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Part IV

Federal Reserve System

12 CFR Part 226
Truth in Lending; Interim Final Rule

FEDERAL RESERVE SYSTEM

12 CFR Part 226

Regulation Z; Docket No. R–1394

RIN AD–7100–56

Truth in Lending

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Interim final rule; request for public comment.

SUMMARY: The Board is publishing for public comment an interim final rule amending Regulation Z (Truth in Lending). The interim rule implements Section 129E of the Truth in Lending Act (TILA), which was enacted on July 21, 2010, as Section 1472 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. TILA Section 129E establishes new requirements for appraisal independence for consumer credit transactions secured by the consumer's principal dwelling. The amendments are designed to ensure that real estate appraisals used to support creditors' underwriting decisions are based on the appraiser's independent professional judgment, free of any influence or pressure that may be exerted by parties that have an interest in the transaction. The amendments also seek to ensure that creditors and their agents pay customary and reasonable fees to appraisers. The Board seeks comment on all aspects of the interim final rule.

DATES: This interim final rule is effective December 27, 2010, except that the removal of § 226.36(b) is effective April 1, 2011.

Compliance Date: To allow time for any necessary operational changes, compliance with this interim final rule is optional until April 1, 2011.

Comments: Comments must be received on or before December 27, 2010.

ADDRESSES: You may submit comments, identified by Docket No. R–1394 and RIN No. AD–7100–56, by any of the following methods:

- *Agency Web Site: http://www.federalreserve.gov.* Follow the instructions for submitting comments at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.*
- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.
- *E-mail: regs.comments@federalreserve.gov.* Include the docket number in the subject line of the message.
- *Fax:* (202) 452–3819 or (202) 452–3102.
- *Mail:* Address to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

All public comments will be made available on the Board's Web site at *http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm* as submitted, unless modified for technical reasons. Accordingly, comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP–500 of the Board's Martin Building (20th and C Streets, NW.) between 9 a.m. and 5 p.m. on weekdays.

FOR FURTHER INFORMATION CONTACT: Jamie Z. Goodson, Attorney, or Lorna M. Neill, Senior Attorney; Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551, at (202) 452–2412 or (202) 452–3667. For users of Telecommunications Device for the Deaf (TDD) only, contact (202) 263–4869.

SUPPLEMENTARY INFORMATION:

I. Background

The Truth in Lending Act (TILA), 15 U.S.C. 1601 *et seq.,* seeks to promote the informed use of consumer credit by requiring disclosures about its costs and terms. TILA requires additional disclosures for loans secured by consumers' homes and permits consumers to rescind certain transactions that involve their principal dwelling. TILA directs the Board to prescribe regulations to carry out the purposes of the law and specifically authorizes the Board, among other things, to issue regulations that contain such classifications, differentiations, or other provisions, or that provide for such adjustments and exceptions for any class of transactions, that in the Board's judgment are necessary or proper to effectuate the purposes of TILA, facilitate compliance with TILA, or prevent circumvention or evasion of TILA. 15 U.S.C. 1604(a). TILA is implemented by the Board's Regulation Z, 12 CFR part 226. An Official Staff Commentary interprets the requirements of the regulation and provides guidance to creditors in applying the rules to specific transactions. *See* 12 CFR part 226, Supp. I.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was signed into law.[1] Section 1472 of the Dodd-Frank Act amended TILA to establish new requirements for appraisal independence. Specifically, the appraisal independence provisions in the Dodd-Frank Act:

- Prohibit coercion, bribery and other similar actions designed to cause an appraiser to base the appraised value of the property on factors other than the appraiser's independent judgment;
- Prohibit appraisers and appraisal management companies from having a financial or other interest in the property or the credit transaction;
- Prohibit a creditor from extending credit if it knows, before consummation, of a violation of the prohibition on coercion or of a conflict of interest;
- Mandate that the parties involved in the transaction report appraiser misconduct to state appraiser licensing authorities;
- Mandate the payment of reasonable and customary compensation to a "fee appraiser" (*e.g.,* an appraiser who is not the salaried employee of the creditor or the appraisal management company hired by the creditor); and
- Provides that when the Board promulgates the interim final rule, the Home Valuation Code of Conduct, the current standard for appraisal independence for loans purchased by Fannie Mae and Freddie Mac, will have no further force or effect.[2]

These provisions are contained in TILA Section 129E, which applies to any consumer credit transaction that is secured by the consumer's principal dwelling. TILA Section 129E(g)(1) authorizes the Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Federal Housing Finance Authority ("FHFA"), and the Consumer Financial Protection Bureau to issue rules and guidelines. TILA Section 129E(g)(2), however, requires the Board to issue interim final regulations to implement the appraisal independence requirements within 90 days of enactment of the Dodd-Frank Act. As discussed below, the Board finds there is good cause for issuing an interim final rule without opportunity for advance notice and comment.

Appraisal independence. Over the years concerns have been raised about the need to ensure that appraisals are provided free of any coercion or improper influence. The Board and the other federal banking agencies have jointly issued regulations and supervisory guidance on appraisal independence.[3] However, the guidance

[1] Public Law 111–203, 124 Stat. 1376.

[2] "Home Valuation Code of Conduct" (HVCC), available at *http://www.fhfa.gov/webfiles/2302/HVCCFinalCODE122308.pdf.*

[3] *See, e.g.,* the Board's regulation at 12 CFR 225.65, and its guidance, available at *http://www.federalreserve.gov/boarddocs/srletters/1994/sr9455.htm.* Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) was enacted to protect federal financial

is limited to federally supervised institutions. Based on concerns about consumers obtaining home-secured loans based on misstated appraisals, in 2008, the Board used its authority under the Home Ownership and Equity Protection Act (HOEPA) to prohibit a creditor or mortgage broker from coercing or influencing an appraiser to misstate the value of a consumer's principal dwelling (2008 Appraisal Independence Rules). 12 CFR 226.36(b); 15 U.S.C. 1639(l)(2). The 2008 Appraisal Independence Rules took effect on October 1, 2009. Section 1472 of the Dodd-Frank Act essentially codifies the 2008 Appraisal Independence Rules, and expands on the protections in those rules. This interim final rule incorporates the provisions in the 2008 Appraisal Independence Rules. Thus, the Board is removing the 2008 Appraisal Independence Rules effective on April 1, 2010.

In December 2008, Fannie Mae and Freddie Mac ("the GSEs") announced the Home Valuation Code of Conduct (HVCC), which established appraisal independence standards for loans the GSEs would purchase. The HVCC is based on an agreement between the GSEs, New York State Attorney General Andrew Cuomo, and the FHFA. The HVCC provides that, among other things, only a creditor or its agent may select, engage, and compensate an appraiser and that a creditor must ensure that its loan production staff do not influence the appraisal process or outcome. As noted, however, the Dodd-Frank Act mandates that the HVCC shall have no effect, once the Board issues this interim final rule.[4]

II. Summary of the Interim Final Rule

The interim final rule applies to a person who extends credit or provides services in connection with a consumer credit transaction secured by a consumer's principal dwelling. Although TILA and Regulation Z generally apply only to persons to whom the obligation is initially made payable and that regularly engage in extending consumer credit, TILA Section 129E and the interim final rule apply to persons that provide services without regard to whether they also extend consumer credit by originating mortgage loans.[5] Thus, the interim final rule applies to creditors, appraisal management companies, appraisers, mortgage brokers, realtors, title insurers and other firms that provide settlement services.

Other scope issues. The interim final rule applies to appraisals for any consumer credit transaction secured by the consumer's principal dwelling. Covering consumer credit transactions is consistent with the scope of TILA generally, which only applies to credit extended for personal, family or household purposes. However, the scope of the interim final rule is broader than the 2008 Appraisal Independence Rules; those rules apply to closed-end loans but not to home-equity lines of credit (HELOCs). The broader scope is required by Section 1472 of the Dodd-Frank Act, which does not limit coverage to closed-end loans and also covers HELOCs.

In addition, with a few exceptions, the interim final rule applies to any person who performs valuation services, performs valuation management functions, and to any valuation of the consumer's principal dwelling, not just to a licensed or certified "appraiser," an "appraisal management company," or to a formal "appraisal." This approach implements the statutory provisions and is consistent with the 2008 Appraisal Independence Rules, and is designed to ensure that consumers are protected regardless of the valuation method chosen by the creditor, and to prevent circumvention of the appraisal independence rules. These provisions are discussed in more detail in the section-by-section analysis below.

Coercion and prohibited extensions of credit. Consistent with the Dodd-Frank Act, the interim final rule prohibits certain practices that the Board's 2008 HOEPA rules also prohibit. First, the interim final rule prohibits covered persons from engaging in coercion, bribery, and other similar actions designed to cause anyone who prepares a valuation to base the value of the property on factors other than the person's independent judgment. The interim final rule adds examples from the Dodd-Frank Act and the Board's 2008 HOEPA rules of actions that do and do not constitute unlawful coercion. Second, the interim final rule prohibits a creditor from extending credit based on a valuation if the creditor knows, at or before consummation, that (a) coercion or other similar conduct has occurred, or (b) that the person who prepares a valuation or who performs valuation management services has a prohibited interest in the property or the transaction as discussed below, *unless* the creditor uses reasonable diligence to determine that the valuation does not materially misstate the value of the property.

Conflicts of interest. The interim final rule provides that a person who prepares a valuation or who performs valuation management services may not have an interest, financial or otherwise, in the property or the transaction. The Dodd-Frank Act does not expressly ban the use of in-house appraisers or affiliates. However, because the Act prohibits appraisers from having an "indirect financial interest" in the transaction, it is possible to interpret the Act to prohibit creditors from using in-house staff appraisers and affiliated appraisal management companies (AMCs). The interim final rule clarifies that an employment relationship or affiliation does not, by itself, violate the prohibition. The interim final rule also contains establishes a safe harbor and specific criteria for establishing firewalls between the appraisal function and the loan production function, to prevent conflicts of interest. Special guidance on firewalls is provided for small institutions, because they likely cannot completely separate appraisal and loan production staff. Small institutions are those with assets of $250 million or less.

Mandatory reporting of appraiser misconduct. The interim final rule provides that a creditor or settlement service provider involved in the transaction who has a reasonable basis to believe that an appraiser has not complied with ethical or professional requirements for appraisers under applicable federal or state law, or the Uniform Standards of Appraisal Practice (USPAP) must report the failure to comply to the appropriate state licensing agency. The interim final rule limits the duty to report compliance failures to those that are likely to affect the value assigned to the property. The interim final rule also provides that a person has a "reasonable basis" to believe an appraiser has not complied with the law or applicable standards, only if the person has knowledge or evidence that would lead a reasonable person under the circumstances to believe that a material failure to comply has occurred.

Customary and reasonable rate of compensation for fee appraisers. Under the interim final rule, a creditor and its agent must pay a fee appraiser at a rate

and public policy interests in real estate transactions. 12 U.S.C. 3339. It requires the Board, the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, and the National Credit Union Administration (the federal banking agencies) to adopt regulations on the preparation and use of appraisals by federally regulated financial institutions. 12 U.S.C. 3331.

[4] TILA Section 129E(j), 15 U.S.C. 1639e(j).

[5] Under the interim final rule, a person provides a service if he provides a "settlement service" as defined in the Real Estate Settlement Procedures Act, 12 U.S.C. 2602(3). *See* § 226.42(b)(1).

that is reasonable and customary in the geographic market where the property is located. The rule provides two presumptions of compliance. Under the first, a creditor and its agent is presumed to have paid a customary and reasonable fee if the fee is reasonably related to recent rates paid for appraisal services in the relevant geographic market, and, in setting the fee, the creditor or its agent has:

- Taken into account specific factors, which include, for example, the type of property and the scope of work; and
- Not engaged in any anticompetitive actions, in violation of state or federal law, that affect the appraisal fee, such as price-fixing or restricting others from entering the market.

Second, a creditor or its agent would also be presumed to comply if it establishes a fee by relying on rates established by third party information, such as the appraisal fee schedule issued by the Veteran's Administration, and/or fee surveys and reports that are performed by an independent third party (the Act provides that these surveys and reports must not include fees paid by AMCs).

III. Legal Authority

Rulemaking Authority

As noted above, TILA Section 105(a) directs the Board to prescribe regulations to carry out the act's purposes. 15 U.S.C. 1604(a). In addition, TILA Section 129E, added by the Dodd-Frank Act, includes several grants of rulemaking authority to implement the provisions of that section. Specifically, Section 129E(g)(1) authorizes the Board, the other federal banking agencies, the Federal Housing Finance Agency, and the Consumer Financial Protection Bureau to jointly issue rules, guidelines, and policy statements "with respect to acts or practices that violate appraisal independence in the provision of mortgage lending services * * * within the meaning of subsections (a), (b), (c), (d), (e), (f), (h), and (i)." 15 U.S.C. 1639e(g)(1). Second, Section 129E(g)(2) directs the Board to prescribe interim final regulations no later than 90 days after the law's enactment date, "defining with specificity acts or practices that violate appraisal independence in the provision of mortgage lending services" and "defining any terms in this section or such regulations." 15 U.S.C. 1639e(g)(2). The Board's interim final regulations under Section 129E(g)(2) are deemed to be rules prescribed by the agencies jointly. Third, Section 129E(h), authorizes the Board, the banking agencies, the FHFA and the Consumer Financial Protection Bureau to jointly issue rules regarding appraisal report portability. 15 U.S.C. 1639e(h).

The Board is issuing this interim final rule pursuant to its general authority in Section 105(a) and the specific authority conferred by Section 129E(g)(2) to implement the appraisal independence provisions in Section 129E. Some industry representatives have asserted that the appraiser compensation provisions in Section 129E(i) do not relate to appraisal independence and, therefore, should not be addressed by the Board's interim final rules issued under Section 129E(g)(2). The Board concludes, however, that the legislative directive to issue interim final rules includes the appraiser compensation provisions in Section 129E(i). In particular, the Board believes that its authority under Section 129E(g)(2) should be read consistently with the authority granted in Section 129E(g)(1), which expressly identifies the compensation provision in Section 129E(i) as an "appraisal independence" provision.

Authority To Issue Interim Final Rule Without Notice and Comment

The Administrative Procedures Act (APA), 5 U.S.C. 551 *et seq.,* generally requires public notice before promulgation of regulations. *See* 5 U.S.C. 553(b). The APA also provides an exception, however, when there is good cause because notice and public procedure is impracticable. 5 U.S.C. 553(b)(B). The Board finds that for this interim rule there is "good cause" to conclude that providing notice and an opportunity to comment would be impracticable and, therefore, is not required. The Board's finding of good cause is based on the following considerations. Congress imposed a 90 day deadline for issuing the interim final rule. Providing notice and an opportunity to comment is impracticable, because 90 days does not provide sufficient time for the Board to prepare and publish proposed regulations, provide a period for comment, and publish in the **Federal Register** before the statutory deadline. Even if the Board were able to publish proposed rules for public comment, the comment period would have been too short to afford interested parties sufficient time to prepare well-researched comments or to afford time for the Board to conduct a meaningful review and analysis of those comments. Consequently, the Board finds that the use of notice-and-comment procedures before issuing these rules would be impracticable. Interested parties will still have an opportunity to submit comments in response to this interim final rule before permanent final rules are issued.

Moreover, the Board believes that the Dodd-Frank Act's mandate that the Board issue interim final rules that will be effective before the issuance of permanent rules also supports the Board's determination that notice and comment are impracticable. If the legislation had contemplated a notice and comment period, the rules issued by the Board could have been referred to as "final rules" rather than "interim final rules." The term "interim final regulations" or "interim final rules" has long been recognized to mean rules that an agency issues without first giving notice of a proposed rule and having a public comment period.[6]

IV. Section-by-Section Analysis

Section 226.5b Requirements for Home-Equity Plans

Section 1472 of the Dodd-Frank Act adds to TILA a new Section 129E that establishes appraiser independence requirements for a consumer credit transaction secured by the consumer's principal dwelling. 15 U.S.C. 1639e. TILA Section 129E applies to both open- and closed-end consumer credit transactions secured by the consumer's principal dwelling, as discussed in detail below in the section-by-section analysis of § 226.42. Accordingly, new comment 5b–7 is being adopted to clarify that home-equity plans subject to § 226.5b that are secured by the consumer's principal dwelling also are subject to the requirements of new TILA Section 129E and § 226.42.

Section 226.42 Valuation Independence

Overview

This part discusses the implementation of the appraisal independence provisions added to TILA by the Dodd-Frank Act by this interim final rule. TILA Section 129E(a) prohibits persons that extend credit or provide any service for a consumer credit transaction secured by the consumer's principal dwelling (covered transaction) from engaging in "any acts or practices that violate appraisal independence as described in or pursuant to regulations prescribed under [TILA Section 129E]." 15 U.S.C.

[6] *See, e.g.,* Office of the Federal Register, "A Guide to the Rulemaking Process, *http://www.federalregister.gov/learn/the_rulemaking_process.pdf;* Administrative Conference of the U.S., Recommendation 95–4 (1995); U.S. Government Accountability Office, Federal Rulemaking: Agencies Often Published Final Actions Without Proposed Rules, GAO/GGD–98–126, 7 (1998); American Bar Ass'n, A Guide to Federal Agency Rulemaking, 3rd Ed., 83–Y4 (2006).

1639e(a). This provision applies to both closed- and open-end extensions of credit. TILA Section 129E(b) describes certain acts and practices that violate appraisal independence. 15 U.S.C. 1639e(b). TILA Section 129E(c) also specifies certain acts and practices that are deemed to be permissible. 15 U.S.C. 1639e(c). Under TILA Section 129E(f), a creditor that knows about a violation of the appraiser independence standards or a prohibited conflict of interest at or before consummation of the transaction is prohibited from extending credit based on the appraisal unless the creditor documents that it has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of such dwelling. 15 U.S.C. 1639e(f).

TILA Section 129E(b) and (c) are substantially similar to the appraisal regulations that the Board issued in 2008, which became effective on October 1, 2009. 15 U.S.C. 1639e(b), (c). *See* § 226.36(b); 73 FR 44522, 44604 (Jul. 30, 2008) (2008 Appraisal Independence Rules). The Board's 2008 Appraisal Independence Rules prohibit creditors and mortgage brokers and their affiliates from directly or indirectly coercing, influencing, or otherwise encouraging an appraiser to misstate or misrepresent the value of the consumer's principal dwelling. *See* § 226.36(b)(1). However, the 2008 rules apply only to closed-end mortgage loans. The prohibition on certain extensions of credit in TILA Section 129E(f) also is substantially similar to § 226.36(b)(2) of the Board's 2008 Appraisal Independence Rules. 15 U.S.C. 1639e(f).

The Board is removing § 226.36(b), effective April 1, 2011, the mandatory compliance date for this interim final rule. The Board is removing § 226.36(b) because the provision is substantially similar to TILA Section 129E(b), (c), and (f), implemented in § 226.42 by this interim final rule. Through March 31, 2011, creditors, mortgage brokers, and their affiliates may comply with either § 226.36(b) or new § 226.42. If such persons comply with § 226.42, they are deemed to comply with § 226.36(b).

TILA Section 129E also adds provisions not covered by the Board's 2008 Appraisal Independence Rules. For a covered transaction, TILA Section 129E(d) prohibits an appraiser that conducts and an appraisal management company that procures or facilitates an appraisal of the consumer's principal dwelling from having a direct or indirect interest in the dwelling or the covered transaction, as discussed in detail below in the section-by-section analysis of § 226.42(d). Under TILA Section 129E(f), a creditor that knows about a violation of the conflicts of interest provisions under TILA Section 129E(d) is prohibited from extending credit based on the appraisal, unless the creditor documents that it has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of such dwelling. 15 U.S.C. 1639e(f). TILA Section 129E(e) imposes a requirement for reporting certain compliance failures by appraisers to state appraiser certifying and licensing agencies. 15 U.S.C. 1539e(e). TILA Section 129E(i) provides that lenders and their agents must compensate fee appraisers at a rate that is "customary and reasonable for appraisal services performed in the market area of the property being appraised." [7] 15 U.S.C. 1639e(i).

42(a) Scope

TILA Section 129E(a) generally prohibits acts or practices that violate appraisal independence "in extending credit or in providing any services" for a consumer credit transaction secured by the consumer's principal dwelling. 15 U.S.C. 1639e(a). Thus, the coverage of the prohibition in Section 129E is not limited to creditors, mortgage brokers, and their affiliates, as is the case with the Board's 2008 Appraisal Independence Rules contained in § 226.36(b). Section 129E also covers open-end credit plans secured by the consumer's principal dwelling, which are not covered by the Board's 2008 rules. *See* comment 42(a)-1. Consistent with the statute, this interim final rule applies only to transactions secured by the principal dwelling of the consumer who obtains credit. *See* comment 42(a)–2.

42(b) Definitions

42(b)(1) "Covered Person"

This interim final rule uses the term "covered person" in defining the persons that are subject to the prohibition on coercion and similar practices in TILA Section 129E(b) and the mandatory reporting requirement in TILA Section 129E(e). 15 U.S.C. 1639e(b), (e). TILA Section 129E(a) prohibits an act or practice that violates appraisal independence "in extending credit or in providing any services" for a covered transaction. Consistent with the statutory language, the Board is defining "covered persons" to include a creditor with respect to a covered transaction or a person that provides "settlement services," as defined under the Real Estate Settlement Procedures Act (RESPA), in connection with a covered transaction. *See* § 226.42(b)(1).

