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RE: Home Valuation Code of Conduct

Dear Sirs:

The American Bankers Association ("ABA") welcomes the opportunity to comment to Fannie Mae and Freddie Mac (collectively the "GSEs") on the Home Valuation Code of Conduct ("the Code"). Each of the GSEs have entered into an agreement with the Director of the Office of Federal Housing Enterprise Oversight ("OFHEO") and the Attorney General of New York requiring lenders that sell loans to the GSEs to represent and warrant that loans sold to the GSEs be made in compliance with the Home Valuation Code of Conduct.

#### **ABA Position**

The ABA will provide comments in several general areas. First, this letter addresses the legal and procedural processes that have lead to the request for comments on the Home Valuation Code of Conduct. The ABA has significant concerns regarding the process and the precedent that the agreements and the Code may establish.

The ABA also has concerns generally about the Home Valuation Code of Conduct. Its adoption will require that all mortgage lenders, including insured depository institutions, change the structure of their lending operations. We urge the GSEs to reconsider the Home Valuation Code of Conduct. The ABA supports a review of appraisal practices but recommends a "principles based" approach rather than the adoption of a framework that requires mortgage lenders to change their structural operations.

Alternatively, if the Code is adopted by the GSEs, the ABA requests a number of clarifications and revisions. These revisions will help lenders as they comply with the requirements. We strongly urge that our revisions be adopted before the Code is adopted into Fannie Mae and Freddie Mac seller/servicer guidelines.

## **Background**

On March 3, 2008, Fannie Mae and Freddie Mac each entered into an agreement with the New York State Attorney General and the Director of the Office of Federal Housing Enterprise Oversight requiring that each of the GSEs adopt a Home Valuation Code of Conduct. The Code establishes requirements governing the relationship that lenders doing business with the GSEs will have with appraisers. The items addressed in the Code of Conduct include: appraiser selection, solicitation, compensation, conflicts of interest and corporate independence. The GSEs have agreed with the New York Attorney General and OFHEO that they will not purchase loans from a lender that does not agree to comply with the Code of Conduct. There is a limited exclusion from some of the requirements for those lenders that meet the definition of "small bank" established in the Community Reinvestment Act, 12 USC § 2980. A small bank is one with \$250 million in assets or less.

All insured depository lenders are required to comply with rules and regulations promulgated by their primary federal regulators that establish requirements for appraisals and for the training and certification of the appraisers they use. These rules apply whether insured depository lenders hold loans in portfolio or sell to Fannie Mae, Freddie Mac, or any other secondary market outlet.

In 1989, Congress required the federal banking agencies, including the National Credit Union Administration, to adopt regulations on the preparation and use of appraisals by federally regulated financial institutions. Title XI of the Financial Institutions Reform, Recovery and Enforcement Act states:

The purpose of this title is to provide that financial and public policy interests in real estate related transactions will be protected by requiring that real estate appraisals utilized in connection with federally related transactions are performed in writing, in accordance with uniform standards, by individuals whose competency has been demonstrated and whose professional conduct will be subject to effective supervision.

In addition to requiring that the federal banking agencies issued regulations that establish standards for appraisers, Congress established the Appraisal Subcommittee within the Federal Financial Institutions Examination Council to monitor the requirements by the states for certification and licensing of individuals qualified to perform appraisals, including the monitoring of the development of a code of professional responsibility. The Appraisal Subcommittee also was established to monitor the appraisal related requirements of the federal banking agencies, to monitor The Appraisal Foundation polices, to maintain a national registry of state licensed and certified appraisers and to prepare and deliver an Annual Report to Congress on the FFIEC's performance of its statutory functions in this area.

The federal banking agencies were required to promulgate regulations to establish standards and requirements for using state licensed and certified appraisers. These

regulations were required to be developed and adopted in accordance with the Administrative Procedures Act. In addition to these regulations, Congress required each of the federal banking agencies to issue real estate lending guidelines that require the institution to adopt a policy that addresses portfolio management, loan administration and underwriting criteria. One of the elements to be addressed in the policy is the establishment of an appraisal and evaluation program. The purpose of the required real estate lending policy is to ensure consistent safe and sound banking practices in the area of real estate lending.

