope of New Rule.

The Rule applies to any person or entity which extends credit or provides services in connection with a consumer credit transaction secured by a consumer’s principal dwelling. This is an expansion of general TILA and Regulation Z coverage to expand the effects of the Rule to persons and entities that provide services whether or not they actually extend credit. It obviously applies to creditors, appraisal management companies, and appraisers. However, coverage of the Rule, includes persons that provide settlement services as defined under the Real Estate Settlement and Procedures Act (‘RESPA’) which would include people who provide credit reports, provide legal services, prepare documents, survey real estate or provide pest inspections as well as title companies, realtors and mortgage brokers. Consumers, guarantors, and those residing in the consumer’s principal dwelling are not covered by these provisions.

The new Rule applies to consumer credit transactions secured by the principal dwelling of the consumer. As required by the Dodd-Frank Act, the coverage not only includes closed end loans but it now also covers HELOCS.

With few exceptions, the Interim Final Rule applies to any persons who perform valuation services, valuation management functions, and any valuation of the consumer’s principal dwelling, not just licensed or certified appraisers in a formal appraisal. A valuation means any estimate of the value of the consumer’s principal dwelling in written or electronic form 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.

Valuation does not include an estimate of value produced exclusively using an automated model or system, although it does include an estimate of value, developed by a natural person based in part on an estimate produced using an automated model or system. The Board has asked for comments to determine whether or not these automatic valuation models should in fact be included. As said, as of now they are not.

Coercion.

The Interim Final Rule prohibits covered persons from engaging in coercion, bribery, and other similar actions that are designed to cause anyone who prepares a valuation to base the value of the property on factors other than the person's independent judgment. It also prohibits a creditor from extending credit based on a valuation if the creditor knows at or before consummation that such coercion or other similar conduct has occurred. A creditor may avoid this liability by showing reasonable diligence to conclude that the valuation does not materially misstate the value of the property.

The Truth in Lending Act, as amended by Dodd-Frank, sets out a number of specifics as to what would violate appraiser independence which include:

- + Causing a value to be assigned based on any factor other than the independent judgment of an appraiser, such as compensating, coercing, extorting, colluding with, instructing, inducing, bribing or intimidating a person conducting or involved in an appraisal.**
- + Mischaracterizing or suborning mischaracterization of the value of the property.**
- + Influencing an appraiser to encourage a targeted value in order to facilitate the making or pricing of a transaction.**
- + Withholding or threatening to withhold timely payment for an appraisal report or appraisal services rendered when the report or services are provided in accordance with the governing contract.**
- + Seeking to influence an appraiser to assign a targeted value to facilitate the making or pricing of a covered transaction.**
- + Withholding or threatening to withhold timely payment for an appraisal report. Specific value includes, predetermined thresholds, predetermined minimums, maximums or ranges of value.**
- + Advising an appraiser a minimum reported value of the consumer's principal dwelling that is needed to approve a loan.**
- + Implying to a person who prepares valuations that future business depends on the value of the consumer's principal dwelling.**

- ✚ **Preparing a valuation which materially misrepresents the value of the consumer's principal dwelling (this does not include a bonafide error).**

The Act does not prohibit a person or entity from:

- ✚ **Considering additional appropriate property information including information regarding additional comparable properties to support an appraisal.**
- ✚ **Providing further detail, substantiation or explanation for the appraiser's value conclusion or correcting errors in the appraisal report.**
- ✚ **Providing incentives such as additional compensation to a person who prepares valuations or performs valuation management functions, as long as the covered person does not cause or attempt to cause the value assigned to the consumer's principal dwelling to be based on a factor other than the independent judgment who prepares the evaluation.**

Significantly, the new Regulation Z in Section 226.42 (c) (3) (iv) provides an example of an action that does not violate the new prohibitions, that is, in obtaining multiple valuations for the consumer's principal dwelling to select the most reliable valuation as long as the creditor adheres to a policy of selecting the most reliable appraisal rather than the appraisal that states the highest value.

Other Restrictions.

The Interim Final Rule provides that a person who prepares a valuation or who performs valuation management services may, neither directly nor indirectly, have an interest, financial or otherwise in the property of the transaction. While it is possible to interpret the phrase "indirect financial interest" as prohibiting creditors from using in-house staff appraisers and affiliated appraisal management companies, the Rule specifically clarifies that an employee relationship or affiliation does not by itself, violate this prohibition. The

Rule provides a Safe Harbor and specific criteria for establishing “fire walls” between the appraiser function and the loan production function to prevent conflicts of interest. For small institutions (with assets of \$250 million or less) specific guidance is provided in establishing fire walls where separate appraisal and loan production staff cannot effectively be separated.

The Interim Rule also provides that a settlement service provider involved in a credit transaction, who has a reasonable basis to believe that an appraiser has not complied with ethical requirements for appraisers under federal or state law, or under the Uniform Standards of Appraisal Practice Act, must report such failure to comply, to the appropriate state licensing agency. Only those compliance failures that are likely to affect the value of the property are included in this reporting requirement.

Finally, under the Interim Rule a creditor and its agent must pay a fee appraiser at a rate that is reasonable and customary in the market where the property is located. The Interim Rule sets out two presumptions which if met, will presume compliance with the requirements:

- 1. The fee is reasonably related to recent rates paid for appraisal services in that market, taking into account specific factors such as type of property.**
- 2. The fee is set by relying on rates established by third party information such as appraisal fee schedules.**

The Interim Rule, its commentary and the supporting information provided by the Federal Reserve Board give us considerable guidance on what is allowed and what is not. Obviously, there will be many future questions and just as obviously, your specific issues should be addressed individually and with knowledge of the entire Interim Rule and its related materials.

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sherry.edwards@altandassociates.com

ALT & ASSOCIATES provides regulatory, compliance, operational advice and transactional assistance, as well as litigation representation, to the financial services industry. Over the past two decades, members of the firm have represented Institutional Lenders and Mortgage Bankers and Brokers in all aspects of their operations. If you have any questions please contact:

David J. Alt, Esq.

David.j.alt@altandassociates.com

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