The Board notes that "settlement services" under RESPA is a broad class of activities, covering any service provided in connection with settlement, including rendering of credit reports, providing legal services, preparing documents, surveying real estate, and pest inspections. Some providers of settlement services may, as a practical matter, have little opportunity or incentive to coerce or influence an appraiser, or to have a reasonable basis to believe that an appraiser has not complied with USPAP or other applicable authorities. In such cases, the benefits of the rule may not justify applying it to these parties, however, by the same token, these entities may have little or no compliance burden under the circumstances. The Board solicits comment on whether some settlement service providers should be exempt from some or all of the interim final rule's requirements.

Examples of "covered persons" include creditors, mortgage brokers, appraisers, appraisal management companies, real estate agents, title insurance companies, and other persons that provide "settlement services" as defined under RESPA. *See* comment 42(b)(1)–1. The Board notes that persons that perform "settlement services" include persons that conduct appraisals. *See* 12 U.S.C. 2602(3). Comment 42(b)(1)–2 clarifies that the following persons are not "covered persons": (1) The consumer who obtains credit through a covered transaction; (2) a person secondarily liable for a covered transaction, such as a guarantor; and (3) a person that resides in or will reside in the consumer's principal dwelling but will not be liable on the covered transaction, such as a non-obligor spouse.

42(b)(2) "Covered Transaction"

TILA Section 129E applies to "a consumer credit transaction secured by the principal dwelling of the consumer." 15 U.S.C. 1639e. This interim rule refers to such a transaction as a "covered transaction," for simplicity. For purposes of § 226.42, the existing provisions of Regulation Z and accompanying commentary apply in determining what constitutes a principal dwelling. *See* comment 42(b)(1)–1. Regulation Z provides that, for the purposes of the consumer's right to rescind certain loans secured by the consumer's principal dwelling, a consumer may have only one principal dwelling at a time. *See, e.g.,*

[7] This interim final rule does not implement TILA Section 129E(h), which authorizes the Board and other specified Federal agencies to jointly issue regulations concerning appraisal report portability. Public Law 111–203, 124 Stat. 2187 (to be codified at 15 U.S.C. 1639e(h)).

§ 226.2(a)(19), 226.2(a)(24), comment 2(a)(24)–3.

42(b)(3) "Valuation"

TILA Section 129E uses the terms "appraisal" and "appraiser" without defining the terms. In some cases, a creditor might engage a person not certified or licensed under state law to estimate a dwelling's value in connection with a covered transaction, such as when a creditor engages a real estate agent to provide an estimate of market value.[8] The Board believes that TILA Section 129E applies to acts or practices that compromise the independent estimation of the value of the consumer's principal dwelling, without regard to whether the creditor uses a licensed or certified appraiser or another person to produce a valuation. Therefore, this interim final rule uses the broader term "valuation" and refers to a person that prepares a "valuation" rather than use the terms "appraisal" and "appraiser," for purposes of the following provisions: (1) The prohibition on causing or attempting to cause the value assigned to the consumer's principal dwelling to be based on a factor other than the independent judgment of a person that prepares valuations, through coercion or certain other similar acts or practices, under § 226.42(c); (2) the prohibition on having an interest in the consumer's principal dwelling or the transaction, under § 226.42(d); and (3) the prohibition on extending credit where a creditor knows of a violation of § 226.42(c) or (d) unless certain conditions are met under § 226.42(e). This is consistent with the 2008 Appraisal Independence Rules, which define "appraiser" broadly to mean a person who engages in the business of providing assessments of the value of dwellings.[9]

Section 226.42(b)(5) uses the term "valuation" to mean an estimate of the value of the consumer's principal dwelling in written or electronic form, other than one produced solely by an automated model or system. This definition is consistent with the definition of "appraisal" in the Uniform Standards of Professional Appraisal Practice (USPAP) as "an opinion of value."[10] As used in § 226.42(b)(5), the term "valuation" applies to an estimate of the value of the consumer's principal dwelling whether or not a person applies USPAP in preparing such estimate. Comment 42(b)(3)–1 clarifies that 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. Comment 42(b)(3)–1 also clarifies that the term includes photographic or other information included with an estimate of value. Comment 42(b)(3)–1 clarifies further that a "valuation" includes an estimate provided or viewed electronically, such as an estimate transmitted via electronic mail or viewed using a computer.

Comment 42(b)(3)–2 clarifies that, although a "valuation" does not include an estimate of value produced exclusively using an automated model or system, a "valuation" includes an estimate of value developed by a natural person based in part on an estimate produced using an automated model or system. The Board solicits comment on the exclusion of automated valuation models from the definition of "valuation" below, in the section-by-section analysis of § 226.42(c). Comment 42(b)(3)–3 clarifies that an estimate of the value of the consumer's principal dwelling includes an estimate of a range of values for the consumer's principal dwelling.

42(b)(4) "Valuation Management Functions"

This interim final rule uses the term "valuation management functions" to refer to a variety of administrative activities undertaken in connection with the preparation of a valuation. The term "valuation management functions" is used in implementing TILA Section 129E(b)(1), which prohibits causing or attempting to cause the value assigned to the consumer's principal dwelling to be based on a factor other than the independent judgment of a person that prepares valuations, through coercion or certain other similar acts or practices. 15 U.S.C. 1639e(b)(1). The term "valuation management functions" also is used in implementing TILA Section 129E(d), which provides that an appraisal management company may not have an interest in a covered transaction or the consumer's principal dwelling. 15 U.S.C. 1639e(d). This interim final rule applies that prohibition on conflicts of interest to a person that performs administrative functions in connection with valuations of the consumer's principal dwelling, even if the person is not an "appraisal management company" (for example, a company that employs appraisers or an appraisal reviewer employed by a creditor), as discussed below in the section-by-section analysis of § 226.42(b)(d). This interim final rule therefore uses the term "valuation management functions" rather than "appraisal management" for purposes of § 226.42(d).

Section 226.42(b)(4) defines "valuation management functions" to mean (1) recruiting, selecting, or retaining a person to prepare a valuation; (2) contracting with or employing a person to prepare a valuation; (3) managing or overseeing the process of preparing a valuation (including by providing administrative services such as receiving orders for and receiving a valuation, submitting a completed valuation to creditors and underwriters, collecting fees from creditors and underwriters for services provided in connection with a valuation, and compensating a person that prepare valuations); or (4) reviewing or verifying the work of a person that prepares valuations. The term is used in § 226.42(c) and (d), which are discussed in detail below.

42(c) Valuation of Consumer's Principal Dwelling

TILA Section 129E(b) provides that, for purposes of TILA Section 129E(a), acts or practices that violate appraisal independence include: (1) Causing or attempting to cause the value assigned to the property to be based on a factor other than the independent judgment of an appraiser, by compensating, coercing, extorting, colluding with, instructing, inducing, bribing, or intimidating a person conducting or involved in an appraisal; (2) mischaracterizing, or suborning any mischaracterization of, the appraised value of the property securing the extension of credit; (3) seeking to influence an appraiser or otherwise to encourage a targeted value in order to facilitate the making or pricing of the transaction; and (4) withholding or threatening to withhold timely payment for an appraisal report or for appraisal services rendered when the appraisal report or services are provided for in accordance with the contract between the parties. 15 U.S.C. 1639e(b).

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[8] Section 1473(r) of the Dodd-Frank Act adds new Section 1126 to FIRREA, which prohibits the use of a real estate broker's opinion of value "as the primary basis" of determining the value of the consumer's principal dwelling in certain types of transactions. Public Law 111–203, 124 Stat. 2198 (to be codified at 12 U.S.C. 3355).

[9] For purposes of the provisions requiring payment of a customary and reasonable rate to appraisers and reporting of appraisers' failure to comply with USPAP or ethical or professional requirements to the appropriate state appraiser certifying and licensing agencies, this interim final rule limits persons considered "appraisers" to persons subject to the state agencies' jurisdiction. § 226.36(f), (g).

[10] *See* Appraisal Standards Bd., Appraisal Fdn., USPAP (2010) at U–1; see also Appraisal Standards Bd., Appraisal Fdn., Advisory Op. 18 (stating that "the output of an [automated valuation model] is not, by itself, an appraisal" but may become the basis of an appraisal if credible).

TILA Section 129E(c) provides that TILA Section 129E(b) shall not be construed as prohibiting a mortgage lender, mortgage broker, mortgage banker, real estate broker, appraisal management company, employee of an appraisal management company, consumer, or any other person with an interest in a real estate transaction from asking an appraiser to: (1) Consider additional, appropriate property information, including information regarding additional comparable properties to make or support an appraisal; (2) provide further detail, substantiation, or explanation for the appraiser's value conclusion; or (3) correct errors in the appraisal report. 15 U.S.C. 1639e(c).

TILA Section 129E(b) and (c) are substantially similar to the 2008 Appraisal Independence Rules. 15 U.S.C. 1639e(b), (c); § 226.36(b). The Board is implementing TILA Section 129E(b) and (c) in § 226.42(c), pursuant to its authority under TILA Section 129E(g)(2) to prescribe interim final regulations defining with specificity acts or practices that violate appraisal independence in the provision of mortgage lending services or mortgage brokerage services for a covered transaction and any terms under TILA Section 129E or such regulations. 15 U.S.C. 1639e(g)(2). The prohibitions of certain acts and practices under TILA Section 129E(b) that are substantially similar to the Board's 2008 Appraisal Independence Rules are implemented in § 226.42(c)(1). The prohibition on "mischaracterizing or suborning any mischaracterization of the appraised value of property securing the extension of credit" under TILA Section 129E(b)(2), which has no direct corollary in the 2008 Appraisal Independence Rules, is implemented in § 226.42(c)(2). 15 U.S.C. 1639e(b)(2). TILA Section 129E(c), regarding acts and practices that are permissible under TILA Section 129E, is implemented in § 226.42(c)(3).

42(c)(1) Coercion

TILA Section 129E(b)(1) prohibits a person with an interest in the underlying transaction to compensate, coerce, extort, collude, instruct, induce, bribe, or intimidate a person, appraisal management company, firm, or other entity conducting or involved in an appraisal, or attempting to do so, for the purpose of causing the value assigned to the consumer's principal dwelling to be based on a factor other than the independent judgment of the appraiser. 15 U.S.C. 1639e(b)(1). Section 226.42(c)(1) implements and is substantially similar to TILA Section 129E(b)(1). Section 226.42(c)(1) uses the terms "covered person" and "covered transaction" and refers to persons that prepare "valuations" or perform "valuation management functions," for clarity and comprehensiveness, as discussed above in the section-by-section analysis of § 226.42(b). Also, § 226.42(c)(1) uses the term "person" to implement the reference in TILA Section 129E(b)(1) to certain acts or practices directed towards a "person, appraisal management company, firm, or other entity," for simplicity. 15 U.S.C. 1639e(b)(1). TILA Section 103(d) provides that "person" means a natural person or an organization, and § 226.2(a)(22) clarifies that an organization includes a corporation, partnership, proprietorship, association, cooperative, estate, trust, or government unit. 15 U.S.C. 1602(d).

Prohibited acts and practices. Consistent with TILA Section 129E(b)(1), § 226.42(c)(1) provides that no person shall attempt to or cause the value assigned to the consumer's principal dwelling to be based on a factor other than the independent judgment of a person that prepares valuations, through coercion, extortion, inducement, bribery or intimidation of, compensation or instruction to, or collusion with a person that prepares a valuation or a person that performs valuation management functions. Comment 42(c)(1)–1 provides that the terms used for those prohibited actions have the meaning given them by applicable state law or contract. *See* § 226.2(b)(3). In some cases, state law may define one of the terms in a context that is not applicable to a covered transaction, for example, where state law defines "bribery" to mean the offering, giving, soliciting, or receiving of something of value to influence the action of an official in the discharge of his or her public duties. The Board believes, however, that the terms used in TILA Section 129E(b)(1) and § 226.42(c)(1) cover a range of acts and practices sufficiently broad to address a wide variety of actions that compromise the independent estimation of the value of the consumer's principal dwelling. Further, § 226.42(c)(1)(i) provides examples of actions that violate § 226.42(c)(1), as discussed below. 15 U.S.C. 1639e(b)(1).

Comment 42(c)(1)–2 clarifies that a covered person does not violate § 226.42(c)(1) if the person does not engage in an act or practice set forth in § 226.42(c)(1) for the purpose of causing the value assigned to the consumer's principal dwelling to be based on a factor other than the independent judgment of a person that prepares valuations. For example, comment 42(c)(1)–2 states that requesting that a person that prepares a valuation take certain actions, such as considering additional, appropriate property information, does not violate § 226.42(c), because such request does not supplant the independent judgment of the person that prepares a valuation. *See* § 226.42(c)(3)(i). Also, comment 42(c)(1)–2 clarifies that a covered person may provide incentives, such as additional compensation, to a person that 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 of a person that prepares valuations. The Board notes, however, that provisions of federal law other than § 226.42(c)(1) or state law may apply in determining whether or not a covered person may engage in certain acts or practices in connection with valuations of the consumer's principal dwelling.

Person that prepares valuations. Comment 42(c)(1)–3 clarifies that § 226.42(c)(1) is violated if a covered person attempts to or causes the value assigned by a person that prepares valuations to be based on a factor other than the independent judgment of the person that prepares valuations through coercion or certain other acts or practices, whether or not the person that prepares valuations is a state-licensed or state-certified appraiser. For example, comment 42(c)(1)(1)–3 clarifies that a covered person violates § 226.42(c)(1) by seeking to coerce a real estate agent to assign a market value to the consumer's principal dwelling based on a factor other than the real estate agent's independent judgment, in connection with a covered transaction. Although § 226.42(c)(1) broadly prohibits certain acts and practices directed toward any person who prepares valuations, the Board notes that in some cases applicable law or guidance may call for a creditor to obtain an appraisal prepared by a state-licensed or state-certified appraiser for a covered transaction. For example, the federal financial institution regulatory agencies require the creditors they supervise to obtain an appraisal by a state-certified appraiser for certain federally-related mortgage transactions.[11]

Indirect acts or practices. Comment 42(c)(1)–4 clarifies that § 226.42(c)(1) may be violated indirectly, for example,

[11] *See,* Board: 12 CFR 225.63(a); OCC: 12 CFR 34.43(a); FDIC: 12 CFR 323.3(a); OTS: 12 CFR 564.3(a); NCUA: 12 CFR 722.3(a).

where a creditor attempts to cause the value an appraiser engaged by an appraisal management company assigns to the consumer's principal dwelling to be based on a factor other than the appraiser's independent judgment. Thus, the commentary provides that it is a violation to threaten to withhold future business from a title company affiliated with an appraisal management company unless the valuation ordered through the appraisal management company assigns a value to the consumer's principal dwelling that meets or exceed a minimum threshold.

Automated valuation systems. Under this interim final rule, § 226.42(c)(1) does not apply in connection with the development or use of an automated model or system that estimates value. (The definition of "valuation" does not include an estimate of value produced exclusively using such an automated system. *See* § 226.42(b)(3).) The Board requests comment, however, on whether creditors or other persons exercise or attempt to exercise improper influence over persons that develop an automated model or system for estimating the value of the consumer's principal dwelling.

42(c)(1)(i)

TILA Sections 129E(b)(3) and (4) provide that the following actions violate appraisal independence: (1) Seeking to influence an appraiser to assign a targeted value to facilitate the making or pricing of a covered transaction; and (2) withholding or threatening to withhold timely payment for an appraisal report provided or for appraisal services rendered in accordance with the parties' contract. 15 U.S.C. 1639e(b)(3), (4). The Board believes that the prohibition on causing or attempting to cause the value assigned to the consumer's principal dwelling to be based on a factor other than the independent judgment of the person that prepares a valuation, through coercion, inducement, intimidation, and certain other acts and practices, encompass the acts and practices prohibited by TILA Section 129E(b)(3) and (4). This interim rule therefore uses the acts and practices prohibited by TILA Section 129E(b)(3) and (4) as examples of acts and practices prohibited by TILA Section 129E(b)(1). (This interim final rule implements the prohibition under TILA Section 129E(b)(2) of "mischaracterizing" the value of the consumer's principal dwelling separately from the other provisions of TILA Section 129E(b), because that provision may be violated without outside pressure, as discussed below in the section-by-section analysis of § 226.42(c)(2). 15 U.S.C. 1639e(b).)

Section 226.42(c)(1)(i)(A) and (B) implement TILA Section 129E(b)(3) and (4) and are substantially similar to existing § 226.36(b)(1)(C) and (D). In addition, § 226.42(c)(1)(i)(D) through (E) mirror current § 226.36(b)(1)(i)(A), (B), and (E). The examples provided in § 226.42(c)(1)(i) illustrate cases where prohibited action is taken towards a person that prepares valuations. The Board notes that § 226.42(c)(1) nevertheless applies to prohibited acts and practices directed towards a person that performs valuation management functions or such person's affiliate. *See* comment 42(c)(1)(i)–1. As used in the examples of prohibited actions, the terms "specific value" and "predetermined threshold" includes a predetermined minimum, maximum, or range of values. *See* comment 42(c)(1)(i)–2. Further, although the examples assume a covered person's actions are designed to cause the value assigned to the consumer's principal dwelling to equal or exceed a certain amount, the rule also applies to cases where a covered person's prohibited actions are designed to cause the value assigned to the dwelling to be below a certain amount. *See id.*

42(c)(1)(i)(A)

TILA Section 129E(b)(3) prohibits a covered person from seeking to influence a person that prepares valuations, or otherwise encouraging the reporting of a targeted value for the consumer's principal dwelling, to facilitate the making or pricing of a covered transaction. 15 U.S.C. 1639e(b)(3). This provision is substantially similar to current § 226.36(b)(1)(ii)(C), which prohibits "telling an appraiser a minimum reported value of the consumer's principal dwelling that is needed to approve the loan." Section 226.42(c)(1)(i)(A) implements TILA Section 129E(b)(3), with minor revisions for clarity.

42(c)(1)(i)(B)

TILA Section 129E(b)(4) provides that appraisal independence is violated if a person withholds or threatens to withhold timely payment for a valuation or for services rendered to provide a valuation, when the valuation or the services are provided in accordance with the contract between the parties. 15 U.S.C. 1639e(b)(4). This provision is substantially similar to current § 226.36(b)(1)(ii)(D), which prohibits "failing to compensate an appraiser because the appraiser does not value the consumer's principal dwelling at or above a certain amount." Section 226.42(c)(2)(i)(B) implements TILA Section 129E(b)(4), with minor revisions for clarity. The Board notes that withholding compensation for breach of contract or substandard performance of services does not violate § 226.42(c)(1). *See* § 226.42(c)(3)(v).

42(c)(1)(i)(C), (D), and (E)

TILA Section 129E(b)(1) prohibits certain acts or practices that 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 of a person that prepares valuations. 15 U.S.C. 1639e(b)(1). The Board believes that the acts and practices currently prohibited under § 226.36(b)(1)(i)(A) through (E) are prohibited by TILA Section 129E(b)(1). Therefore, the interim final rule includes the examples of prohibited practices provided in current § 226.36(b)(1)(ii)(A), (B), and (E) in new § 226.42(c)(2)(i)(C), (D), and (E).

Section 226.42(c)(1)(i)(C) provides that an example of an action that violates § 226.42(c)(1) is implying to a person that prepares valuations that current or future retention of the person depends on the amount at which the person estimates the value of the consumer's principal dwelling. Section 226.42(c)(1)(i)(D) provides that an example of an action that violates § 226.42(c)(1) is excluding a person that prepares valuations from consideration for future engagement because the person reports a value for the consumer's principal dwelling that does not meet or exceed a predetermined threshold. A "predetermined threshold" includes a predetermined minimum, maximum, or range of values. *See* comment 42(c)(1)(i)–2. Section 226.42(c)(1)(i)(E) provides that an example of an action that violates § 226.42(c)(1) is conditioning the compensation paid to a person that prepares valuations on consummation of a covered transaction. The examples provided under § 226.42(c)(1)(i) are illustrative, not exhaustive, and other actions may violate § 226.42(c)(1).

42(c)(2) Mischaracterization of Value

TILA Section 129E(b)(2) prohibits mischaracterizing or suborning any mischaracterization of the appraised value of property securing a covered transaction. 15 U.S.C. 1639e(b)(2). The Board implements that prohibition separately from the prohibition under § 226.42(c)(1) of causing or attempting to cause the value assigned to the consumer's principal dwelling to be based on a factor other than the independent judgment of a person that prepares valuations, through coercion and other similar acts and practices.

This is because a person may mischaracterize such value without any outside pressure. This interim final rule implements TILA Section 129E(b)(2) in § 226.42(c)(2).

42(c)(2)(i) Misrepresentation

Section 226.42(c)(2)(i) provides that a person that prepares valuations shall not materially misrepresent the value of the consumer's principal dwelling in a valuation. Section 226.42(c)(2)(i) applies specifically to persons that prepare valuations, because such persons represent that the value they assign to the consumer's principal dwelling is consistent with their opinion regarding such value. Section 226.42(c)(2)(i) provides that a *bona fide* error is not a mischaracterization. The Board believes that Congress intended to prohibit the intentional misrepresentation of the value of the consumer's principal dwelling, not *bona fide* errors. Comment 42(c)(2)(i)–1 clarifies that a person misrepresents the value of the consumer's principal dwelling by assigning a value to such dwelling that does not reflect the person's opinion of such dwelling's value. For example, comment 42(c)(2)(i)–1 clarifies that an appraiser violates § 226.42(c)(2)(i) if the appraiser estimates that the value of such dwelling is $250,000 applying USPAP but assigns a value of $300,000 to such dwelling in a Uniform Residential Appraisal Report.