Since 1992, the federal banking agencies have issued interpretive guidance and questions and answers interpreting the appraisal regulations and addressing developments as they arise. Revisions have been made using the procedures required by the Administrative Procedures Act.

### **General**

As a general matter, the ABA supports an appraisal profession that works to ensure a safe underwriting process for lenders of all types. We believe that the process developed over the past 20 years for insured institutions provides sufficient checks, restrictions and the ability to change the requirements in a timely fashion to address concerns regarding appraisal fraud.

We strongly support the continued availability of a principles based framework that governs the appraisal process. We urge the GSEs and OFHEO to work with the federal and state banking agencies to address any changes that may be necessary to respond to incidences of appraisal fraud without requiring changes to the structure of lending operations of mortgage lenders. The current problems in the mortgage industry would be exacerbated by requiring organizational changes within the operations of lenders – especially organization changes on the scale required by the Code of Conduct.

While the balance of the ABA's response will address the substance of the Code of Conduct, as a threshold issue we believe that this attempt by OFHEO and the Attorney General of New York (specifically, making use of a "settlement agreement" to impose the substantive rules and requirements of the Home Valuation Code of Conduct upon the industry) rests upon an unsound legal foundation which may ultimately be deemed to violate federal law. The legal grounds for questioning the ultimate enforceability of the Code of Conduct include but are not limited to arguments that (i) the imposition of the terms of the agreement upon the industry violates the Administrative Procedure Act; (ii) OFHEO has unlawfully delegated its regulatory authority to a third party; (iii) the New York Attorney General is unlawfully seeking to exercise regulatory authority that resides exclusively with the Federal Government; (iv) OFHEO has exceeded its statutory authority by seeking to impose regulatory requirements upon institutions that it does not regulate, and (v) the agreement upsets the comprehensive framework for regulating appraisals established by Congress in Title XI of the Federal Financial Institution Reform, Recovery and Enforcement Act of 1989. In short, ABA believes that OFHEO's

apparent abdication of its regulatory authority in this instance to the New York Attorney General violates fundamental principles of administrative law and federalism, rendering the arrangement null and void.

Turning to the text of the Home Valuation Code of Conduct, we are very concerned about the breadth of its application across the industry. While only lenders that sell loans to Fannie Mae and Freddie Mac will be required to represent and warrant that the loans sold to the GSEs are made in conformance with the Home Valuation Code of Conduct, the reality of the market is that every mortgage lender would be required to comply for every loan. Fannie Mae and Freddie Mac are dominant in the secondary market and lenders must originate loans that meet their requirements whether they sell to other participants, or sell to the GSEs, or wish to retain the important option of selling to either at a future date.

Other secondary market participants have generally adopted the Fannie Mae and Freddie Mac standards and underwriting criteria for similar reasons. The practical effect of the adoption of the requirements is a change to a regulatory and operational framework that has worked well for 20 years. We are concerned that any implementation of the Home Valuation Code of Conduct, as drafted, will result in operational changes in the mortgage lending area that will detrimentally impact the ability of lenders to underwrite loans in a safe and sound manner.

As insured depository institutions, ABA members are examined and supervised regularly. Their policies are reviewed for compliance with regulations and guidance as well as for purposes of safety and soundness. The management of institutions works to correct concerns that might be raised by examiners. Those institutions that employ in-house appraisers have established methods of ensuring the independence of the appraisal function in accordance with regulations and guidance.

The ABA members that do business with Fannie Mae and Freddie Mac are familiar with the seller/servicer guidelines. We understand that the GSEs change the guidelines without the benefit of the notice and comment process that is required of the federal banking agencies. We believe that the opportunity to comment is an acknowledgement by OFHEO, the Attorney General and the GSEs of the dramatic impact that these changes would have on the mortgage market and that input must be sought prior to making such sweeping changes. However, we are concerned that using the process gives the appearance of a rulemaking while it is not. It has none of the procedural requirements and safeguards of the Administrative Procedures Act, and does not ensure adequate vetting and opportunity for review that a regular rulemaking would provide.