42(c)(2)(ii) Falsification or Alteration

TILA Section 129E(b)(2) prohibits "mischaracterizing or suborning any mischaracterization" of the value of the consumer's principal dwelling. 15 U.S.C. 1639e(b)(2). That provision is implemented in § 226.42(c)(2)(ii). Section 226.42(c)(2)(ii) provides that no covered person shall falsify, and no covered person other than a person that prepares valuations shall materially alter, a valuation. An alteration is material for purposes of § 226.42(c)(2)(ii) if the alteration is likely to significantly affect the value assigned to the consumer's principal dwelling.

Alterations to a valuation generally should be made by the person that prepares the valuation, because the valuation reflects that person's estimate of the value of the consumer's principal dwelling. (Covered persons may request that a person that prepares a valuation take certain actions, including correct errors in the valuation, however. *See* § 226.42(c)(3).) The Board solicits comment, however, on whether there are specific types of alterations that other persons may make that do not affect the value assigned to the consumer's dwelling and therefore should not be deemed material for purposes of § 226.42(c)(2)(ii).

42(c)(2)(iii) Inducement of Mischaracterization

Section 226.42(c)(2)(iii) provides that no covered person shall induce a person to violate the prohibitions under § 226.42(c)(2)(i) or (ii). For example, comment 42(c)(2)(iii)–1 clarifies that a loan originator may not coerce a loan underwriter to alter an appraisal report to increase the value assigned to the consumer's principal dwelling.

42(c)(3) Permitted Actions

TILA Section 129E(c) provides that TILA Section 129E(b) shall not be construed to prohibit a mortgage lender, mortgage broker, mortgage banker, real estate broker, appraisal management company, employee of an appraisal management company, consumer, or any other person with an interest in a real estate transaction from asking an appraiser to undertake certain actions. 15 U.S.C. 1639e(c). To implement TILA Section 129E(c), § 226.42(c)(3) provides examples of actions that do not violate § 226.42(c)(1) or (2). The Board notes that the examples provided under § 226.42(c)(3) are illustrative, not exhaustive, and there are other actions that are permitted under § 226.42(c)(1) or (2).

42(c)(3)(i), (ii), and (iii)

TILA Section 129E(c)(1) provides that it is permissible under TILA Section 129E(b) to ask an appraiser to consider additional property information, including information regarding comparable properties. 15 U.S.C. 1639e(c)(1). TILA Section 129E(c)(2) provides that it is permissible under TILA Section 129E(b) to ask an appraiser to provide further detail, substantiation, or explanation for the appraiser's value conclusion. 15 U.S.C. 1639e(c)(1). TILA Section 129E(c)(3) provides that it is permissible under TILA Section 129E(b) to ask an appraiser to correct errors in an appraisal report. 15 U.S.C. 1639e(c)(3). TILA Section 129E(c)(1) through (3) are substantially similar to current § 226.36(b)(1)(ii)(A) through (C). The interim final rule implements TILA Section 129E(c)(1) through (3) in § 226.42(c)(3)(i) through (iii).

42(c)(3)(iv), (v), and (vi)

The Board believes that the acts and practices allowed under current § 226.36(b)(1)(ii)(D) through (F) do not compromise the exercise of independent judgment in estimating the value of the consumer's principal dwelling. The Board therefore includes the examples of permitted practices provided under current § 226.36(b)(1)(ii)(D) through (F) in new § 226.42(c)(3)(iv) through (vi). Section 226.42(c)(3)(iv) provides that an example of an action that does not violate § 226.42(c)(1) or (2) is obtaining multiple valuations for the consumer's principal dwelling to select the most reliable valuation. Section 226.42(c)(3)(iv) is substantially similar to current § 226.36(b)(1)(ii)(D) but omits the statement in that provision that obtaining multiple appraisals is permitted under § 226.36(b) "as long as the creditor adheres to a policy of selecting the most reliable appraisal, rather than the appraisal that states the highest value." That statement is omitted because it may suggest an unintended distinction between selecting the valuation that states the highest value and selecting the valuation that states the lowest value. No substantive change is intended.

Section 226.42(c)(3)(v) provides that an example of an action that does not violate § 226.42(c)(1) or (2) is withholding compensation for breach of contract or substandard performance of services. Section 226.42(c)(3)(vi) provides that example of an action that does not violate § 226.42(c)(1) or (2) is taking action permitted or required by applicable federal or state statute, regulation, or agency guidance. Section 226.42(b)(3)(v) and (vi) are substantially similar to current § 226.36(b)(1)(ii)(E) and (F).

42(d) Prohibition on Conflicts of Interest

Background

Section 226.42(d) implements TILA Section 129E(d), which states that "no certified or licensed appraiser conducting, and no appraisal management company procuring or facilitating, an appraisal in connection with a consumer credit transaction secured by the principal dwelling of a consumer may have a direct or indirect interest, financial or otherwise, in the property or transaction involving the appraisal." This new TILA provision is generally consistent with longstanding Federal banking agency appraisal regulations and supervisory guidance applicable to federally-regulated depository institutions. The federal banking agency regulations require that appraisers employed by the institution extending credit (termed "staff appraisers" in the regulations) be "independent of the lending, investment, and collection functions and not involved, except as an appraiser, in the transaction, and have no direct or indirect interest, financial or otherwise, in the property." [12] The federal banking agency regulations also prohibit appraisers who are not employees of the institution extending credit, but rather hired on a contract basis (termed "fee appraisers" in the regulations) from having a "direct or indirect interest, financial or otherwise, in the property or the transaction." [13]

Federal Banking Agency Appraisal Guidance

Reaffirming independence standards in federal banking agency appraisal regulations, the federal banking agencies have issued Interagency Appraisal and Evaluation Guidelines (Interagency Guidelines). The Interagency Guidelines state that the collateral valuation process "should be isolated from the institution's loan production process," and that a person providing an appraisal or evaluation "should be independent of the loan and collection functions of the institution and have no interest, financial or otherwise, in the property or the transaction." [14] The Interagency Guidelines acknowledge, however, that for some creditors, such as small or rural institutions or branches, separating loan production staff from collateral valuation staff may not always be possible or practical because the only individual qualified to analyze the real estate collateral may also be a loan officer, other officer, or director of the institution. In these cases, the Interagency Guidelines state that, "[t]o ensure their independence, lending officials, officers, or directors should abstain from any vote or approval involving loans on which they performed an appraisal or evaluation." [15]

More recently, the federal banking agencies proposed similar guidance in the Proposed Interagency Appraisal and Evaluation Guidelines (Proposed Interagency Guidelines).[16] In addition to incorporating the existing guidance stated above, the Proposed Interagency Guidelines advise institutions to "establish reporting lines independent of loan production for staff that order, accept, and review appraisals and evaluations." For institutions unable to achieve absolute lines of independence between the collateral valuation and loan production processes, the Proposed Interagency Guidelines advise that an institution should nonetheless "be able to demonstrate clearly that it has prudent safeguards to isolate its collateral valuation program from influence or interference from the loan production process."

HVCC

The HVCC, which covers appraisals performed by state-licensed or state-certified appraisers for loans sold to Fannie Mae and Freddie Mac, also incorporates several provisions to prohibit conflicts of interest in the appraisal process.

First, the HVCC regulates the process of selecting and communicating with a person or entity involved in conducting an appraisal. Specifically, (1) members of the creditor's loan production staff; and (2) any person who (i) is compensated on a commission basis based on whether the loan closes, or (ii) reports ultimately to any officer of the creditor who is not independent of loan production, may not do the following:

- Select, retain, recommend, or influence the selection of any appraiser for a particular appraisal assignment or for inclusion on a list or panel of approved or disapproved appraisers; or
- Have "substantive communications" with an "appraiser or appraisal management company" involving or impacting valuation, including ordering or managing an appraisal assignment.[17]

Second, the HVCC prohibits the creditor from using any appraisal prepared by a person or entity that may have a conflict of interest. In particular, a creditor may not use any appraisal prepared by an appraiser employed by: (1) The creditor; (2) an affiliate of the creditor; (3) an entity owned wholly or partly by the creditor; or (4) an entity that wholly or partly owns the creditor. A creditor also may not use an appraisal prepared by any appraiser employed, engaged as an independent contractor, or otherwise retained by "any appraisal company or appraisal management company" affiliated with, or that wholly or partly owns or is owned by the creditor or an affiliate of the creditor.[18] A creditor may use in-house staff appraisers, however, to: (1) Order appraisals; (2) review appraisals, both pre- and post-loan funding; (3) develop, deploy, or use internal AVMs; and (4) prepare appraisals for transactions other than mortgage origination transactions, such as "loan workouts," if the appraiser complies with the terms of the HVCC.[19]

Third, the HVCC permits the creditor to use appraisals otherwise prohibited above, as long as the creditor adheres to a list of requirements designed to ensure the independence of any person involved in conducting or managing the appraisal, such as that, among other requirements:

- The appraiser must report to a function independent of the creditor's sales or loan production function;
- The creditor's loan production staff may have no role in selecting, retaining, recommending, or influencing the selection of an appraiser; and
- The appraiser must not be compensated based on the appraiser's conclusion of value or whether the loan closes.[20]

Fourth, the HVCC prohibits a creditor from using an appraisal prepared by an entity affiliated with, or that wholly or partly owns or is owned by, another entity performing settlement services for the same transaction, *unless* the entity performing the appraisal has adopted policies and procedures to implement the HVCC, including training and disciplinary rules on appraiser independence.[21]

The HVCC exempts from compliance with the second, third, and fourth provisions described above, "institutions (including non-banking institutions) that meet the definition of a 'small bank' as set forth in the Community Reinvestment Act,[22] and which Freddie Mac or Fannie Mae determines would suffer hardship due to the provisions, and which otherwise adhere with [the HVCC]." [23]

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[12] Board: 12 CFR 226.65(a); OCC: 12 CFR 34.45(a); FDIC: 12 CFR 323.5(a); OTS: 12 CFR 564.5(a); NCUA: 12 CFR 722.5(a). The regulations define "appraisal" to mean "a written statement independently and impartially prepared by a qualified appraiser setting forth an opinion as to the market value of an adequately described property as of a specific date(s), supported by the presentation and analysis of relevant market information." Board: 12 CFR 226.62(a); OCC: 12 CFR 34.42(a); FDIC: 12 CFR 323.2(a); OTS: 12 CFR 564.2(a); NCUA: 12 CFR 722.2(a). "State-certified appraiser" and "state-licensed appraiser" are defined at, respectively, 12 CFR 226.62(j) and (k); OCC: 12 CFR 34.42(j) and (k); FDIC: 12 CFR 323.2(j) and (k); OTS: 12 CFR 564.2(j) and (k); NCUA: 12 CFR 722.2(j) and (k).

[13] Board: 12 CFR 226.65(b); OCC: 12 CFR 34.45(b); FDIC: 12 CFR 323.5(b); OTS: 12 CFR 564.5(b); NCUA: 12 CFR 722.5(b).

[14] Board, OCC, FDIC, OTS, Interagency Appraisal and Evaluation Guidelines, SR 94–55 (Oct. 28, 1994) (Interagency Guidelines).

[15] *Id.*

[16] Board, OCC, FDIC, OTS, NCUA, Proposed Interagency Appraisal and Evaluation Guidelines, 73 FR 69647, Nov. 19, 2008 (Proposed Interagency Guidelines).

[17] HVCC, Part III.B.

[18] *Id.* Part IV.A.

[19] *Id.* Part IV.C.

[20] *Id.* Part IV.B.

[21] *Id.* Part IV.C.

[22] "Small bank" is defined in the Community Reinvestment Act (CRA) as "any regulated financial institution with aggregate assets of not more than $250,000,000." 12 U.S.C. 2908. However, adjusting asset threshold amounts for inflation, regulations implementing the CRA define "small bank" as "a bank that, as of December 31 of either of the prior two calendar years, had assets of less than $1.098 billion." 12 CFR 228.12(u). These regulations also define the term "intermediate small bank," meaning "a small bank with assets of at least $274 million as of December 31 of both of the prior two calendar years and less than $1.098 billion as of December 31 of either of the prior two calendar years." *Id.*

[23] HVCC, Part IV.D.

The Interim Final Rule

The Board recognizes that the literal language of the statutory prohibition on having a "direct or indirect interest, financial or otherwise" in the property or transaction can be interpreted to mean that a person or entity preparing a valuation or performing valuation management functions should be deemed to have a prohibited interest merely by token of being employed or owned by the creditor. An employee of the creditor could be deemed to have an "indirect" interest in the transaction, for example, because he or she might receive financial benefits, such as higher bonuses or more valuable stock options, as a result of the creditor's loan volume rising. Similarly, under this interpretation, an AMC providing both valuation management functions and title services, including title insurance, for the same transaction could be deemed to have an "indirect" interest in the transaction if the entity profits when title insurance is purchased at closing.

The Board believes, however, that interpreting the statute in this way would be impractical and thus would not be the most effective way to further the purpose of the conflicts of interest prohibition in TILA Section 129E(d)–promoting a healthy mortgage market by ensuring independent valuations. A broad prohibition could interfere with the functioning of many creditors and providers of valuations and valuation management functions, potentially disrupting the mortgage market at a vulnerable time. The Board also notes that, according to the legislative history of TILA Section 129E(d), the conflicts of interest provision "should not be construed as to prohibit work by staff appraisers within a financial institution or other organization, if such an entity has established firewalls, consistent with those outlined in the [HVCC], between the origination group and the appraisal unit designed to ensure the independence of appraisal results and reviews." [24]

The Board understands that many AMCs are wholly or partly owned by creditors, or share a common corporate parent with a creditor, and manage appraisals for a sizable share of the dwelling-secured consumer credit market. The Board is also aware that a few larger creditors still have a segregated in-house collateral valuation function. Some creditor representatives have informally reported to the Board that, based on their experience and quality control testing, appraisals performed by an in-house collateral valuation function are of higher quality than appraisals performed by third parties, including those ordered through third-party AMCs. These creditors might reasonably prefer using in-house appraisals, or appraisals performed through an appraisal company wholly owned by the creditor, to protect both consumers and their own safety and soundness.

In addition, the Board is concerned that small creditors with few staff members, such as institutions or branches in rural areas, could not comply with an overly broad prohibition on conflicts of interest. These entities, particularly in rural areas, may not have the option of choosing a third party to perform or manage collateral valuations. They may need to rely on a single in-house staff member to perform multiple functions, such as, for example, serving as both a loan officer and an appraiser.

For these reasons, the Board's interim final rule:

- Generally prohibits conflicts of interest in the valuation process, as prescribed by TILA Section 129E(d);
- Provides a safe harbor to ensure compliance with the conflicts of interest prohibition by a creditor's in-house valuation staff or affiliated AMC or appraisal company if firewalls and other specified safeguards are in place; and
- Provides a safe harbor to ensure compliance with the conflicts of interest prohibition by a person who prepares valuations or performs valuation management functions in a particular transaction in addition to performing another settlement service, or whose affiliate performs another settlement service, if firewalls and other specified safeguards are in place.

The interim final rule establishes alternative safe harbor safeguards for smaller creditors that are unable to establish firewalls due to practical problems, such as having a limited number of employees.

These provisions are discussed in turn below.

42(d)(1)(i) In General

Section 226.42(d)(1)(i) prohibits a person preparing a valuation or performing valuation management functions for a consumer credit transaction secured by the consumer's principal dwelling from having a direct or indirect interest, financial or otherwise, in the property or transaction for which the valuation is or will be performed. This provision implements TILA Section 129E(d), but uses different terminology (for reasons explained in the section-by-section analysis to § 226.42(b)). Specifically, the term "person preparing valuations" replaces the term "licensed or certified appraiser"; the term "person performing valuation management functions" replaces the term "appraisal management company"; and the term "valuation" replaces the term "appraisal." By using these terms, the interim final rule's conflict of interest provision applies to any form of valuing a property on which a creditor relies to extend consumer credit secured by the consumer's principal dwelling.

Prohibited Interest in the Property

Comment 42(d)(1)(i)–1 clarifies that a person preparing a valuation or performing valuation management functions for a covered transaction has a prohibited interest in the property if the person has any ownership or reasonably foreseeable ownership interest in the property. The comment further clarifies that a person who seeks a mortgage to purchase a home has a reasonably foreseeable ownership interest in the property securing the mortgage, and therefore is not permitted to prepare the valuation or perform valuation management functions for that mortgage transaction under § 226.42(d)(1)(i). This example is illustrative, and is not intended to be exhaustive; other prohibited interests in the covered property may arise, depending on the facts of a particular transaction.

Prohibited Interest in the Transaction

Comment 42(d)(1)(i)–2 clarifies that a person preparing a valuation or performing valuation management functions has a prohibited interest in the transaction under § 226.42(d)(1)(i) if that person or an affiliate of that person also serves as a loan officer of the creditor, mortgage broker, real estate broker, or other settlement service provider for the transaction, and the safe harbor conditions for settlement service providers under § 226.42(d)(4) (discussed below in the section-by-section analysis of that provision) are not satisfied. The comment further clarifies that a person also has a prohibited interest in the transaction if the person is compensated or otherwise receives financial or other benefits based on whether the transaction is consummated. Under these circumstances, the comment explains, the person is not permitted to prepare the valuation or perform valuation management functions for the transaction under § 226.42(d)(1)(i). The

[24] U.S. House of Reps., Comm. on Fin. Services, Report on H.R. 1728, Mortgage Reform and Anti-Predatory Lending Act, No. 111–94, 95 (May 4, 2009) (House Report). The conflict of interest provision adopted in TILA Section 129E(d) appears in Title VI, § 602, of H.R. 1728.

Board notes that these examples of prohibited interests are generally consistent with conflicts of interest provisions in the HVCC.[25] Again, these examples are not intended to be an exhaustive list of prohibited conflicts of interest in covered transactions; others may arise, depending on the circumstances surrounding a particular transaction.

42(d)(1)(ii) Employees and Affiliates of Creditors; Providers of Multiple Settlement Services

Employees and Affiliates of Creditors

Section 226.42(d)(1)(ii)(A) provides that, in any covered transaction, no person violates paragraph (d)(1)(i) of this section based solely on the fact that the person is an employee or affiliate of the creditor. Comment 226.42(d)(1)(ii)–1 explains that, in general, a creditor may use employees or affiliates to prepare a valuation or perform valuation management functions without violating § 226.42(d)(1)(i). The comment clarifies, however, that whether an employee or affiliate has a direct or indirect interest in the property or transaction that creates a prohibited conflict of interest under § 226.42(d)(1)(i) depends on the facts and circumstances of a particular case, including the structure of the employment or affiliate relationship.

Providers of Multiple Settlement Services

Section 226.42(d)(1)(ii)(B) provides that, in any covered transaction, no person violates paragraph (d)(1)(i) of this section based solely on the fact that the person provides a settlement service in addition to preparing valuations or performing valuation management functions, or based solely on the fact that the person's affiliate performs another settlement service. Comment 42(d)(1)(ii)–2 explains that, in general, a person who prepares a valuation or perform valuation management functions for a covered transaction may perform another settlement service for the same transaction without violating § 226.42(d)(1)(i), or the person's affiliate may provide another settlement service for the transaction. The comment clarifies, however, that whether the person has a direct or indirect interest in the property or transaction that creates a prohibited conflict of interest under § 226.42(d)(1)(i) depends on the facts and circumstances of a particular case.

[25] HVCC, Part IV.A and IV.C.

42(d)(2) Employees and Affiliates of Creditors With Assets of More Than $250 Million for Both of the Past Two Calendar Years; 42(d)(3) Employees and Affiliates of Creditors With Assets of $250 Million or Less for Either of the Past Two Calendar Years

Background

As discussed above, one interpretation of TILA Section 129E(d) is that it prohibits entities related to a creditor by ownership and a creditor's in-house appraisal staff from involvement in the collateral valuation process for that creditor. For many creditors and providers of valuations and valuation management services, complying with the statute under this interpretation would be impractical or impossible.

The Board believes that an interpretation of the statute more consistent with Congress's intent is one that recognizes that appropriate firewalls and safeguards can ensure the integrity of the valuation process in certain situations where conflicts might otherwise arise, such as where the person preparing a valuation is the employee of the creditor. The Board also notes that federal banking agency guidance and the HVCC permit creditors to use appraisals prepared by in-house appraisers or affiliated AMCs if they establish firewalls and other safeguards to separate the collateral valuation function from the loan production functions.[26] Appraisers, creditors, and others have informed the Board that the HVCC requirements for firewalls and safeguards, as an alternative to a strict prohibition on direct or indirect conflicts of interest, have generally been effective in ensuring that appraisers provide objective and independent valuations. Again, the legislative history of TILA Section 129E(d) evinces Congress's approval of this approach, stating that the conflict of interest provision "should not be construed as to prohibit work by staff appraisers within a financial institution or other organization, if such an entity has established firewalls, consistent with those outlined in the [HVCC], between the origination group and the appraisal unit designed to ensure the independence of appraisal results and reviews."[27]

Thus, the interim final rule creates two safe harbors for compliance with the prohibition on conflicts of interest under § 226.42(d) for persons who prepare valuations or perform valuation management functions and are also employees or affiliates of the creditor:

(1) One for transactions in which the creditor had assets of more than $250 million as of December 31st for both of the past two calendar years (§ 226.42(d)(2)); and

(2) The other for transactions in which the creditor had assets of $250 million or less as of December 31st for either of the past two calendar years (§ 226.42(d)(3)).

These safe harbors incorporate several firewall and safeguard requirements from the HVCC as well as, for smaller institutions, the federal banking agencies' appraisal regulations and supervisory guidance. As discussed below, the safe harbor conditions under § 226.42(d)(2) and (d)(3) impose obligations on creditors and also require that certain additional conditions be met. If the creditor meets these obligations and the other safe harbor conditions are satisfied, the creditor generally may rely on valuations prepared by its in-house staff or for which its affiliate performed valuation management functions for any covered transaction without violating the regulation.

The interim final rule differentiates between creditors with assets of over $250 million and creditors with assets of $250 million or less for at least three reasons. First, without allowances for staff and other limitations of smaller creditors, these creditors may decrease their consumer lending operations due to an inability to comply with the statute and implementing regulation. This reduction in credit availability could harm many consumers, undermining the goals of the Dodd-Frank Act to protect and benefit consumers. Second, the federal banking agencies have long recognized that smaller institutions may be unable to achieve strict separation between its collateral valuation and loan production functions; therefore, some firewalls and safeguards appropriate for larger institutions are not for smaller institutions. Third, distinguishing between larger and smaller institutions is consistent with the HVCC, which the statute indicates the interim final rule is intended to replace. See TILA Section 129E(j). As discussed earlier, the HVCC exempts from its conflict of interest and firewall rules all institutions (both depositories and nondepositories) meeting the asset threshold for defining a "small bank" under the Community Reinvestment Act. Therefore, this distinction is generally familiar in the

[26] *See* Interagency Guidelines, SR 94–55; HVCC, Part IV.B.

[27] House Report at 95.

industry and should not cause undue confusion.[28]

The Board requests comment on whether the $250 million asset size threshold, some other asset size threshold, or other factors are appropriate for applying the different safe harbor conditions to different types of institutions.

42(d)(2) Employees and Affiliates of Creditors With Assets of More Than $250 Million for Both of the Past Two Calendar Years

Section 226.42(d)(2) provides that, in a transaction in which the creditor had assets of more than $250 million as of December 31st for both of the past two calendar years, a person preparing valuations or performing valuation management functions who is employed by or affiliated with the creditor does not have a conflict of interest in violation of § 226.42(d)(1)(i) of this section based on the person's employment or affiliate relationship with the creditor if:

(1) The compensation of the person preparing a valuation or performing valuation management functions is not based on the value arrived at in any valuation;

(2) The person preparing a valuation or performing valuation management functions reports to a person who is not part of the creditor's loan production function (as defined in § 226.42(d)(5)(i)) and whose compensation is not based on the closing of the transaction to which the valuation relates; and

(3) No employee, officer or director in the creditor's loan production function is directly or indirectly involved in selecting, retaining, recommending or influencing the selection of the person to prepare a valuation or perform valuation management functions, or to be included in or excluded from a list of approved persons who prepare valuations or perform valuation management functions.

Comment 42(d)(2)–1 clarifies that § 226.42(d)(2) creates a safe harbor for a person who prepares valuation or performs valuation management functions for a covered transaction and is an employee or affiliate of the creditor. Such a person will not be deemed to have an interest prohibited under § 226.42(d)(1)(i) on the basis of the employment or affiliate relationship with the creditor if the conditions in § 226.42(d)(2) are satisfied. In addition, the comment explains that, in general, in any covered transaction with a creditor that had assets of more than $250 million for the past two years, the creditor may use its own employee or affiliate to prepare a valuation or perform valuation management functions for a particular transaction if the safe harbor conditions described in § 226.42(d)(2) are satisfied without violating the regulation. The comment also states that, if the safe harbor conditions in § 226.42(d)(2) are not satisfied, whether a person preparing valuations or performing valuation management functions has violated § 226.42(d)(1)(i) depends on all of the facts and circumstances. The three conditions for the safe harbor under § 226.42(d)(2) are discussed in turn below.

Condition one: Compensation. The first condition is that the compensation of the person preparing a valuation or performing valuation management functions may not be based on the value arrived at in any valuation for the transaction. The Board believes that whether the loan closes depends on the conclusion of value; therefore the interim final rule prohibits, as a condition of this safe harbor, basing an appraiser's compensation on the conclusion of value but does not expressly prohibit basing the appraiser's compensation on whether the transaction closes. If this condition is met, the person will not have a stake in stating a certain value, which might color his or her judgment as to the value of the home.

Condition two: Reporting. The second condition requires that the person performing valuations or valuation management functions report to a person who is not part of the creditor's loan production function, or whose compensation is not based on the closing of the transaction to which the valuation relates. The Board believes that this condition is important to ensuring that persons instrumental in the collateral valuation process are not subject to pressure to misrepresent collateral value from managers or similar authorities whose primary objective is increasing loan volume, not obtaining an independent valuation. The Board also notes that this condition is similar to requirements in the HVCC, such as that "the appraiser or, if an affiliate, the company for which the appraiser works," report to a function of the creditor "independent of sales or loan production."[29] It is reflected in the Proposed Interagency Guidance as well, which advises institutions to "establish reporting lines independent of loan production for staff that order, accept, and review appraisals and evaluations."[30]

Comment 42(d)(2)(ii)–1 clarifies the prohibition on reporting to a person who is part of the creditor's loan production function. To this end, the comment provides the following example: if a person preparing a valuation is directly supervised or managed by a loan officer or other person in the creditor's loan production function (as defined in § 226.42(d)(5)(i), or by a person who is directly supervised or managed by a loan officer, the condition under § 226.42(d)(2)(ii) is not met.

Comment 42(d)(2)(ii)–2 clarifies the prohibition on reporting to a person whose compensation is based on the transaction closing. To this end, the comment provides the following example: assume an appraisal management company performs valuation management functions for a transaction in which the creditor is an affiliate of the appraisal management company. If the employee of the appraisal management company who is in charge of valuation management 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 § 226.42(d)(2)(ii) is not met.

Condition three: Selection. The third condition requires that employees, officers, and directors in the creditor's loan production function not be directly or indirectly involved in selecting, retaining, recommending or influencing the selection of the person to perform a particular valuation or to be included in or excluded from a list or panel of approved persons who perform valuations. This safe harbor condition is intended to curtail coercion of appraisers that occurs through giving or withholding assignments, or removing the appraiser from, or including the appraiser on, a panel or list of persons approved to perform valuations. This condition is also intended to prevent loan sales or production staff from interfering with the independence of the valuation by choosing appraisers who pay be perceived to give especially high or low values.

Comment 42(d)(2)(ii)–2 clarifies the prohibition on any employee, officer or director in the creditor's loan production function (as defined in § 226.42(d)(4)(ii)) from direct or indirect involvement in selecting, retaining,

[28] 12 U.S.C. 2908; HVCC, Part IV.E.

[29] HVCC, Part IV.B(1). *See also id.,* Part III.B.

[30] Proposed Interagency Guidelines, 73 FR at 69652.

recommending or influencing the selection of the person to perform a valuation or valuation management functions for a covered transaction, or to be included in or excluded from a list or panel of approved persons who prepare valuations or perform valuation management functions. To this end, the comment provides the following example: if the person who selects the person who will prepare the valuation for a covered transaction is supervised by an employee of the creditor who also supervises loan officers, the condition in § 226.42(d)(2)(iii) is not met.

The Board requests comment on the appropriateness of the three conditions required under § 226.42(d)(2) for inclusion in the final rule.

42(d)(3) Employees and Affiliates of Creditors With Assets of $250 Million or Less for Either of the Past Two Calendar Years

Section 226.42(d)(3) provides a safe harbor for compliance with the prohibition on conflicts of interest under § 226.42(d)(1)(i) for employees and affiliates of creditors with assets of $250 million or less as of December 31st for either of the past two calendar years. Specifically, § 226.42(d)(3) provides that, in a transaction in which the creditor had assets of $250 million or less for either of the past two calendar years, a person who prepares valuations or performs valuation management functions and who is employed by or affiliated with the creditor does not have a conflict of interest in violation of § 226.42(d)(1)(i) based on the person's employment or affiliate relationship with the creditor if:

(1) The compensation of the person preparing a valuation or performing valuation management functions is not based the value arrived at in any valuation; and

(2) The creditor requires that any employee, officer or director of the creditor who orders, performs, or reviews a valuation for a covered transaction abstain from participating in any decision to approve, not approve, or set the terms of that transaction.

Comment 42(d)(3)–1 states that § 226.42(d)(3) creates a safe harbor for compliance with the general prohibition on conflicts of interest under § 226.42(d)(1)(i) by persons who prepare valuations or perform valuation management functions for a covered transaction and are employees or affiliates of the creditor. This comment explains that, in any covered transaction with a creditor that had assets of $250 million or less for either of the past two years, the creditor generally may use its own employee or affiliate to prepare a valuation or perform valuation management functions for a particular transaction, as long as the safe harbor conditions described in § 226.42(d)(3) are satisfied. The comment also explains that, if the safe harbor conditions in § 226.42(d)(3) are not satisfied, whether a person preparing valuations or performing valuation management functions has violated § 226.42(d)(1) depends on all of the facts and circumstances. The two conditions for the safe harbor under § 226.42(d)(3) are discussed in turn below.

Condition one: Compensation. The first condition is that the compensation of the person preparing a valuation or performing valuation management functions may not be based on the value arrived at in any valuation for the transaction. This condition parallels the condition applicable in transactions with larger creditors under § 226.42(d)(2)(i), discussed above. The Board believes that this condition, which in effect prohibits "direct" conflicts of interest in the transaction, is equally appropriate in transactions with smaller creditors as in those with larger creditors.

Condition two: Safeguards. The second condition is that the creditor must require that any employee, officer or director of the institution who orders, performs, or reviews the valuation for a particular transaction abstain from participation in any decision to approve, not approve, or set the terms of that transaction. The Board recognizes that smaller institutions may have difficulty complying with a condition that requires the person conducting the valuation or performing valuation management functions to report to a person independent of the creditor's sales or loan production functions (§ 226.42(d)(2)(ii)) or that prohibits employees in the creditor's loan production functions from being directly or indirectly involved in selecting, retaining, recommending or influencing the selection of a person to perform a particular valuation or to be included in or excluded from a list or panel of approved persons who perform valuations (§ 226.42(b)(2)(iii)). As discussed above, smaller institutions may have only a few employees, so each employee may have to perform multiple functions, including roles involving both collateral valuation and loan production tasks.

For these reasons, the condition in § 226.42(d)(3)(ii) replaces, for smaller creditors, the two conditions applicable to larger creditors described above, which require bright-line isolation of the collateral valuation function from the loan production function (§ 226.42(d)(2)(ii) and (d)(2)(iii)). This safe harbor condition tailored for smaller creditors incorporates provisions included in federal banking agency guidance for small or rural institutions regarding how to ensure independent valuations and protect against conflicts of interest in the collateral valuation process—namely, that a creditor should separate its collateral valuation function from its loan production function and that, to this end, any employee, officer or director of the institution who orders, performs, or reviews the valuation for a particular transaction should abstain from any vote or approval involving that transaction.[31]

The Board requests comment on the appropriateness of the two conditions of the safe harbor under § 226.42(d)(3) for inclusion in the final rule.

42(d)(4) Settlement Service Providers

The Board recognizes that AMCs and appraisal companies or firms are sometimes affiliated with other settlement service providers, such as title companies, and that some AMCs and appraisal companies provide services related to collateral valuation in addition to other settlement services for the same transaction. The Board believes that interpreting the statute to prohibit these AMCs and appraisal companies from providing valuation services and other settlement services in the same transaction in all cases would be contrary to the purposes of the statute; it could disrupt the businesses of many appraisal firms, appraisal management companies, and the creditors for which they provide services, to the detriment of the overall mortgage market. It also could reduce efficiencies created by "one-stop shopping" for settlement services, which can lower overall mortgage costs for consumers. The Board believes that providing a safe harbor consisting of appropriate firewalls and safeguards will ensure the integrity of the valuation process in accordance with the statute; by including this safe harbor, the interim final rule gives providers of multiple settlement services and the creditors for which they provide services an incentive to implement measures to secure valuation independence.

Section 226.42(d)(4) provides alternative safe harbors for compliance with the prohibition on conflicts of interest under § 226.42(d)(1)(i) by persons who prepare valuations or perform valuation management functions for a covered transaction and

[31] Interagency Guidelines, SR 94–55.

provide other settlement services for the same transaction, or whose affiliate provides settlement services. The Board notes that this provision is generally consistent with a similar provision in the HVCC, which prohibits a creditor from using an appraisal prepared by an entity affiliated with another entity that is engaged by the creditor to provide other settlement services for the same transaction, unless the entity providing the appraisal has adopted written policies and procedures implementing the HVCC, including adequate training and disciplinary rules on appraiser independence, and has mechanisms in place to report and discipline anyone who violates the policies and procedures.[32]

As with the safe harbors for employees and affiliates of creditors (§ 226.42(d)(2) and (d)(3)), the interim final rule's safe harbors for multiple settlement service providers differ depending on whether the creditor in the transaction had assets of $250 million or more as of December 31st for the past two calendar years (§ 226.42(d)(4)(i)) or assets of $250 million or less as of December 31st for either of the past two calendar years (§ 226.42(d)(4)(ii)).

Paragraph 42(d)(4)(i)

Under § 226.42(d)(4)(i), in a transaction in which the creditor had assets of more than $250 million for both of the past two calendar years, a person preparing a valuation or performing valuation management functions in addition to performing another settlement service, or whose affiliate performs another settlement service, will not be deemed to have interest prohibited under § 226.42(d)(1)(i) based on the fact that the person or the person's affiliate performs another settlement service for the transaction, as long as the conditions in § 226.42(d)(2)(i) (iii) are met. As discussed earlier, the conditions in § 226.42(d)(2)(i) (iii) are designed to ensure the independence of persons involved with valuations for transactions with larger creditors. Thus they require that:

(1) The compensation of the person preparing a valuation or performing valuation management functions is not based on the value arrived at in any valuation;

(2) The person preparing a valuation or performing valuation management functions reports to a person who is not part of the creditor's loan production function, and whose compensation is not based on the closing of the transaction to which the valuation relates; and

(3) No employee, officer or director in the creditor's loan production function is directly or indirectly involved in selecting, retaining, recommending or influencing the selection of the person to prepare a valuation or perform valuation management functions, or to be included in or excluded from a list of approved persons who prepare valuations or perform valuation management functions.

Comment 42(d)(4)(i)–1 explains that, even if the conditions in paragraph (d)(4)(i) are satisfied, however, the person preparing a valuation or performing valuation management functions may have a prohibited conflict of interest on other grounds, such as if the person performs a valuation for a purchase-money mortgage transaction in which the person is the buyer or seller of the subject property. The comment further explains that, in general, in any covered transaction with a creditor that had assets of more than $250 million for the past two years, a person preparing a valuation or performing valuation management functions, or its affiliate, may provide another settlement service for the same transaction, as long as the conditions described in paragraph (d)(4)(i) are satisfied. This comment also explains that, if the safe harbor conditions in § 226.42(d)(4)(i) are not satisfied, whether a person preparing valuations or performing valuation management functions has violated § 226.42(d)(1) depends on all of the facts and circumstances.

Comment 42(d)(4)(i) 2 explains that the safe harbor under § 226.42(d)(4)(i) is available if the condition specified in § 226.42(d)(2)(ii), among others, is met. Section 226.42(d)(2)(ii) prohibits a person preparing a valuation or performing valuation management functions from reporting to a person whose compensation is based on the closing of the transaction to which the valuation relates. This comment provides the following example to clarify the meaning of this prohibition: Assume an appraisal management company performs both valuation management functions and title services, including providing title insurance, for the same covered transaction. If the appraisal management company employee in charge of valuation management functions for the transaction is supervised by the title insurance agent in the transaction, whose compensation depends in whole or in part on whether title insurance is sold at the loan closing, the condition in § 226.42(d)(2)(ii) is not met.

Paragraph 42(d)(4)(ii)

Under § 226.42(d)(4)(ii), in a transaction in which the creditor in a covered transaction had assets of $250 million or less as of December 31st for either of the past two calendar years, a person performing valuations or valuation management functions in addition to performing another settlement service, or whose affiliate performs another settlement service, will not be deemed to have an interest prohibited under § 226.42(d)(1)(i) based on the fact that the person or the person's affiliate performs another settlement service for the transaction if the conditions in § 226.42(d)(3)(i)–(ii) are met.

Comment 42(d)(4)(ii)–1 explains that, even if the conditions in § 226.42(d)(4)(ii) are satisfied, however, the person may have a prohibited conflict of interest on other grounds, such as if the person performs a valuation for a purchase-money mortgage transaction in which the person is the buyer or seller of the subject property. Thus, this comment explains that, in general, in any covered transaction in which the creditor had assets of $250 million or less for either of the past two years, a person preparing a valuation or performing valuation management functions, or its affiliate, may provide another settlement service for the same transaction, as long as the conditions described in § 226.42(d)(4)(i) are satisfied. The comment further explains that, if the conditions in § 226.42(d)(4)(i) are not satisfied, whether a person preparing valuations or performing valuation management functions has violated § 226.42(d)(1)(i) depends on all of the facts and circumstances.

The Board requests comment on the appropriateness of the conditions under which persons preparing valuations or performing valuations management functions for a transaction in addition to performing another settlement service for the same transaction, or whose affiliate performs another settlement service for the same transaction, will be deemed in compliance with the prohibition on conflicts of interest under § 226.42(d)(1)(i).

[32] HVCC, Part IV.C. More precisely, this provision of the HVCC prohibits use of an appraisal report "by an entity that is *affiliated with, or that owns or is owned, in whole or in part by,* another entity that is engaged by the lender to provide other settlement services," unless certain conditions are met. *Id.* (emphasis added). The Board's Regulation Y defines "affiliate" as "any company that controls, is controlled by, or is under common control with, another company." 12 CFR 225.2(a). Therefore, in the interim final rule and this **SUPPLEMENTARY INFORMATION**, the Board uses the term "affiliate" to include an entity that owns or is owned by another entity, as well as entities with a common owner.

42(d)(5) Definitions

Section 226.42(d)(5) provides three definitions for purposes of § 226.42(d): "loan production function"; "settlement service"; and "affiliate."

42(d)(5)(i) Loan Production Function

Section 226.42(d)(5)(i) provides that the term "loan production function" means an employee, officer, director, department, division, or other unit of a creditor with responsibility for generating covered transactions, approving covered transactions, or both. This definition is generally consistent with the Federal banking agencies' use of the term "loan production function" or "loan production staff." [33] The term appears in § 226.42(d)(2)(ii) and (d)(2)(iii), which require that, respectively, (1) a person preparing the valuation or performing valuation management functions report to a person independent of the creditor's loan production function, and (2) no employee in the creditor's loan production function be directly or indirectly involved in selecting, retaining, recommending or influencing the selection of a person to prepare a particular valuation or valuation management functions, or to be included in or excluded from a list of approved persons who prepare valuations or perform valuation management functions.

Comment 42(d)(5)(i)–1 clarifies the meaning of "loan production function." This comment states that a creditor's "loan production function" includes retail sales staff, loan officers, and any other employee of the creditor with responsibility for taking a loan application, offering or negotiating loan terms or whose compensation is based on loan processing volume. This comment clarifies that a person is not considered part of a creditor's loan production function solely because part of the person's compensation includes a general bonus not tied to specific transactions or percentage of closed transactions, or a profit sharing plan that benefits all employees. The comment further clarifies that a person solely responsible for credit administration or risk management is also not considered part of a creditor's loan production function. The comment explains that credit administration and risk management includes, for example, loan underwriting, loan closing functions (*e.g.,* loan documentation), disbursing funds, collecting mortgage payments and otherwise servicing the loan (*e.g.,* escrow management and payment of taxes), monitoring loan performance, and foreclosure processing.

42(d)(5)(ii) Settlement Service

As discussed above, the interim final rule provides a safe harbor for persons who prepare valuations or perform valuation management functions that also perform another settlement service for the same transaction, or whose affiliate performs another settlement service for the same transaction. *See* § 226.42(d)(4). Section 42(d)(5)(ii) defines "settlement service" to have the same meaning as in the Real Estate Settlement Procedures Act, 12 U.S.C. 2601 *et seq.* The Board notes that this definition is consistent with the definition used in the HVCC regarding its analogous provision on providers of multiple settlement services.[34]

42(d)(5)(iii) Affiliate

Section 226.42(d)(5)(iii) provides that the term "affiliate" has the same meaning as in the Board's Regulation Y, 12 CFR 225.62(a), which defines "affiliate" as "any company that controls, is controlled by, or is under common control with, another company." This term is used in § 226.42(d)(2), (3), and (4), to identify the persons covered by the prohibition on conflicts of interest and safe harbors for complying with the general prohibition under § 226.42(d)(1).