### **Appraiser Independence**

A primary result of the implementation of the Home Valuation Code of Conduct would be to eliminate the opportunity for lenders to use in-house or affiliated appraisers. We note that this practice has developed and evolved over the years and is carefully regulated. The guidance and regulations issued by the federal banking

agencies specifically address the independence of the appraisal function and ensure that appraisals are performed in isolation from the loan production function.

There is no evidence that there is a pervasive violation of the appraisal process by insured institutions that have these operations performed in-house as compared to any other approach. Insured depository institutions and the federal banking agencies have established protections through 20 years of regulations, guidance and question and answer issuances to ensure there is a firewall between the loan origination and the appraisal division of the institution and within the appraisal operation itself. Examiners evaluate the independence of the overall appraisal process for institutions that use in-house appraisers. Violations of the independence requirement for staff and fee appraisers are punished by the issuance of cease and desist orders.

Anecdotally, a number of institutions maintain that this approach of using in-house appraisers actually is better protection from inappropriate pressure than the use of independent fee appraisers. The in-house person does not have to worry about his or her next assignment or paycheck. Given the independence requirements contained in the regulation and the guidance we do not believe that it is necessary to eliminate the use of in-house appraisers or to change the structure of the mortgage lending operation.

Institutions can ensure the appraiser receives the training he or she needs to perform the appraisal and to enhance professionalism. The regulations require that appraisers be licensed or certified depending on the types and complexity of the properties and the transaction value. The institution is better able to ensure the appraiser has the competency to do the work. Prohibiting in-house appraisers would eliminate a valuable option for insured depository institutions and would force banks of all sizes to make changes to their mortgage lending model at a time when the market is already struggling with a credit crunch and other impediments to lending.

### **Operational Risk**

The appraisal process plays a vital role in the mortgage lending operations of insured institutions and other lenders. It is the lenders who need the appraisals to verify the value of the property. Appraiser training, professionalism, licensing, certification and independence are important factors in a lender's determination of which appraiser to use. Lenders, whether they are insured institutions or others, have organized their lending and compliance functions to minimize the risk to the business and the institution and to comply with the rules and regulations. The organization changes that would be required for lenders to comply with the requirements of the Home Valuation Code of Conduct are not prudent and would not minimize the risk.

Lenders that have large mortgage operations have established mechanisms to ensure the independence of in-house or affiliated appraisers. If they employ the services of appraisal companies or service providers, careful due diligence has been done and contractual arrangements have been entered. For insured institutions, the both the

primary federal and the appropriate state regulator examine these arrangements.

Finally, while the Real Estate Settlement Procedures Act ("RESPA") is not addressed in the Home Valuation Code of Conduct, the ability of lenders and brokers to comply with the provisions of RESPA would be dramatically changed and business arrangements would have to be revised, at great cost to many lenders and eventually the consumer as compliance costs are passed along.

### **Exception for Small Institutions**

The agreement that requires compliance with the Home Valuation Code of Conduct contains a limited exception to compliance for those institutions that have \$250 million in assets or less. The limited exceptions include an exemption from the requirement that the small lender may not use an appraisal report prepared by an appraiser employed by the lender; an affiliate of the lender; an entity owned in whole or in part by the lender; or an entity that owns, in whole or in part the lender. However, the small lender must comply with the other requirements and must meet the appropriate standards for independence, even if they meet the hardship test.

Small lenders have been originating mortgage loans in their communities in compliance with the rules and regulations of their respective primary federal and appropriate state regulator, including the independence requirement. In many communities, the choice of appraiser is limited by the number of licensed and certified appraisers available with knowledge of the community. Many of these small institutions will not meet the requirements for exemption under the agreements. These small institutions will be put at a competitive disadvantage and will be forced to use appraisers who are not familiar with the community or who are not experienced with the types of loans or properties being appraised. Such an outcome increases the risk of faulty appraisals.

### **Establishment of Independent Valuation Protection Institute**

While the ABA agrees that "the integrity of the valuation processes involve federal and state law and regulations as well as market practices and standards," we do not agree that the establishment of another body to monitor and study the appraisal area is necessary. The ABA is concerned about the establishment of the Independent Valuation Protection Institute, as described in the agreement between the GSEs, OFHEO and the New York State Attorney General. There currently are several industry organizations that address appraisal issues, including the Appraisal Subcommittee of the FFIEC. We also are concerned that the Institute will inappropriately usurp the role that the states play in the licensing and certification of appraisers.