42(e) When Extension of Credit Prohibited

TILA Section 129E(f) provides that, in connection with a covered transaction, a creditor who knows at or before loan consummation of a violation of the independence standards established in TILA Section 129E(b) or (d) (regarding misrepresentation of value and conflicts of interest, respectively) must not extend credit based on such appraisal, unless the creditor documents that it has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of the consumer's principal dwelling. 15 U.S.C. 1639e(b), (d), (f). Section 226.42(e) implements TILA Section 129E(f). Section 226.42(e) uses the term "valuation" to ensure that the protections in TILA Section 129E(f) apply to a covered transaction even if a creditor uses a valuation that is not a formal "appraisal" performed in accordance with USPAP by a licensed or certified appraiser, as discussed above in the section-by-section analysis of § 226.42(b)(3). Section 226.42(e) is substantially similar to existing § 226.36(b)(2).

Comment 42(e)–1 clarifies that a creditor will be deemed to have acted with reasonable diligence under § 226.42(e) if the creditor extends credit based on a valuation other than the valuation subject to the restriction in § 226.42(e). This is consistent with current comment 36(b)(2)–1. Comment 42(e)(1)–1 clarifies further, however, that a creditor need not obtain a second valuation to document that the creditor has acted with reasonable diligence to determine that the valuation does not materially misstate or misrepresent the value of the consumer's principal dwelling. Comment 42(e)–1 provides an example in which an appraiser notifies a creditor that a covered person had tried—and failed—to get the appraiser to inflate the value assigned to the consumer's principal dwelling. Comment 42(e)(1)–1 clarifies that if the creditor reasonably determines and documents that the appraisal had not misstated the dwelling's value, the creditor could extend credit based on the appraisal. This example is based on supplementary information provided in connection with proposed § 226.36(b)(2), which was adopted substantially as proposed. *See* 73 FR 1672, 1701 (Jan. 9, 2008); *see also* 73 FR 44522, 44568 (Jul. 30, 2008) (discussing the adoption of § 226.36(b)). The example is provided for clarity, and no substantive change is intended.

The interim final rule does not mandate specific due diligence procedures for creditors to follow when they suspect a violation of § 226.42(c) or (d). In addition, under the interim final rule, a violation of § 226.42(e) does not establish a basis for voiding loan agreements. That is, even if a creditor knows of a violation of § 226.42(c) or (d) and nevertheless extends credit in violation of § 226.42(e), this violation does not itself void the consumer's loan agreement with the creditor. Whether the loan agreement is valid is a matter determined by state or other applicable law. The Board notes that applicable federal or state regulations may require creditors to take certain steps in the event the creditor knows about problems with a valuation. The foregoing discussion is consistent with the Board's statements regarding due diligence and the impact of any violation on a creditor's contract under current § 226.36(b)(2). *See* 73 FR 44522, 44568 (Jul. 30, 2008).

42(f) Customary and Reasonable Compensation

Section § 226.42(f) implements TILA Section 129E(i), which requires

[33] *See, e.g.,* Proposed Interagency Guidelines, 73 FR at 69661.

[34] HVCC, Part IV.C.

creditors and their agents to compensate fee appraisers (appraisers who are not their employees) at a rate that is "customary and reasonable for appraisal services in the market area of the property being appraised." TILA Section 129E(i)(1). The statute states that evidence for reasonable and customary fees may be established by objective third-party information, such as government agency fee schedules, academic studies, and independent private sector surveys. "Such fee studies," the statute stipulates, "shall not include assignments ordered by known appraisal management companies." The statute does not define "appraisal management company." In addition, 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.

The Board interprets the statutory language of TILA Section 129E(i) to signify that the marketplace should be the primary determiner of the value of appraisal services, and hence the customary and reasonable rate of compensation for fee appraisers. The "customary and reasonable" compensation provision that Congress adopted as part of TILA is identical to a requirement included in a HUD Mortgagee Letter obligating FHA lenders to ensure that appraisers are paid "at a rate that is customary and reasonable for appraisal services performed in the market area of the property being appraised." [35] HUD's statements regarding this provision recognize the role of the marketplace in determining rates for appraisal services and the importance of accounting for factors that can cause variations in what is a customary and reasonable amount of compensation on a transaction-by-transaction basis.[36] Similarly, TILA Section 129E(i) focuses on the marketplace by permitting use of objective market information to determine rates. The statute also makes allowances for factors that the marketplace acknowledges add to the complexity of an appraisal and thus value of appraisal services in a given transaction, such as "increased time, difficulty, and scope of work." TILA Section 129E(i)(1) and (3).

Accordingly, the interim final rule and alternative presumptions of compliance are designed to be consistent with this approach. The interim final rule is not intended to prohibit a creditor and an appraiser from negotiating a rate for an assignment in good faith, nor is it intended to prohibit a creditor from communicating to a fee appraiser the rates that had been submitted by the other appraisers solicited for the assignment as part of this negotiation. In addition, the interim final rule is not intended to prevent appraisers and creditors from negotiating volume-based discounts for a creditor that provides multiple appraisal assignments to a fee appraiser. *See* comment 42(f)(1)–5.

Specifically, the interim final rule provides that fee appraisers must be paid a customary and reasonable fee for appraisal services performed in the geographic market in which the property being appraised is located. *See* § 226.42(f)(1). In addition, the interim final rule provides two alternative ways in which creditors and their agents may qualify for a presumption of compliance with this requirement.

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; and
- The creditor and its agent do 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.

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)).

The first presumption of compliance described above (§ 226.42(f)(2)) reflects the Board's interpretation of the statutory requirement that fees paid to fee appraisers be "customary": to be "customary," the fee must be reasonably related to recent rates for appraisal services in the relevant geographic market. This first presumption of compliance also reflects the Board's interpretation of the statutory requirement that the fee be "reasonable": to be "reasonable," the fee should be adjusted as necessary to account for factors in addition to geographic market that affect the level of compensation appropriate in a given transaction, such as the type of property and the scope of work. The Board recognizes, however, that if some creditors or AMCs dominate the market through illegal anticompetitive acts, "recent rates" may be an inaccurate measure of what a "reasonable" fee should be. Thus, to qualify for the presumption of compliance, a creditor and its agents also must not commit anticompetitive acts in violation of state or federal law that affect the compensation of fee appraisers.

The second presumption of compliance (§ 226.42(f)(3)) is intended to give effect to TILA Section 129E(i)(1) which expressly permits creditors and their agents to use third-party information to determine customary and reasonable fees. *See* TILA Section 129E(i)(1). The Board believes that the statute supports a presumption of compliance if the creditor or agent based the fee paid to a fee appraiser on objective, third-party market information regarding recent rates for appraisal services that meet the statutory requirements for this information. Thus, in keeping with the statute, the interim final rule stipulates that any fee schedule, survey, or study relied on to qualify for this presumption of compliance may not include fees for

[35] HUD, "Appraiser Independence," Mortgagee Letter 2009–28 (Sept. 18, 2009).

[36] See, HUD, "Frequently Asked Questions—Reasonable Fees/Time," *available at http://portal.hud.gov/portal/page/portal/HUD/groups/appraisers*: "FHA believes that the marketplace best determines what is reasonable and customary in terms of fees. The fee is [the] result of a business decision, which may or may not be negotiated, between the appraiser and the client. * * * Given that a reasonable and customary fee depends on the complexity of the assignment and the expertise needed to perform and report a credible and accurate appraisal of the property, the fee will vary depending on the property type, the purpose of the assignment and the scope of work and, therefore, cannot be easily defined as an objective number." *See http://www.hud.gov/offices/hsg/sfh/appr/faqs_fees-time.pdf.*

appraisals ordered by companies that publicly hold themselves out as appraisal management companies (defined in § 226.42(f)(4)(ii)).

Public Input

In adopting this interim final rule, the Board considered written comments from representatives of appraisers, AMCs and creditors, as well as views expressed by these parties during conference calls with Board staff. Appraisers expressed concerns that AMCs may have recently gained significant control over the residential appraisal market as a result of unintended consequences of the HVCC. Under the HVCC, mortgage brokers are not permitted to order appraisals, and a creditor's in-house appraisers may not perform the appraisal unless strict firewalls to safeguard appraisal independence are in place.[37] The HVCC also prohibits the creditor's "loan production" and certain other staff from having "substantive communications" with appraisers and AMCs, which include ordering or managing an appraisal assignment.[38] To minimize the risk of violating these and similar restrictions, many creditors reportedly have chosen to rely on AMCs as a "middle-man" to select appraisers and generally manage the creditor's appraisal function. According to some, appraisers willing to work for AMCs are often inexperienced in general or in the relevant geographic area and produce poor quality appraisals, undermining consumers' well-being and creditors' safety and soundness.

On the other hand, representatives of AMCs expressed concerns that, depending on how the term "customary and reasonable" rate is interpreted, requiring AMCs to compensate fee appraisers at a rate that is customary and reasonable may force them to raise overall costs charged to creditors—and ultimately to consumers—for appraisals ordered through AMCs. AMC representatives expressed concerns that AMCs would have to pay higher fees to appraisers while still performing management functions for which they would need to charge creditors as well. AMC representatives stated that reputable AMCs have strong quality control systems and produce sound appraisals, and that they perform functions that individual appraisers would have to perform themselves were they not engaged by an AMC. These include marketing appraisal services and handling administrative matters such as submitting the appraisal to the creditor and billing the creditor.

AMC representatives also raised concerns that appropriate appraisal fee studies do not exist and argued that the costs of performing the appraisal itself and the various management functions associated with each appraisal can vary by transaction, complicating the process of determining a generally applicable customary and reasonable rate. These parties argued that an interim final rule implementing TILA Section 129E's "customary and reasonable" rate provision is premature because greater study of the issue is required to avoid a rule that will create undue compliance challenges and litigation risk.

Coverage—"Appraisals" and "Fee Appraisers"

Unlike other provisions of § 226.42, § 226.42(f) does not replace the statutory terms "appraisal" and "appraiser" with terms that cover a broader range of methods for valuing collateral and persons who estimate collateral value. However, the statute clearly states that the persons who must receive customary and reasonable compensation are "fee appraisers," and that the term "fee appraiser" means: (1) State-licensed or state-certified appraisers and, generally, (2) entities that employ state-licensed or state-certified appraisers to perform appraisals and are compensated for the performance of appraisals (as opposed to entities that merely manage the appraisal process). *See* TILA Section 129E(i)(2).

42(f)(1) Requirement To Provide Customary and Reasonable Compensation to Fee Appraisers

Section 226.42(f)(1) requires that, in any covered transaction (defined in § 226.42(b)(1)), the creditor and its agents must compensate a fee appraiser for performing appraisal services at a rate that is customary and reasonable for comparable appraisal services performed in the geographic market of the property being appraised. This provision states that, for purposes of § 226.42(f), "agents" of the creditor do not include any fee appraiser defined in § 226.42(f)(4)(i).

Agents of the Creditor

The reference to "agents" in § 226.42(f)(1) is not intended to signify that agents of creditors are not included in other places where the term "creditor" appears in Regulation Z. To the contrary, the term "creditor" used throughout Regulation Z includes agents of the creditor, as determined by applicable state law. The Board believes that Congress was especially concerned that AMCs, serving as creditors' agents in managing the appraisal process, be covered by this provision. Consequently, the regulatory text follows the statutory language, which applies the requirement to pay fee appraisers customary and reasonable fees to both "a lender and its agent."

Comment 42(f)(1)–1 clarifies that whether a person is an "agent" of the creditor is determined by applicable law. This comment also confirms the regulatory exclusion of "fee appraisers" as defined in § 226.42(f)(4)(i) from the meaning of "agent" of the creditor for purposes of § 226.42(f). The comment explains that, therefore, fee appraisers are not required to pay other fee appraisers customary and reasonable compensation under § 226.42(f).

The Board believes that the express exclusion of "fee appraisers" from the meaning of "agents" is consistent with Congress's intention regarding the parties that should be required to pay fee appraisers customary and reasonable compensation. As discussed in more detail in the section-by-section of § 226.42(f)(4)(i) (defining "fee appraiser"), TILA Section 129E(i)(2) defines "fee appraisers" to which customary and reasonable fees should be paid to mean (1) individual state-licensed or state-certified appraisers (natural persons), and (2) companies or firms that employ individual state-licensed or state-certified appraisers and receive compensation for performing appraisals. In this way, the statute reflects that natural persons as well as appraisal companies or firms may contract with creditors and AMCs to perform appraisals. Appraisal companies or firms that contract with AMCs to perform appraisals typically have state-licensed or state-certified appraisers on staff to perform appraisals. These staff appraisers meet the definition of "fee appraiser" under the statute; thus, a strict interpretation of the statute would require appraisal companies to pay their staff appraisers at a "customary and reasonable" rate. The Board understands, however, that these companies or firms often pay their appraisers on an hourly basis and provide their employees with office services as well as health insurance and other employment benefits. Requiring that they pay their staff appraisers "customary and reasonable" fees for each appraisal assignment could be unduly financially burdensome for these entities, and ultimately could undermine their viability as an avenue for appraisal services. The Board believes that this result would harm consumers by reducing competition in the appraisal services industry.

[37] *See* HVCC, Part IV.A and IV.B.

[38] *See Id.* Part III.B.

The Board requests comment on whether the final rule should define "agent" to exclude fee appraisers or any other parties.

Geographic Market of the Property Being Appraised

As noted, TILA Section 129E(i) requires payment of customary and reasonable compensation to fee appraisers for appraisal services performed "in the market area of the property being appraised." Section 226.42(f)(1), (f)(2), and (f)(3) (discussed below) substitute the term "geographic market" for the statutory term "market area." Comment 42(f)(1)–2 clarifies that, for purposes of § 226.42(f), the "geographic market of the property being appraised" means the geographic market relevant to the appropriate compensation levels for appraisal services.[39] This comment explains that, depending on the facts and circumstances, the relevant geographic market may be a state, metropolitan statistical area (MSA), metropolitan division, area outside of an MSA, county, or other geographic area. The comment provides two examples. First, assume that fee appraisers who normally work in County A generally accept $400 to appraise an attached single-family property in County A. Assume also that *very few or no* fee appraisers who normally work only in contiguous County B will accept a rate comparable to $400 to appraise an attached single-family property in County A. The relevant geographic market for an attached single-family property in County A may reasonably be defined as County A.

Second, assume that fee appraisers who normally work only in County A generally accept $400 to appraise an attached single-family property located in County A. Assume also that *many* fee appraisers who normally work only in contiguous County B will accept a rate comparable to $400 to appraise an attached single-family property located in County A. The relevant geographic market for an attached single-family property in County A may reasonably be defined to include both County A and County B.

Failure To Perform Contractual Obligations

A few creditors and AMC representatives requested that the Board clarify whether creditors and their agents could withhold an appraiser's fee for failing to meet contractual obligations. Comment 42(f)(1)–3 clarifies that § 226.42(f)(1) does not prohibit a creditor or its agent from withholding compensation from a fee appraiser for failing to meet contractual obligations, such as for failing to provide the appraisal report or violating state or federal appraisal laws in performing the appraisal. The Board requests comment on whether the Board should specify particular types of contractual obligations that, if breached, would warrant withholding compensation without violating § 226.42(f).

Agreement That Fee Is Customary and Reasonable

Comment 42(f)(1)–4 clarifies that a document signed by a fee appraiser indicating that the appraiser agrees that the fee paid to the appraiser is "customary and reasonable" does not by itself create a presumption of compliance with § 226.42(f) or otherwise satisfy the requirement to compensate a fee appraiser at a customary and reasonable rate. In the Board's view, a fee appraiser's agreement that a fee is "customary and reasonable" is insufficient to establish that the fee meets the statutory "customary and reasonable" standard. Objective factors or information such as that set forth in § 226.42(f)(2) and (f)(3) (discussed below) generally should support the creditor's or agent's determination of the appropriate amount of compensation to pay a fee appraiser for a particular appraisal assignment. In theory, the fact that an appraiser is willing to accept a particular fee for an appraisal assignment may bear on whether the fee is customary, reasonable, or both. However, an appraiser may be willing to accept a low fee because the appraiser is new to the industry and wishes to establish herself, or simply because the appraiser needs any work he can obtain in a slow housing market. In addition, the Board understands that some AMCs have begun requiring fee appraisers to agree that the fee is "customary and reasonable" as a condition of obtaining the appraisal assignment. In these situations, the Board believes that an appraiser's agreement that a fee is "customary and reasonable" is an unreliable measure of whether the fee in fact meets the statutory standard.

Volume-Based Discounts

The Board recognizes that competition and efficiencies may both be enhanced when market participants negotiate volume-based discounts for services. For this reason, comment 42(f)(1)–5 clarifies that § 226.42(f)(1) does not prohibit a fee appraiser and a creditor (or its agent) from agreeing to compensation based on transaction volume, so long as the compensation is customary and reasonable. 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 assignments from the creditor. The Board requests comment on whether further guidance is needed concerning the permissibility of volume-based discounts under § 226.42(f)(1).

42(f)(2) Presumption of Compliance

Section 226.42(f)(2) provides that a creditor and its agents will be presumed to comply with the requirement to compensate a fee appraiser at a customary and reasonable rate if the creditor or its agent satisfy two conditions.

First, the creditor or its agents must compensate the fee appraiser in an amount that is reasonably related to recent rates paid for comparable appraisal services performed in the geographic market of the property being appraised. In determining this amount, the creditor or its agent must review the factors below and make any adjustments to recent rates paid in the relevant geographic market necessary to ensure that the amount of compensation is reasonable:

(1) The type of property;
(2) The scope of work;
(3) The time in which the appraisal services are required to be performed;
(4) Fee appraiser qualifications;
(5) Fee appraiser experience and professional record; and
(6) Fee appraiser work quality.

Second, the creditor and its agents must not engage in any anticompetitive acts in violation of state or federal law that affect the compensation paid to fee appraisers, including—

(1) Entering into any contracts or engaging in any conspiracies to restrain trade through methods such as price fixing or market allocation, as prohibited under section 1 of the Sherman Antitrust Act, 15 U.S.C. 1, or any other relevant antitrust laws; or

(2) Engaging in any acts of monopolization such as restricting any person from entering the relevant geographic market or causing any person to leave the relevant geographic market, as prohibited under section 2 of the Sherman Antitrust Act, 15 U.S.C. 2, or any other relevant antitrust laws.

[39] For further discussion of "relevant geographic markets," *see, e.g.,* U.S. Dept. of Justice and Federal Trade Commission, "Horizontal Merger Guidelines," § 4.2 (Aug. 19, 2010), found at *http://www.justice.gov/atr/public/guidelines/hmg-2010.html#4f.*

Comment 42(f)(2)–1 explains that creditor and its agent are presumed to comply with the requirement to pay a fee appraiser at a customary and reasonable rate under § 226.42(f)(1) if the creditor or its agent meets the conditions specified in § 226.42(f)(2), stated above, in determining the compensation. The comment clarifies that these conditions are not requirements for compliance with § 226.42(f)(1), but that, if met, they create a presumption that the creditor or its agent has complied. The comment further clarifies that a person may rebut this presumption with evidence that the amount of compensation paid to a fee appraiser was not customary and reasonable. The creditor would have met the conditions in § 226.42(f)(2), so this evidence must be distinguishable from allegations that the creditor or its agent failed to satisfy the conditions in § 226.42(f)(2). Finally, the comment explains that, if a creditor or its agent does not meet one of the conditions in § 226.42(f)(2), the creditor's and its agent's compliance with the requirement to pay a fee appraiser at a customary and reasonable rate is determined based on all of the facts and circumstances without a presumption of either compliance or violation.

Paragraph 42(f)(2)(i)

Compensation Must Be Reasonably Related to Recent Rates

As explained in comment 42(f)(2)(i)–1, the first element of the presumption of compliance under § 226.42(f)(2) requires creditor or its agent to engage in a two-step process to determine the appropriate compensation. First, the creditor or its agent must identify recent rates paid for comparable appraisal services in the relevant geographic market. Second, once recent rates have been identified, the creditor or its agent must review the factors listed in § 226.42(f)(2)(i)(A)–(F) and make any adjustments to recent rates appropriate to ensure that the amount of compensation is appropriate for the current transaction.

Comment 42(f)(2)(i)–2 further explains the first step in this process, which requires the creditor or its agents to identify recent rates for appraisal services in the geographic market of the property being appraised. Specifically, this comment clarifies that whether rates may reasonably be considered "recent" depends on the facts and circumstances, but that generally a rate would be considered "recent" if it had been charged within one year of the creditor's or its agent's reliance on this information to qualify for the presumption of compliance under § 226.42(f)(2). This comment also states that, for purposes of the presumption of compliance under § 226.42(f)(2), a creditor or its agent may gather information about recent rates by using a reasonable method that provides information about rates for appraisal services in the geographic market of the relevant property. The comment further provides that a creditor or its agent may, but is not required to, use or perform a fee survey. As indicated by this comment, qualifying for this presumption of compliance does not require that a creditor use third-party information that excludes appraisals ordered by AMCs, for example, as required to qualify for the presumption of compliance available under § 226.42(f)(3), discussed below. The Board requests comment on whether additional guidance regarding how creditors may identify recent rates is needed, and solicits views on what guidance in particular may be helpful.

Comment 42(f)(2)(i)–3 provides guidance on the second step in the process, which requires the creditor or its agent to review the factors listed in paragraph (f)(2)(i)(A)–(F) to determine appropriate rate for the current transaction may be determined. For further clarification, this comment provides an example: If the recent rates identified by the creditor or its agent were solely for appraisal assignments in which the scope of work required consideration of two comparable properties, but the current transaction required an appraisal that considered three comparable properties, the creditor or its agent might reasonably adjust the rate by an amount that reasonably accounts for the increased scope of work.