Further, as described in the agreement, the Independent Valuation Protection Institute will, among other things, provide a hotline for consumers, will be a place for appraisers to voice concerns, and will report to OFHEO and the New York

Attorney General's office on a bi-annual basis. We are very concerned about the potential for overlap regarding the activities of the Institute and the activities of the appropriate federal or state regulator. For example, each of the federal banking agencies has a process in place for handling consumer complaints about the banks with which the consumers do business.

The appraisal process has been developed over the years as part of the underwriting process and as a method of providing safety and soundness protection to the insured depository institution or lender that is making the loan. Other federal consumer protection requirements provide that consumers may obtain a copy of the appraisal. Inserting the consumer in this process, as the Code would do, adds a layer of complexity to a process that is already difficult for many consumers to understand. While we oppose the additional regulatory burdens imposed by the Code in this area, we request that if this requirement is to be retained that the permissible method of delivery be identified. Additionally we seek clarification for transactions in which Automated Valuation Methods ("AVMs") are used, specifically, what document should be provided to the consumer if only batch AVMs are provided to the lender.

We also are concerned about any enforcement that the Institute may take against a lender outside of the enforcement process provided for by the appropriate federal and state regulators. The ABA would like to ensure that any overlap of responsibilities is appropriately addressed, and that lenders who are not insured depositories are appropriately supervised and face appropriate enforcement.

### **Hotline Requirement**

We are concerned that the requirement that a hotline and email address be established to take complaints for appraisers, consumers and others is burdensome, particularly as the Home Valuation Code of Conduct requires that only specified employees may have access to the hotline or email address. We again note that each of the federal banking agencies already has a process in place to receive and address consumer complaints. The requirement that an investigation be begun within 72 hours also is burdensome. Finally, we believe that providing the consumer with this information is duplicative and adds to the complexity of the process.

### **Requested Clarifications**

While we do not agree with the adoption of the Home Valuation Code of Conduct, we provide the following requests for clarification of the current form of the document. There are a number of terms that are used in the Code of Conduct for which definitions or clarifications are needed. For example, "substandard performance", "flawed", and "tainted" are terms that need definition. Several phrases including "appropriately trained and qualified in the area of real estate and appraisals" and "any indication of improper conduct" need to be explained and the meaning made clear in the context of practical and well-established business procedure and regulation. How would the lender prove the conduct or the facts intended?

## Conclusion

The ABA strongly urges the GSEs, OFHEO, and the Attorney General to reconsider the implementation of the Code of Conduct. We believe that both the process for imposing the Code and the substance of the Code itself are flawed. If, however, parts of the Code are to be integrated into the GSEs' seller/servicer guides, we believe they must be redrafted to address numerous concerns and to reflect the current market processes and structure. The goals of the Code can be achieved without requiring a costly restructuring of the mortgage lending process that will harm consumers and lenders alike.

The ABA appreciates the opportunity to comment on this very important matter. The appraisal process plays a vital role in mortgage lending by all types of institutions and companies. We urge the GSEs, OFHEO and the New York Attorney General to work with the federal banking agencies to suggest any changes that might be necessary to the existing rules, regulations and guidance to accomplish the goals of the Home Valuation Code of Conduct. The ABA does not believe that a public policy that will require mortgage lenders to change their business model should be made in the manner proposed, and so urge all parties to work within the current industry and regulatory structure to achieve the intended goals.

We stand ready to work with the GSEs and the federal bank regulators to address the concerns that the respective organizations have regarding the independence or operations of appraisers used by lenders. We urge the GSEs to reconsider the Home Valuation Code of Conduct and the negative precedential impact its adoption will have on mortgage lending operations.

Please contact the undersigned if you have any questions or concerns regarding this letter.

Sincerely,



Robert R. Davis

Copy to:       The Honorable Andrew M. Cuomo  
                  Attorney General  
                  State of New York  
                  Albany, NY

The Honorable James B. Lockhart III  
Director  
Office of Federal Housing Enterprise Oversight  
Washington, DC