The factors that must be considered in this second step for determining the appropriate rate of fee appraiser compensation are listed in § 226.42(f)(i)(A)–(F) and discussed in turn below. Appraisal assignments vary and appraisers have different skills and experience, and these variations and differences may legitimately contribute to determining what level of compensation for a particular assignment is reasonable. For example, an appraisal requiring an interior inspection may be more expensive to perform and may warrant greater compensation than an appraisal requiring only an exterior or "drive-by" inspection. Similarly, an appraisal of a dwelling in a rural area with several additional outbuildings and significant acreage in real property might be more expensive to perform and may warrant higher compensation for the appraiser than an appraisal of a detached single-family dwelling in a suburban area. As discussed earlier, the statute itself acknowledges these variances, by expressly permitting a creditor or its agent to pay an appraiser more for a "complex" assignment than for a comparatively "non-complex" assignment. TILA Section 129E(i)(3).

At the same time, the Board recognizes that each of these factors may not in all transactions determine the quality of an appraisal and the value of appraisal services. For example, an appraiser with 20 years of experience appraising properties may not necessarily provide a higher quality appraisal than an appraiser with five years of experience. Thus, the interim final rule states that the rate must be adjusted as "necessary" to ensure a reasonable rate, and does not specify exact percentages or amounts by which compensation should vary based on each factor.

Type of property. After the creditor or its agent identifies recent rates in the relevant geographic market, the first factor that must be accounted for is the type of property. *See* § 226.42(f)(2)(i)(A). Comment 42(f)(2)(i)(A)–1 provides several examples of different property types that may appropriately bear on the value of appraisal services: Detached or attached single-family property, condominium or cooperative unit, or manufactured home. The property type may contribute to, for example, the difficulty or ease of a particular appraisal assignment, and thus can affect the value of appraisal services.

Scope of work. The second factor that must be accounted for is the scope of work. See § 226.42(f)(2)(i)(B). Comment 42(f)(2)(i)(B) clarifies that relevant elements of the scope of work to consider would include the type of inspection (for example, exterior only or both interior and exterior) and the number of comparable properties that the appraiser is required to review to perform the assignment. To comply with USPAP, appraisers must identify the extent of work and analysis required to obtain credible results for an appraisal assignment.[40] The scope of work may vary based on a number of factors, such as the extent to which the property must be inspected, the type and extent of data that must be researched, and the type and extent of analyses required to reach credible conclusions. Thus, the compensation of an appraiser may reasonably be higher

[40] *See* The Appraisal Foundation, *Uniform Standards of Professional Appraisal Practice* (USPAP), ed. 2010–2011, "Scope of Work Rule," U–13.

where the scope of work required for the appraisal is more extensive than the scope of work required for another appraisal performed by the same appraiser.

The time in which the appraisal services are required to be performed. The third factor is the time in which the appraisal services are required to be performed or "turnaround" time. *See* § 226.42(f)(2)(i)(C). Concerns have been expressed to the Board that a quick turnaround time is sometimes over-emphasized in determining whether to hire an appraiser and how much to pay the appraiser, to the detriment of the appraisal's quality. The Board recognizes that required turnaround time can be a legitimate factor to consider in determining an appraiser's rate, but stresses that appraiser competency and accurate appraisals should be a creditor's chief concerns, not how quickly the assignment can be performed. As reflected in the remaining factors discussed below, and consistent with longstanding federal banking agency supervisory guidance, the Board expects creditors and their agents to select an appraiser foremost on the basis of whether the appraiser has the requisite education, expertise and competence to complete the assignment.[41]

Fee appraiser qualifications. The fourth factor is the fee appraiser's professional qualifications. *See* § 226.42(f)(2)(i)(D). Comment 42(f)(2)(i)(D)–1 clarifies that professional qualifications that appropriately affect the value of appraisal services include whether the appraiser is state-licensed or state-certified in accordance with the minimum criteria issued by the Appraisal Qualifications Board of the Appraisal Foundation.[42] For example, a state-licensed appraiser could legitimately command a higher rate for appraisal services than an appraiser-in-training who has not yet received a license. Relevant qualifications may also include the appraiser's completion of continuing education courses on effective appraisal methods and related topics.

Comment 42(f)(2)(i)(D)–2 clarifies that permitting a creditor to consider an appraiser's qualifications does not override state or federal laws prohibiting the exclusion of an appraiser from consideration for an assignment solely by virtue of membership or lack of membership in any particular appraisal organization.[43] The Board and other federal banking agencies recognize that fellow members of a particular appraisal organization may favor one another in selecting an appraiser for a given assignment, creating an unfair playing field for other appraisers. For this reason, federal banking agency regulations prohibit excluding a state-licensed or state-certified appraiser from consideration for an assignment for a federally related transaction solely by virtue of membership or lack of membership in any particular appraisal organization. The Board requests comment on whether the final rule should expressly prohibit basing an appraiser's *compensation* on an appraiser's membership or lack of membership in particular appraisal organization.

Fee appraiser experience and professional record. The fifth factor is the professional record and experience of the fee appraiser. *See* § 226.42(f)(2)(i)(E). Comment 42(f)(2)(i)(E)–1 clarifies that the fee appraiser's level of experience may include, for example, the fee appraiser's years of service as a state-licensed or state-certified appraiser, or years of service appraising properties in a particular geographical area or of a particular type. In the Board's view, a fee for appraisal services may reasonably be higher when the fee appraiser has been state-licensed or state-certified for 15 years and has been appraising properties in the relevant geographic area during all that time than when the fee appraiser is more recently licensed and has appraised properties in that area for only six months.

Comment 42(f)(2)(i)(E)–1 further clarifies that, regarding the appraiser's professional record, a creditor or its agent may consider, for example, whether an appraiser has a past record of suspensions, disqualifications, debarments, or judgments for waste, fraud, abuse or breach of legal or professional standards. The Board expects that a creditor or its agent would exercise caution in engaging an appraiser with a blemished professional record, and would carefully scrutinize the appraiser's work. A creditor or its agent might reasonably pay less for the appraiser's services than for the services of an appraiser with an unblemished record.

Fee appraiser work quality. The sixth factor is the quality of the appraiser's work. *See* § 226.42(f)(2)(i)(F). Comment 42(f)(2)(i)(F)–1 clarifies that "work quality" in this factor principally comprises the soundness of the appraiser's appraisal assignments; the fee appraiser's work quality may include, for example, the past quality of appraisals performed by the appraiser based on the written performance and review criteria of the creditor or agent of the creditor. A creditor or its agent might reasonably pay an appraiser with an excellent performance history at a higher rate than an appraiser with a performance history showing problems with past assignments.

The Board solicits comment on whether the factors in § 226.42(f)(2)(i)(A)–(F) are appropriate, and whether other factors should be included.

Paragraph 42(f)(2)(ii)

No Anticompetitive Acts

As noted above, the Board recognizes that if some creditors or AMCs dominate the market through illegal anticompetitive acts, "recent rates" identified under § 226.42(f)(2)(i) may be an inaccurate measure of what a "reasonable" fee should be. Thus, under § 226.42(f)(2)(ii), to qualify for the presumption of compliance afforded under § 226.42(f)(2), a creditor and its agents must not engage in any anticompetitive acts in violation of state or federal law that affect the compensation of fee appraisers, including—

(1) Entering into any contracts or engaging in any conspiracies to restrain trade through methods such as price fixing or market allocation, as prohibited under section 1 of the Sherman Antitrust Act, 15 U.S.C. 1, or any other relevant antitrust laws (§ 226.42(f)(2)(ii)(A)); or

(2) Engaging in any acts of monopolization such as restricting any person from entering the relevant geographic market or causing any person to leave the relevant geographic market, as prohibited under section 2 of the Sherman Antitrust Act, 15 U.S.C. 2, or any other relevant antitrust laws (§ 226.42(f)(2)(ii)(B)).

Comment 42(f)(2)(ii)–1 explains that, under § 226.42(f)(2)(ii)(A), a creditor or its agent would not qualify for § 226.42(f)(2)'s presumption of compliance if it engaged in any acts to restrain trade such as entering into a price fixing or market allocation agreement that affect the compensation of fee appraisers. For example, if appraisal management company A and appraisal management company B agreed to compensate fee appraisers at no more than a specific rate or range of

[41] *See* Interagency Guidelines, SR 94–55; *see also* Proposed Interagency Guidelines, 73 FR at 69652.

[42] Appraiser Qualifications Board, The Appraisal Foundation, "The Real Property Appraiser Qualification Criteria" (Apr. 2010).

[43] *See* Board: 12 CFR 225.66(a); OCC: 12 CFR 34.46(a); FDIC: 12 CFR 323.6(a); OTS: 12 CFR 564.6(a); NCUA: 12 CFR 722.6(a).

rates, neither appraisal management company would qualify for the presumption of compliance. Likewise, if appraisal management company A and appraisal management company B agreed that appraisal management company A would limit its business to a certain portion of the relevant geographic market and appraisal management company B would limit its business to a different portion of the relevant geographic market, and as a result each appraisal management company unilaterally set the fees paid to fee appraisers in their respective portions of the market, neither appraisal management company would qualify for the presumption of compliance under paragraph (f)(2).

Comment 42(f)(ii)–2 explains that, under § 226.42(f)(2)(ii)(B), a creditor or its agent would not qualify for § 226.42(f)(2)'s presumption of compliance if it engaged in any act of monopolization such as restricting entry into the relevant geographic market or causing any person to leave the relevant geographic market, resulting in anticompetitive effects that affect the compensation paid to fee appraisers. For example, if only one appraisal management company exists or is predominant in a particular market area, that appraisal management company might not qualify for the presumption of compliance if it entered into exclusivity agreements with all creditors in the market or all fee appraisers in the market, such that other appraisal management companies had to leave or could not enter the market. Whether this behavior would be considered an anticompetitive act that affects the compensation paid to fee appraisers depends on all of the facts and circumstances, including applicable law.

The Board requests comment on whether additional guidance is needed regarding anticompetitive acts that would disqualify a creditor or its agent from the presumption of compliance under § 226.42(f)(2).

42(f)(3) Alternative Presumption of Compliance

Rates Based on Objective Third-Party Information

Section 226.42(f)(3) provides creditors and their agents with an alternative means to qualify for a presumption of compliance with the requirement to pay fee appraisers at a customary and reasonable rate under § 226.42(f)(1). Specifically, a creditor and its agents are presumed to comply with the requirement if the creditor or its agents determine the amount of compensation paid to the fee appraiser by relying on rates in the geographic market of the property being appraised that satisfies three conditions. First, the information must be 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 (§ 226.42(f)(3)(i)). Second, it must be based on recent rates paid to a representative sample of providers of appraisal services in the geographic market of the property being appraised or the fee schedules of those providers (§ 226.42(f)(3)(ii)). Third, in the case of fee schedules, studies, and surveys, such fee schedules, studies and surveys or information derived from them must exclude compensation paid to fee appraisers for appraisals ordered by an AMC, as defined in § 226.42(f)(4)(iii).

Regarding this third condition, the Board recognizes that the express statutory language states, "Fee *studies* shall exclude assignments ordered by known appraisal management companies." TILA Section 129E(i)(1)(emphasis added). However, the Board does not see a meaningful distinction between, for example, a fee "study" and a fee "survey," both of which require at least some evaluation of gathered data. The Board also is not aware of a rationale consistent with the statute that would treat fee studies differently than fee surveys or fee schedules. The Board requests comment, however, on whether studies and surveys should be treated differently for the purposes of this rule.

Comment 42(f)(3)–1 explains that a creditor and its agent are presumed to comply with § 226.42(f)(1) if the creditor or its agent determine the compensation paid to a fee appraiser based on information about rates that satisfies the three conditions discussed above. This comment clarifies that reliance on information satisfying these conditions is not a requirement for compliance with § 226.42(f)(1), but creates a presumption that the creditor or its agent has complied. The comment further clarifies that a person may rebut this presumption with evidence that the rate of compensation paid to a fee appraiser by the creditor or its agent is not customary and reasonable. The creditor or its agent would already have satisfied the presumption of compliance by relying on information meeting the three conditions; therefore, evidence rebutting the presumption would have to be based on facts or information other than third-party information satisfying the presumption of compliance conditions of § 226.42(f)(3). This comment also explains that, if a creditor or its agent does not rely on information that meets the conditions in § 226.42(f)(3), the creditor's and its agent's compliance with the requirement to compensate fee appraisers at a customary and reasonable rate is determined based on all of the facts and circumstances without a presumption of either compliance or violation.

Comment 42(f)(3)–2 clarifies that the term "geographic market" is explained in comment 42(f)(1)–2. *See* the section-by-section analysis to § 226.42(f)(1). Comment 42(f)(3)–3 clarifies that whether rates may reasonably be considered "recent" under § 226.42(f)(3) depends on the facts and circumstances. Generally, however, "recent" rates would include rates charged within one year of the creditor's or its agent's reliance on this information to qualify for the presumption of compliance under § 226.42(f)(3).

In discussions with Board staff, concerned parties argued that existing appraisal fee schedules, surveys and studies have various flaws and thus may not be reliable indicators of customary and reasonable rates for appraisals in all home-secured consumer credit transactions. In preparing this interim final rule, the Board did not identify appraisal fee schedules, surveys or studies that would be appropriate to designate as a "safe harbor" for creditors and their agents to comply with § 226.42(f)(1). The Board solicits comment on whether and on what basis the final rule should give creditors or their agents a safe harbor for relying on a fee study or similar source of compiled appraisal fee information. The Board also requests comment on what additional guidance may be needed regarding third-party rate information on which a creditor and its agents may appropriately rely to qualify for the presumption of compliance.

42(f)(4) Definitions

Section 226.24(f)(4) defines three terms for purposes of § 226.42(f): "Fee appraiser," "appraisal services," and "appraisal management company."

Fee Appraiser

First, the term "fee appraiser" is defined to mean—

(1) A natural person who is a state-licensed or state-certified appraiser and receives a fee for performing an appraisal, but who is not an employee of the person engaging the appraiser (§ 226.42(f)(4)(i)(A)); or

(2) An organization that, in the ordinary course of business, employs state-licensed or state-certified

appraisers to perform appraisals, receives a fee for performing appraisals, and is not subject to the requirements of section 1124 of FIRREA, 12 U.S.C. 3331 *et seq.* (§ 226.42(f)(4)(i)(B)).

The interim final rule's definition of "fee appraiser" is intended to be consistent with the statute, as well as the Board's longstanding use of the term and with the meaning of "fee appraiser" generally accepted in the appraisal industry.[44] Thus, the interim final rule specifies that a fee appraiser includes a natural person who is a state-licensed or state-certified appraiser hired on a contract or other non-permanent basis to perform appraisal services.

Comment 42(f)(4)(i)–1 clarifies that the term "organization" in § 226.42(f)(4)(i)(B) includes a corporation, partnership, proprietorship, association, cooperative, or other business entity and does not include a natural person. Section 226.42(f)(4)(i)(B) also cross-references section 1124 of FIRREA. The Dodd-Frank Act added Section 1124 to FIRREA. Section 1124 requires the federal banking agencies and the FHFA to issue rules that require AMCs (as newly defined in FIRREA Section 1121) to register with state appraiser certifying and licensing agencies according to minimum criteria set by these rules.[45] Thus, only entities that perform appraisals and that would not be required to register under the new rules satisfy the definition of fee appraiser. Unlike AMCs as defined under FIRREA and commonly known in the industry, these entities do not merely perform managerial tasks regarding the appraisal process, but oversee individual appraisers whom they employ to perform the appraisal. The definition of "appraisal management company" for purposes of the registration requirement under FIRREA is further addressed below in the discussion of the interim final rule's definition of "appraisal management company" under § 226.42(f)(4)(iii).

Appraisal Services

Section 226.42(f)(4)(ii) states that, for purposes of § 226.42(f), "appraisal services" include only the services required to perform the appraisal, such as defining the scope of work, inspecting the property, reviewing necessary and appropriate public and private data sources (for example, multiple listing services, tax assessment records and public land records), developing and rendering an opinion of value, and preparing and submitting the appraisal report. The Board understands that agents of the creditor such as AMCs split the total appraisal fee between the AMC (for appraisal management functions) and the appraiser (for the appraisal). The interim final rule is thus intended to clarify that the customary and reasonable rate applies to compensation for tasks that the fee appraiser performs, not the entire cost of the appraisal (including management functions).

Appraisal Management Company

Section 226.42(f)(4)(iii) defines an "appraisal management company" in § 226.42(f) as any person authorized to do the following actions on behalf of the creditor—(1) recruit, select, and retain appraisers; (2) contract with appraisers to perform appraisal assignments; (3) manage the process of having an appraisal performed, including providing administrative duties such as receiving appraisal orders and appraisal reports, submitting completed appraisal reports to creditors and underwriters, collecting fees from creditors and underwriters for services provided, and compensating appraisers for services performed; or (4) review and verify the work of appraisers. This definition is based on the new definition of "appraisal management company" in the Dodd-Frank Act's amendments to FIRREA, for purposes of requiring AMCs to register with the appropriate state appraiser certifying and licensing agency and related purposes.[46] The sole difference between the definitions is that the definition under FIRREA limits the meaning of AMC to entities that oversee a network or panel of more than 15 certified or licensed appraisers in a state or 25 or more nationally within a given year.

For purposes of FIRREA's requirement that AMCs register, the Board understands that Congress may have sought to relieve smaller entities from administrative burdens by excluding them from this requirement. It is not clear, however, that FIRREA's more limited definition of AMC is appropriate under TILA Section 129E(i); this TILA provision is a technical requirement regarding the content of fee studies rather than a direct administrative obligation imposed on AMCs. The interim final rule therefore does not limit the meaning of "appraisal management company" to entities with an appraiser panel of a particular size. The Board requests comment on whether the interim final rule's definition of "appraisal management company" is appropriate for the final rule.

42(g) Mandatory Reporting

TILA Section 129E(e) requires certain persons to report an appraiser to the applicable state appraiser certifying and licensing agency if the person has a reasonable basis to believe the appraiser is failing to comply with USPAP, is violating applicable laws, or is otherwise engaging in unethical or unprofessional conduct. 15 U.S.C. 1639e(e). This provision applies to creditors, mortgage brokers, real estate brokers, appraisal management companies, and any other persons providing a service for a covered transaction. The interim final rule implements this requirement in § 226.42(g). The Act does not expressly define the term "appraiser" for purposes of TILA Section 129E(e). TILA Section 129E(e) is intended to enable state certifying and licensing agencies to exercise the authority granted to them under state law. Therefore, for purposes of § 226.42(g), an "appraiser" is a natural person who provides opinions of the value of dwellings and is required to be licensed or certified under the laws of the state in which the consumer's principal dwelling or otherwise is subject to the jurisdiction of the state appraiser certifying and licensing agency. *See* comment 42(g)–6.

42(g)(1) Reporting Required

Section 226.42(g)(1) 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. Further, § 226.42(g) clarifies that reporting of a failure to comply with an ethical or professional requirement is required only if the requirement is codified in an applicable state or federal statute or regulation (ethical or professional requirement). Other statutes or regulations may contain broader reporting requirements, however.

The Board interprets TILA Section 129E(e) to apply only to a material failure to comply with USPAP or a codified standard of ethical or professional conduct. The Board believes that this interpretation is consistent with the Act's purpose of ensuring that values assigned to a consumer's principal dwelling are assigned free of any coercion or inappropriate influence, so that

[44] *See, e.g.,* 12 CFR 225.65; Interagency Guidelines, SR 94–55 (Oct. 28, 1994).

[45] *See* Dodd-Frank Act, Section 1473(f) (amending FIRREA Sections 1121 and 1124), Public Law 111–203, 124 Stat. 2191–2192 (to be codified at 12 U.S.C. 3332 and 3353, respectively).

[46] *Id.*

creditors base their underwriting decisions on appraisals that do not misstate the value of the dwelling. Thus, the interim final rule mandates reporting failures to comply that would affect the value assigned to the dwelling. The Board solicits comment on whether reporting should be required only if a material failure to comply causes the value assigned to the consumer's principal dwelling to differ from the value that would have been assigned had the material failure to comply not occurred by more than a certain tolerance, for example, by 10 percent or more.

Reasonable basis. TILA Section 129E(e) requires reporting only if a covered person has a "reasonable basis to believe" that an appraiser has not complied with USPAP or ethical or professional requirements. 15 U.S.C. 1639e(e). Comment 42(g)(1)–1 states that a covered person has a reasonable basis to believe that an appraiser has materially failed to comply with USPAP or ethical or professional requirements if the person 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 requirements.

Examples of material failures to comply. Comment 42(g)(1)–2 provides the following examples of a material failure to comply: (1) Materially mischaracterizing the value of the consumer's principal dwelling, in violation of § 226.42(c)(2); (2) performing an appraisal in a grossly negligent manner, in violation of a USPAP rule; and (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. Comment 42(g)(1)–3 clarifies that § 226.42(g)(1) does not require reporting of failure to comply that is not material within the meaning of § 226.42(g)(1). For example, an appraiser's disclosure of confidential information, in violation of applicable state law, or an appraiser's failure to maintain errors and omissions insurance, in violation of applicable state law, would not be material for purposes of § 226.42(g)(1).

Coverage of reporting requirement. TILA Section 129E(e) provides that any mortgage lender, mortgage broker, mortgage banker, real estate broker, appraisal management company, employee of an appraisal management company, or any other person "involved in a real estate transaction" must report failures to comply with USPAP or ethical or professional requirements. 15 U.S.C. 1639e(e). Section 226.42(g)(1) provides that a "covered person" must report a material failure to comply. *See* § 226.42(b)(1). Comment 42(g)(1)–4 clarifies that "covered persons" required to report an appraiser's material failure to with USPAP or ethical or professional requirements in connection with a covered transaction include creditors, mortgage brokers, appraisers, appraisal management companies, real estate agents, and other persons that provide "settlement services" as defined under RESPA and regulations implementing RESPA.

Comment 42(g)(1)–5 clarifies that the following persons are not "covered persons" required to report an appraiser's material failure to comply with USPAP or ethical or professional requirements: (1) The consumer who obtains credit through a covered transaction; (2) a person secondarily liable for a covered transaction, such as a guarantor; and (3) a person that resides in or will reside in the consumer's principal dwelling but will not be liable on the covered transaction, such as a non-obligor spouse. Comments 42(g)(1)–4 and –5 are consistent with commentary on the definition of "covered person," discussed in detail above in the section-by-section analysis of § 226.42(b)(2).

42(g)(2) Timing of Reporting

TILA Section 129E(e) does not establish a time by which a person must report a failure to comply with USPAP or ethical or professional requirements. Section 226.42(g)(2) provides that a covered person must report a material failure to comply within a reasonable period of time after the person determines that there is a reasonable basis to believe that such a material failure to comply has occurred. The Board requests comment on what constitutes a reasonable period of time within which to report a material failure to comply under § 226.42(g).

42(g)(3) Definition

Section 226.42(g) requires covered persons to report a failure to comply to the appropriate "state agency." Consistent with the statute, § 226.42(g)(3) defines the term "state agency" to mean the "state appraiser certifying and licensing agency" as defined by Title XI of FIRREA, codified under 12 U.S.C. 3350(1), and any implementing regulations. Section 226.42(g)(3) clarifies that the agency for the state in which the consumer's principal dwelling is located is the appropriate agency to which to report a material failure to comply.

V. Effective Date and Mandatory Compliance Date

This interim final rule is effective on December 27, 2010 and compliance with it is mandatory for all applications received by a creditor on or after April 1, 2011. The Dodd-Frank Act does not provide effective or mandatory compliance dates for rules implementing TILA Section 129E. Appraisers have generally urged the Board to act quickly to put the interim rule in place, noting that the Dodd-Frank Act effectively sunsets the HVCC when the Board's interim final rule is promulgated. Some industry representatives, on the other hand, have stated that they will need sufficient lead time to implement the interim final rule.

Under TILA Section 105(d), certain of the Board's disclosure requirements are to have an effective date of October 1 that follows the issuance by at least six months. 15 U.S.C. 1604(d). However, the Board may at its discretion lengthen the implementation period for creditors to adjust their forms to accommodate new requirements, or shorten the period where the Board finds that such action is necessary to prevent unfair or deceptive disclosure practices. There is no similar effective date provision for non-disclosure requirements. The Riegle Community Development and Regulatory Improvement Act of 1994, however, requires that agency regulations which impose additional reporting, disclosure and other requirements on insured depository institutions take effect on the first day of a calendar quarter following publication in final form. 12 U.S.C. 4802(b).

The Board believes a mandatory compliance date of April 1, 2011 will provide creditors and others subject to the rule sufficient time to take the steps necessary to comply. Although some provisions in the interim final rule are similar to existing § 226.36(b), the interim final rule contains new requirements, such as the reasonable and customary fee requirement. In addition, the rule covers HELOCs, whereas existing § 226.36(b) applies only to closed-end loans secured by the consumer's principal dwelling. The rule's new requirements will likely require creditors and AMCs to change their systems, adjust policies, and train staff. The Board believes that five months should be sufficient for these purposes. Accordingly, the interim final rule is mandatory for consumer credit transactions secured by the consumer's principal dwelling in which an application is received by the creditor on or after April 1, 2011.

As noted, certain provisions of this interim final rule are substantially similar to the provisions of current § 226.36(b). The Board is therefore removing § 226.36(b) and related staff commentary, effective April 1, 2011, for applications received on or after that date. Section 226.36(b) remains in effect until compliance with this interim final rule becomes mandatory, and it applies to credit applications received before April 1, 2011, even if the credit is not extended until after that date. Thus, if a creditor receives an application for a loan that will be secured by the consumer's principal dwelling on March 20, 2011, and the loan is consummated on May 1, 2011, § 226.36(b) applies to that transaction. The Board notes, however, that covered persons may wish to comply with this interim final rule before April 1, 2011, and may do so. Compliance with § 226.42 constitutes compliance with § 226.36(b). Accordingly, creditors, mortgage brokers, and their affiliates subject to § 226.36(b) may comply with this interim final rule for applications received by creditors before April 1, 2011, in lieu of complying with § 226.36(b).

VI. Initial Regulatory Flexibility Analysis

In accordance with section 4 of the Regulatory Flexibility Act (RFA), 5 U.S.C. 601 *et seq.,* the Board is publishing an initial regulatory flexibility analysis for the interim final rule. The RFA generally requires an agency to assess the impact a rule is expected to have on small entities.[47] Based on its analysis and for the reasons stated below, the Board believes that this interim final rule will have a significant economic impact on a substantial number of small entities. The Board invites comments on the effect of the interim final rule on small entities.

A. Reasons for the Interim Final Rule

As discussed above in the **SUPPLEMENTARY INFORMATION**, Section 1472 of the Dodd-Frank Act amended TILA by inserting a new section 129E. Section 129E makes it unlawful to engage in any act that violates appraisal independence in consumer credit transactions secured by the consumer's principal dwelling. The Dodd-Frank Act requires the Board to prescribe interim final rules within 90 days of enactment to define with specificity the acts or practices that violate appraisal independence.

B. Summary of the Dodd-Frank Act

As discussed above in the **SUPPLEMENTARY INFORMATION**, the Dodd-Frank Act prohibits any person, in extending credit or providing services, from violating appraisal independence for consumer credit transactions secured by the consumer's principal dwelling. The Dodd-Frank Act specifies that practices that violate appraisal independence include: (1) Coercing or otherwise influencing any person, appraisal management company, firm or other entity conducting or involved in an appraisal for the purpose of causing the appraised value to be based on any factor other than the appraiser's independent judgment; (2) mischaracterizing or suborning any mischaracterization of the appraised value; (3) seeking to influence or encourage a target value in order to make or price a transaction; and (4) withholding or threatening to withhold timely payment for appraisal services or reports.

The Dodd-Frank Act also prohibits appraisers and appraisal management companies from having direct or indirect interest, financial or otherwise, in the property or transaction. In addition, the Dodd-Frank Act prohibits a creditor from extending credit if the creditor knows before consummation that a violation of the prohibition on appraiser coercion or the conflict of interest provision has occurred, unless the creditor performs due diligence. Under the Dodd-Frank Act, a creditor or any person providing services in connection with the transaction who has a reasonable basis to believe an appraiser is failing to comply with the Uniform Standards of Professional Appraisal Practice, or is engaging in unethical or unprofessional conduct in violation of applicable law, must refer the issue to the state appraiser certifying and licensing agency. The Dodd-Frank Act also requires that creditors and their agents compensate fee appraisers at a customary and reasonable rate for the market area of the property appraised.

C. Statement of Objectives and Legal Basis

The **SUPPLEMENTARY INFORMATION** sets forth the objectives and the legal basis for the interim final rule. In summary the objectives of the interim final rule are to ensure that appraisals used to support creditors' underwriting decisions for consumer credit transactions secured by the consumer's principal dwelling are based on the appraiser's independent professional judgment, free of any influence or pressure that may be exerted by parties that have an interest in the transaction. The amendments also seek to ensure that creditors and their agents pay customary and reasonable fees to appraisers.

The legal basis for the interim final rule is in Sections 105(a) and 129E(g) of TILA. A more detailed discussion of the Board's rulemaking authority is set forth in part III of the **SUPPLEMENTARY INFORMATION**.

D. Description of Small Entities to Which the Interim Final Rule Would Apply

The interim final rule would apply 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. Because of this, the requirements of the interim final rule will apply to a substantial number of parties, which include banks, credit unions, mortgage companies, mortgage brokers, appraisers, appraisal management companies, title insurance companies, and realtors. The Board is not aware of a reliable source for the total number of small entities likely to be affected by the final rule, but provides the following information and estimates about certain entities subject to the interim final rule.

Depository institutions and mortgage companies. The Board can identify through data from Reports of Condition and Income (call reports) the approximate numbers of small depository institutions that will be subject to the final rule. Based on March 2010 call report data, approximately 8,845 small institutions would be subject to the final rule. Approximately 15,658 depository institutions in the United States filed call report data, approximately 11,148 of which had total domestic assets of $175 million or less and thus were considered small entities for purposes of the Regulatory Flexibility Act. Of 3,898 banks, 523 thrifts and 6,727 credit unions that filed call report data and were considered small entities, 3,776 banks, 496 thrifts, and 4,573 credit unions, totaling 8,845 institutions, extended mortgage credit. For purposes of this analysis, thrifts include savings banks, savings and loan entities, co-operative banks and industrial banks.

[47] Under standards the U.S. Small Business Administration sets (SBA), an entity is considered "small" if it had $175 million or less in assets for banks and other depository institutions; and $6.5 million or less in revenues for non-bank mortgage lenders, mortgage brokers, and loan servicers. U.S. Small Business Administration, Table of Small Business Size Standards Matched to North American Industry Classification System Codes, available at *http://www.sba.gov/idc/groups/public/documents/sba_homepage/serv_sstd_tablepdf.pdf.*

Further, 1,507 non-depository institutions (independent mortgage companies, subsidiaries of a depository institution, or affiliates of a bank holding company) filed HMDA reports in 2009 for 2008 lending activities. Based on the small volume of lending activity reported by these institutions, most are likely to be small entities.

Similarly, the Board cannot identify with certainty the number of mortgage brokers, appraiser, realtors, appraisal management companies, or title insurance companies subject to the rule that also qualify as small entities. The Board can, however, attempt to estimate approximate total numbers of each group.

Mortgage brokers. In its 2008 proposed rule under HOEPA, 73 FR 1672, 1720; Jan. 9, 2008, the Board noted that, according to the National Association of Mortgage Brokers (NAMB), there were 53,000 mortgage brokerage companies in 2004 that employed an estimated 418,700 people.[48] On the other hand, the U.S. Census Bureau's 2002 Economic Census indicates that there were only 17,041 "mortgage and nonmortgage loan brokers" in the United States at that time.[49] The Census Bureau's 2007 Economic Census preliminary data indicate that there are approximately 24,299 "mortgage and nonmortgage loan brokers establishments" with approximately 134,507 employees.[50]

Appraisers. The Census Bureau's 2007 Economic Census preliminary data indicate that there are approximately 16,018 "offices of real estate appraisers" employing 43,999 employees.[51] Based on information provided by the Appraisal Subcommittee the Board estimates that, as of October 2010, there are approximately 93,429 individual, licensed appraisers. That number includes some appraisers that do not conduct appraisals of 1–4 family residential properties.

Realtors. According to the National Association of Realtors' September 2010 Monthly membership report, there are at least 1,088,919 Realtors in the United States that would be subject to the interim final rule.[52] The Census Bureau's 2007 Economic Census preliminary data, however, indicate approximately 108,651 "offices of real estate agents and brokers" with 360,560 total employees.[53]

Appraisal management companies. The Board is not aware of any source of information about the number of appraisal management companies.

Title insurance companies. While the Census Bureau has not yet released data for title insurance companies, according to the Census Bureau's 2006 Statistics of U.S. Business, there were approximately 6,943 "direct title insurance carriers" which employ approximately 105,145 payroll employees.[54]

Title, abstract, and settlement services. Preliminary data from the Census Bureau's 2007 Economic Census indicate that there were approximately 12,160 title, abstract, and settlement offices employing 18,749,687 employees.[55]

Surveying and Mapping. Preliminary data from the Census Bureau's 2007 Economic Census indicate that there were approximately 9,690 surveying and mapping establishments (excluding establishments that provide geophysical services) employing 69,941 employees.[56]

Escrow agents. The Census Bureau's 2007 Economic Census does not contain a separate category for escrow agents but rather includes escrow agents in the category "Other activities related to real estate." (That category excludes lessors of real estate, offices of real estate agents and brokers, real estate property managers, and offices of real estate appraisers.) Preliminary data from the 2007 Economic Census indicate that approximately 16,504 establishments, employing 72,058 employees, were in that category.[57] The Board is not aware of a comprehensive source of data specifically regarding the number of establishments providing escrow services.

Extermination and pest control services. Preliminary data from the Census Bureau's 2007 Economic Census indicate that approximately 12,523 establishments, employing 96,140 employees, provided extermination and pest control services.[58]

Legal services providers. Preliminary data from the Census Bureau's 2007 Economic Census indicate that there were approximately 189, 486 legal services establishments employing 1,199,306 employees, including approximately 174,523 lawyers' offices employing 1,107,394 employees.[59]

Credit bureaus. Preliminary data from the Census Bureau's 2007 Economic Census indicate that there were approximately 813 credit bureaus employing 19,866 employees.[60]

It is unclear exactly how many of these parties subject to the rule would meet the small business requirements. The Board believes, however, that most mortgage brokers, appraisers, realtors, title insurance companies, title abstract and settlement service providers, surveying and mapping establishments, escrow services providers, exterminators and pest control providers, and legal services providers are small entities. The Board notes that some of these entities may, as a practical matter, have little opportunity or incentive to coerce or influence an appraiser, or to have a reasonable basis to believe that an appraiser has not complied with USPAP or other applicable authorities. In such cases, these entities may have little or no compliance burden. As noted in the **SUPPLEMENTARY INFORMATION**, the Board is soliciting comment on whether some settlement service providers should be exempt from some or all of the interim final rule's requirements.

E. Projected Reporting, Recordkeeping, and Other Compliance Requirements

The compliance requirements of the final rules are described in the **SUPPLEMENTARY INFORMATION**. As indicated above, creditors and mortgage brokers currently are subject to the 2008 Appraisal Independence Rules, which are essentially codified in section 1472 of the Dodd-Frank Act. The interim final rule, consistent with the Dodd-Frank

[48] *http://www.namb.org/namb/Industry Facts.asp?SnID=719224934.* This page of the NAMB Web site, however, no longer provides an estimate of the number of mortgage brokerage companies.

[49] *http://www.census.gov/prod/ec02/ec0252a1us.pdf* (NAICS code 522310).

[50] *http://factfinder.census.gov/servlet/IBQTable?_bm=y&-ds_name=EC0752I1&-ib_type=NAICS2007&-NAICS2007=522310.*

[51] *http://factfinder.census.gov/servlet/IBQTable?_bm=y&-ds_name=EC0753I1&-ib_type=NAICS2007&-NAICS2007=531320.*

[52] *http://www.realtor.org/wps/wcm/connect/2b353d80442806058dc6ed34cafa6d66/09-2010.pdf?MOD=AJPERES&CACHEID=2b353d80442806058dc6ed34cafa6d66.*

[53] *http://factfinder.census.gov/servlet/IBQTable?_bm=y&-ds_name=EC0753I1&-ib_type=NAICS2007&-NAICS2007=531210.*

[54] *http://www.census.gov/epcd/susb/latest/us/US524127.HTM.*

[55] *http://factfinder.census.gov/servlet/IBQTable?_bm=y&-ds_name=EC0754I1&-NAICS2007=541191&-ib_type=NAICS2007&-geo_id=&-_industry=541191&-_lang=en&-fds_name=EC0700A1.*

[56] *http://factfinder.census.gov/servlet/IBQTable?_bm=y&-ds_name=EC0754I1&-ib_type=NAICS2007 NAICS2007&-NAICS2007=541370.*

[57] *http://factfinder.census.gov/servlet/IBQTable?_bm=y&-ds_name=EC0753I1&-ib_type=NAICS2007&-NAICS2007=531390.*

[58] *http://factfinder.census.gov/servlet/IBQTable?_bm=y&-ds_name=EC0756I1&-NAICS2007=561710&-ib_type=NAICS2007&-geo_id=&-_industry=561710&-_lang=en&-fds_name=EC0700A1.*

[59] *http://factfinder.census.gov/servlet/IBQTable?_bm=y&-ds_name=EC0754I1&-NAICS2007=5411/541110&-ib_type=NAICS2007&-_industry=541110&-_lang=en&-fds_name=EC0700A1.*

[60] *http://factfinder.census.gov/servlet/IBQTable?_bm=y&-ds_name=EC0756I1&-NAICS2007=561450&-ib_type=NAICS2007&-geo_id=&-_industry=561450&-_lang=en&-fds_name=EC0700A1.*

Act, expands the parties covered by those provisions to persons who provide settlement services in connection with a covered transaction. Moreover, as discussed in the **SUPPLEMENTARY INFORMATION**, the Dodd-Frank Act expands the requirements for appraisal independence significantly beyond the requirements in the 2008 Appraisal Independence Rules. The effect of the interim final rule on small entities is unknown. Some small entities would be required, among other things, to modify their systems to comply with the interim final rules. The precise costs to small entities of updating their systems are difficult to predict.

F. Other Federal Rules

The Board has not identified any federal rules that conflict with the proposed interim final rule. The Board has identified, however, several federal rules that overlap to varying degrees with the requirements of the interim final rule. Title XI of FIRREA, enacted in 1989, provides that the Board and the other banking agencies must issue regulations for appraisal standards. These regulations include provisions on appraisal independence which overlap with the interim final rule.[61] In addition, the Equal Credit Opportunity Act, 15 U.S.C. 1691 *et seq.,* and the Board's Regulation B, 12 CFR 202.14, require creditors to provide a copy of an appraisal report used in connection with an application for credit secured by a dwelling.[62] As noted, the 2008 Appraisal Independence Rules addressed appraiser independence; those rules, however, are removed effective on April 1, 2011, the mandatory compliance date for the interim final rule.

Additionally, both the Veteran's Administration and Federal Housing Administration provide guidance related to appraiser fees which overlap with the interim final rule. The VA provides a specific appraiser fee schedule for VA loans, while FHA Roster appraisers are compensated at a rate that is customary and reasonable for the market area of the property.[63]

G. Significant Alternatives to the Interim Final Rule

As noted above, the final rule implements the statutory requirements of the Dodd-Frank Act. The Board has implemented these requirements to minimize burden while retaining benefits and protections for consumers. As discussed above in parts of the **SUPPLEMENTARY INFORMATION** the Board has provided small institutions, defined as creditors with assets of $250 million or less as of December 31 of either of the two preceding calendar years, with an alternative safe harbor to the prohibition on conflicts of interest that is tailored to the circumstances of small creditors. The Board welcomes comment on any significant alternatives that would minimize the impact of the interim final rule on small entities.

The Board also welcomes further information and comment on any costs, compliance requirements, or changes in operating procedures arising from the application of the interim final rule to small business.

VII. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3506; 5 CFR part 1320 Appendix A.1), the Board reviewed the interim final rule under the authority delegated to the Board by the Office of Management and Budget (OMB). The collection of information that is required by this final rule is found in Subpart E—Special Rules for Certain Home Mortgage Transactions—12 CFR 226.42(g). The Board may not conduct or sponsor, and an organization is not required to respond to, this information collection unless the information collection displays a currently valid OMB control number. The OMB control number is 7100–0199.

This information collection is required to provide benefits for consumers and is mandatory (15 U.S.C. 1601 *et seq.*). Since the Board does not collect any information, no issue of confidentiality arises. The respondents/recordkeepers for this interim final rulemaking are creditors, appraisal management companies, appraisers, mortgage brokers, realtors, title insurers and other firms that provide settlement services (covered person(s)).

TILA and Regulation Z are intended to ensure effective disclosure of the costs and terms of credit to consumers. For closed-end loans, such as mortgage and installment loans, cost disclosures are required to be provided prior to consummation. Special disclosures are required in connection with certain products, such as reverse mortgages, certain variable-rate loans, and certain mortgages with rates and fees above specified thresholds. To ease the burden and cost of complying with Regulation Z (particularly for small entities), the Board provides model forms, which are appended to the regulation. TILA and Regulation Z also contain rules concerning credit advertising. Creditors are required to retain evidence of compliance with Regulation Z for 24 months (12 CFR 226.25), but Regulation Z does not specify the types of records that must be retained.

Under the PRA, the Board accounts for the paperwork burden associated with Regulation Z for the state member banks and other entities supervised by the Board that engage in activities covered by Regulation Z and, therefore, are respondents under the PRA. Appendix I of Regulation Z defines the institutions supervised by the Federal Reserve System as: State member banks, branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act. Other Federal agencies account for the paperwork burden imposed on the entities for which they have administrative enforcement authority under TILA.

The current total annual burden to comply with the provisions of Regulation Z is estimated to be 1,497,362 hours for the 1,138 institutions supervised by the Federal Reserve that are deemed to be respondents for the purposes of the PRA.

As discussed in the preamble, the Board is adopting a rule that requires reporting of a violation of Uniform Standards of Professional Appraisal Practice (USPAP) or of a standard of ethical or professional conduct under applicable state or federal statute or regulation only if the violation is material, that is, if the violation is likely to affect the value assigned to a covered property. The new reporting requirement will impose a one-time increase in the total annual burden under Regulation Z for respondents supervised by the Federal Reserve involved in the extension of consumer credit that is secured by the principal dwelling of the consumer. The Board estimates that 567 respondents[64]

[61] Board: 12 CFR 225.65; OCC: 12 CFR 34.45; FDIC: 12 CFR 323.5; OTS: 12 CFR 564.5; NCUA: 12 CFR 722.5. The agencies have also issued supervisory guidance on appraisal independence: *See, e.g.,* Interagency Guidelines, SR 94–55.

[62] Section 1474 of the Dodd-Frank Act amends the ECOA's requirement to provide a copy of the appraisal report to the consumer. Public Law 111–203, 124 Stat. 2199 (to be codified at 15 U.S.C. 1691).

[63] Veterans Administration fee schedule, (as of Apr. 7, 2010), available at *http://www.benefits.va.gov/homeloans/fee_timeliness.asp;* Appraiser Independence HUD Mortgagee Letter 2009–28 (Sept. 18, 2009).

[64] Based on loan transactions reported for 2009 under the Home Mortgage Disclosure Act (HMDA), 12 U.S.C. 2801 *et seq.;* 12 CFR part 203, the Board estimates that 567 institutions engaged in such

Continued

supervised by the Federal Reserve will take, on average, 40 hours (one business week) to update their systems, internal procedure manuals, and provide training for relevant staff to comply with the new reporting requirements in § 226.42(g)(1).[65] This revision is estimated to result in a one-time increase in burden by 22,680 hours.

Accordingly, the Board estimates that the new reporting requirement will increase the total annual burden on a one-time basis for respondents supervised by the Federal Reserve from 1,497,362 to 1,520,042 hours.[66] This total estimated burden increase represents averages for all respondents supervised by the Federal Reserve. The Board expects that the amount of time required to implement each of the changes for a given institution may vary based on the size and complexity of the respondent.

The other Federal financial institution supervisory agencies (the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Administration (NCUA)) are responsible for estimating and reporting to OMB the total paperwork burden for the domestically chartered commercial banks, thrifts, and Federal credit unions and U.S. branches and agencies of foreign banks for which they have primary administrative enforcement jurisdiction under TILA Section 108(a), 15 U.S.C. 1607(a). These agencies may, but are not required to, use the Board's methodology for estimating burden. Using the Board's method, the total current estimated annual burden for the approximately 16,200 domestically chartered commercial banks, thrifts, and federal credit unions and U.S. branches and agencies of foreign banks supervised by the Board, OCC, OTS, FDIC, and NCUA under TILA would be approximately 21,813,445 hours. The final rule will impose a one-time increase in the estimated annual burden for the estimated 6,543 institutions thought to engage in mortgage transactions by 261,720 hours. The total annual burden is estimated to be 22,075,165 hours. The above estimates represent an average across all respondents and reflect variations between institutions based on their size, complexity, and practices.

The Board has a continuing interest in the public's opinions of its collections of information. At any time, comments regarding the burden estimate or any other aspect of this collection of information, including suggestions for enhancing the quality of information collected and ways for reducing the burden on respondent. Comments on the collection of information may be sent to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551; and to the Office of Management and Budget, Paperwork Reduction Project (7100–0199), Washington, DC 20503.

List of Subjects in 12 CFR Part 226

Consumer protection, Federal Reserve System, Mortgages, Truth in lending.

Authority and Issuance

■ For the reasons set forth in the preamble, the Board amends Regulation Z, 12 CFR part 226, as set forth below:

PART 226—TRUTH IN LENDING (REGULATION Z)

■ 1. The authority citation for part 226 is revised to read as follows:

Authority: 12 U.S.C. 3806; 15 U.S.C. 1604, 1637(c)(5), 1639(l); Pub. L. 111–24 § 2, 123 Stat. 1734; Pub. L. 111–203 § 1472(a), 124 Stat. 1376, 2188 (to be codified at 15 U.S.C. 1639e).

Subpart E—Special Rules for Certain Home Mortgage Transactions

§ 226.36 [Amended]

■ 2. Effective April 1, 2011, § 226.36 is amended by removing and reserving paragraph (b).

■ 3. Effective December 27, 2010, new section 226.42 is added to read as follows:

§ 226.42 Valuation independence.

(a) *Scope.* This section applies to any consumer credit transaction secured by the consumer's principal dwelling.

(b) *Definitions.* For purposes of this section:

(1) "Covered person" means a creditor with respect to a covered transaction or a person that provides "settlement services," as defined in 12 U.S.C. 2602(3) and implementing regulations, in connection with a covered transaction.

(2) "Covered transaction" means an extension of consumer credit that is or will be secured by the consumer's principal dwelling, as defined in § 226.2(a)(19).

(3) "Valuation" means an estimate of the value of the consumer's principal dwelling in written or electronic form, other than one produced solely by an automated model or system.

(4) "Valuation management functions" means:

(i) Recruiting, selecting, or retaining a person to prepare a valuation;

(ii) Contracting with or employing a person to prepare a valuation;

(iii) Managing or overseeing the process of preparing a valuation, including by providing administrative services such as receiving orders for and receiving a valuation, submitting a completed valuation to creditors and underwriters, collecting fees from creditors and underwriters for services provided in connection with a valuation, and compensating a person that prepares valuations; or

(iv) Reviewing or verifying the work of a person that prepares valuations.

(c) *Valuation of consumer's principal dwelling*—(1) *Coercion.* In connection with a covered transaction, no covered person shall or shall attempt to directly or indirectly cause the value assigned to the consumer's principal dwelling to be based on any factor other than the independent judgment of a person that prepares valuations, through coercion, extortion, inducement, bribery, or intimidation of, compensation or instruction to, or collusion with a person that prepares valuations or performs valuation management functions.

(i) Examples of actions that violate paragraph (c)(1) include:

(A) Seeking to influence a person that prepares a valuation to report a minimum or maximum value for the consumer's principal dwelling;

(B) Withholding or threatening to withhold timely payment to a person that prepares a valuation or performs valuation management functions because the person does not value the consumer's principal dwelling at or above a certain amount;

(C) Implying to a person that prepares valuations that current or future retention of the person depends on the amount at which the person estimates the value of the consumer's principal dwelling;

(D) Excluding a person that prepares a valuation from consideration for future engagement because the person reports a value for the consumer's principal dwelling that does not meet or exceed a predetermined threshold; and

mortgage transactions are supervised by the Federal Reserve.

[65] The Board believes that, on a continuing basis, since financial institutions are familiar with the existing provisions Title XI of FIRREA (12 U.S.C. 3348) and the Interagency Guidelines (SR letter 94–55) which require similar reporting, implementation of requirements in § 226.42(g) should not be overly burdensome.

[66] The burden estimate for this rulemaking does not include the burden addressing changes to implement the following provisions announced in separate rulemakings:

- Closed-End Mortgages (Docket No. R–1366) (74 FR 43232) (75 FR 58470),
- Home-Equity Lines of Credit (Docket No. R–1367) (74 FR 43428), or
- Reverse Mortgages (Docket No. R–1390) (75 FR 58539).

(E) Conditioning the compensation paid to a person that prepares a valuation on consummation of the covered transaction.

(2) *Mischaracterization of value*—(i) *Misrepresentation.* In connection with a covered transaction, no person that prepares valuations shall materially misrepresent the value of the consumer's principal dwelling in a valuation. A misrepresentation is material for purposes of this paragraph (c)(2)(i) if it is likely to significantly affect the value assigned to the consumer's principal dwelling. A *bona fide* error shall not be a misrepresentation.

(ii) *Falsification or alteration.* In connection with a covered transaction, no covered person shall falsify and no covered person other than a person that prepares valuations shall materially alter a valuation. An alteration is material for purposes of this paragraph (c)(2)(ii) if it is likely to significantly affect the value assigned to the consumer's principal dwelling.

(iii) *Inducement of mischaracterization.* In connection with a covered transaction, no covered person shall induce a person to violate paragraph (c)(2)(i) or (ii) of this section.

(3) *Permitted actions.* Examples of actions that do not violate paragraph (c)(1) or (c)(2) include:

(i) Asking a person that prepares a valuation to consider additional, appropriate property information, including information about comparable properties, to make or support a valuation;

(ii) Requesting that a person that prepares a valuation provide further detail, substantiation, or explanation for the person's conclusion about the value of the consumer's principal dwelling;

(iii) Asking a person that prepares a valuation to correct errors in the valuation;

(iv) Obtaining multiple valuations for the consumer's principal dwelling to select the most reliable valuation;

(v) Withholding compensation due to breach of contract or substandard performance of services; and

(vi) Taking action permitted or required by applicable federal or state statute, regulation, or agency guidance.

(d) *Prohibition on conflicts of interest*—(1)(i) *In general.* No person preparing a valuation or performing valuation management functions for a covered transaction may have a direct or indirect interest, financial or otherwise, in the property or transaction for which the valuation is or will be performed.

(ii) *Employees and affiliates of creditors; providers of multiple settlement services.* In any covered transaction, no person violates paragraph (d)(1)(i) of this section based solely on the fact that the person—

(A) Is an employee or affiliate of the creditor; or

(B) Provides a settlement service in addition to preparing valuations or performing valuation management functions, or based solely on the fact that the person's affiliate performs another settlement service.

(2) *Employees and affiliates of creditors with assets of more than $250 million for both of the past two calendar years.* For any covered transaction in which the creditor had assets of more than $250 million as of December 31st for both of the past two calendar years, a person subject to paragraph (d)(1)(i) of this section who is employed by or affiliated with the creditor does not have a conflict of interest in violation of paragraph (d)(1)(i) of this section based on the person's employment or affiliate relationship with the creditor if:

(i) The compensation of the person preparing a valuation or performing valuation management functions is not based on the value arrived at in any valuation;

(ii) The person preparing a valuation or performing valuation management functions reports to a person who is not part of the creditor's loan production function, as defined in paragraph (d)(5)(i) of this section, and whose compensation is not based on the closing of the transaction to which the valuation relates; and

(iii) No employee, officer or director in the creditor's loan production function, as defined in paragraph (d)(5)(i) of this section, is directly or indirectly involved in selecting, retaining, recommending or influencing the selection of the person to prepare a valuation or perform valuation management functions, or to be included in or excluded from a list of approved persons who prepare valuations or perform valuation management functions.

(3) *Employees and affiliates of creditors with assets of $250 million or less for either of the past two calendar years.* For any covered transaction in which the creditor had assets of $250 million or less as of December 31st for either of the past two calendar years, a person subject to paragraph (d)(1)(i) of this section who is employed by or affiliated with the creditor does not have a conflict of interest in violation of paragraph (d)(1)(i) of this section based on the person's employment or affiliate relationship with the creditor if:

(i) The compensation of the person preparing a valuation or performing valuation management functions is not based the value arrived at in any valuation; and

(ii) The creditor requires that any employee, officer or director of the creditor who orders, performs, or reviews a valuation for a covered transaction abstain from participating in any decision to approve, not approve, or set the terms of that transaction.

(4) *Providers of multiple settlement services.* For any covered transaction, a person who prepares a valuation or performs valuation management functions in addition to performing another settlement service for the transaction, or whose affiliate performs another settlement service for the transaction, does not have a conflict of interest in violation of paragraph (d)(1)(i) of this section as a result of the person or the person's affiliate performing another settlement service for the transaction if:

(i) The creditor had assets of more than $250 million as of December 31st for both of the past two calendar years and the conditions in paragraph (d)(2)(i)–(iii) are met; or

(ii) The creditor had assets of $250 million or less as of December 31st for either of the past two calendar years and the conditions in paragraph (d)(3)(i)–(ii) are met.

(5) *Definitions.* For purposes of this paragraph, the following definitions apply:

(i) *Loan production function.* The term "loan production function" means an employee, officer, director, department, division, or other unit of a creditor with responsibility for generating covered transactions, approving covered transactions, or both.

(ii) *Settlement service.* The term "settlement service" has the same meaning as in the Real Estate Settlement Procedures Act, 12 U.S.C. 2601 *et seq.*

(iii) *Affiliate.* The term "affiliate" has the same meaning as in Regulation Y, 12 CFR 225.2(a).

(e) *When extension of credit prohibited.* In connection with a covered transaction, a creditor that knows, at or before consummation, of a violation of paragraph (c) or (d) of this section in connection with a valuation shall not extend credit based on the valuation, unless the creditor documents that it has acted with reasonable diligence to determine that the valuation does not materially misstate or misrepresent the value of the consumer's principal dwelling. For purposes of this paragraph (e), a valuation materially misstates or misrepresents the value of the consumer's principal dwelling if the valuation contains a misstatement or misrepresentation that affects the credit decision or the terms on which credit is extended.

(f) *Customary and reasonable compensation*—(1) *Requirement to provide customary and reasonable compensation to fee appraisers.* In any covered transaction, the creditor and its agents shall compensate a fee appraiser for performing appraisal services at a rate that is customary and reasonable for comparable appraisal services performed in the geographic market of the property being appraised. For purposes of paragraph (f) of this section, "agents" of the creditor do not include any fee appraiser as defined in paragraph (f)(4)(i) of this section.

(2) *Presumption of compliance.* A creditor and its agents shall be presumed to comply with paragraph (f)(1) if—

(i) The creditor or its agents compensate the fee appraiser in an amount that is reasonably related to recent rates paid for comparable appraisal services performed in the geographic market of the property being appraised. In determining this amount, a creditor shall review the factors below and make any adjustments to recent rates paid in the relevant geographic market necessary to ensure that the amount of compensation is reasonable:

(A) The type of property,

(B) The scope of work,

(C) The time in which the appraisal services are required to be performed,

(D) Fee appraiser qualifications,

(E) Fee appraiser experience and professional record, and

(F) Fee appraiser work quality; and

(ii) The creditor and its agents do not engage in any anticompetitive acts in violation of state or federal law that affect the compensation paid to fee appraisers, including—

(A) Entering into any contracts or engaging in any conspiracies to restrain trade through methods such as price fixing or market allocation, as prohibited under section 1 of the Sherman Antitrust Act, 15 U.S.C. 1, or any other relevant antitrust laws; or

(B) Engaging in any acts of monopolization such as restricting any person from entering the relevant geographic market or causing any person to leave the relevant geographic market, as prohibited under section 2 of the Sherman Antitrust Act, 15 U.S.C. 2, or any other relevant antitrust laws.

(3) *Alternative presumption of compliance.* A creditor and its agents shall be presumed to comply with paragraph (f)(1) if the creditor or its agents determine the amount of compensation paid to the fee appraiser by relying on information about rates that:

(i) Is based on 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;

(ii) Is based on recent rates paid to a representative sample of providers of appraisal services in the geographic market of the property being appraised or the fee schedules of those providers; and

(iii) In the case of information based on fee schedules, studies, and surveys, such fee schedules, studies, or surveys, or the information derived therefrom, excludes compensation paid to fee appraisers for appraisals ordered by appraisal management companies, as defined in paragraph (f)(4)(iii) of this section.

(4) *Definitions.* For purposes of this paragraph (f), the following definitions apply:

(i) *Fee appraiser.* The term "fee appraiser" means—

(A) A natural person who is a state-licensed or state-certified appraiser and receives a fee for performing an appraisal, but who is not an employee of the person engaging the appraiser; or

(B) An organization that, in the ordinary course of business, employs state-licensed or state-certified appraisers to perform appraisals, receives a fee for performing appraisals, and is not subject to the requirements of section 1124 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3331 *et seq.*).

(ii) *Appraisal services.* The term "appraisal services" means the services required to perform an appraisal, including defining the scope of work, inspecting the property, reviewing necessary and appropriate public and private data sources (for example, multiple listing services, tax assessment records and public land records), developing and rendering an opinion of value, and preparing and submitting the appraisal report.

(iii) *Appraisal management company.* The term "appraisal management company" means any person authorized to perform one or more of the following actions on behalf of the creditor—

(A) Recruit, select, and retain fee appraisers;

(B) Contract with fee appraisers to perform appraisal services;

(C) Manage the process of having an appraisal performed, including providing administrative services such as receiving appraisal orders and appraisal reports, submitting completed appraisal reports to creditors and underwriters, collecting fees from creditors and underwriters for services provided, and compensating fee appraisers for services performed; or

(D) Review and verify the work of fee appraisers.

(g) *Mandatory reporting*—(1) *Reporting required.* Any covered person that reasonably believes an appraiser has not complied with the Uniform Standards of Professional Appraisal Practice or ethical or professional requirements for appraisers under applicable state or federal statutes or regulations shall refer the matter to the appropriate state agency if the failure to comply is material. For purposes of this paragraph (g)(1), a failure to comply is material if it is likely to significantly affect the value assigned to the consumer's principal dwelling.

(2) *Timing of reporting.* A covered person shall notify the appropriate state agency within a reasonable period of time after the person determines that there is a reasonable basis to believe that a failure to comply required to be reported under paragraph (g)(1) of this section has occurred.

(3) *Definition.* For purposes of this paragraph (g), "state agency" means "state appraiser certifying and licensing agency" under 12 U.S.C. 3350(1) and any implementing regulations. The appropriate state agency to which a covered person must refer a matter under paragraph (g)(1) of this section is the agency for the state in which the consumer's principal dwelling is located.

■ 4. In Supplement I to Part 226:

■ A. Under *Section 226.1—Authority, Purpose, Coverage, Organization, Enforcement and Liability,* paragraph 1(d)(5)–1 is revised.

■ B. Under *Section 226.5b—Requirements for Home-equity Plans,* new paragraph 7 is added.

■ C. Effective April 1, 2011, under *Section 226.36—Prohibited Acts or Practices in Connection with Credit Secured by a Consumer's Principal Dwelling,* the headings *36(b) Misrepresentation of the value of consumer's principal dwelling* and *36(b)(2) When extension of credit prohibited* and paragraphs 36(b)(2)–1 and –2 are removed.

■ D. Effective December 27, 2010, new *Section 226.42 Valuation Independence* is added.

Supplement I to Part 226—Official Staff Interpretations

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Section 226.1—Authority, Purpose, Coverage, Organization, Enforcement and Liability

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Paragraph 1(d)(5).

1. *Effective dates.*

i. The Board's revisions published on July 30, 2008 (the "final rules") apply to covered loans (including refinance loans and assumptions considered new transactions under § 226.20) for which the creditor receives an application on or after October 1, 2009, except for the final rules on advertising, escrows, and loan servicing. But see comment 1(d)(3)–1. The final rules on escrow in § 226.35(b)(3) are effective for covered loans (including refinancings and assumptions in § 226.20) for which the creditor receives an application on or after April 1, 2010; but for such loans secured by manufactured housing on or after October 1, 2010. The final rules applicable to servicers in § 226.36(c) apply to all covered loans serviced on or after October 1, 2009. The final rules on advertising apply to advertisements occurring on or after October 1, 2009. For example, a radio ad occurs on the date it is first broadcast; a solicitation occurs on the date it is mailed to the consumer. The following examples illustrate the application of the effective dates for the final rules.

A. *General.* A refinancing or assumption as defined in § 226.20(a) or (b) is a new transaction and is covered by a provision of the final rules if the creditor receives an application for the transaction on or after that provision's effective date. For example, if a creditor receives an application for a refinance loan covered by § 226.35(a) on or after October 1, 2009, and the refinance loan is consummated on October 15, 2009, the provision restricting prepayment penalties in § 226.35(b)(2) applies. However, if the transaction were a modification of an existing obligation's terms that does not constitute a refinance loan under § 226.20(a), the final rules, including for example the restriction on prepayment penalties, would not apply.

B. *Escrows.* Assume a consumer applies for a refinance loan to be secured by a dwelling (that is not a manufactured home) on March 15, 2010, and the loan is consummated on April 2, 2010. The escrow rule in § 226.35(b)(3) does not apply.

C. *Servicing.* Assume that a consumer applies for a new loan on August 1, 2009. The loan is consummated on September 1, 2009. The servicing rules in § 226.36(c) apply to the servicing of that loan as of October 1, 2009.

(ii) The interim final rule on appraisal independence in § 226.42 published on October 28, 2010 is mandatory on April 1, 2011, for open- and closed-end extensions of consumer credit secured by the consumer's principal dwelling. Section 226.36(b), which is substantially similar to § 226.42(b) and (e), is removed effective April 1, 2011. Applications for closed-end extensions of credit secured by the consumer's principal dwelling that are received by creditors before April 1, 2011, are subject to § 226.36(b) regardless of the date on which the transaction is consummated. However, parties subject to § 226.36(b) may, at their option, choose to comply with § 226.42 instead of § 226.36(b), for applications received before April 1, 2011. Thus, an application for a closed-end extension of credit secured by the consumer's principal dwelling that is received by a creditor on March 20, 2011, and consummated on May 1, 2011, is subject to § 226.36(b), however, the creditor may choose to comply with § 226.42 instead. For an application for open- or closed-end credit secured by the consumer's principal dwelling that is received on or after April 1, 2011, the creditor must comply with § 226.42.

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Section 226.5b—Requirements for Home-Equity Plans

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7. *Appraisals and other valuations.* For consumer credit transactions subject to § 226.5b and secured by the consumer's principal dwelling, creditors and other persons must comply with the requirements for appraisals and other valuations under § 226.42.

* * * * *

Section 226.42—Valuation Independence

42(a) Scope.

1. *Open- and closed-end credit.* Section 226.42 applies to both open-end and closed-end transactions secured by the consumer's principal dwelling.

2. *Consumer's principal dwelling.* Section 226.42 applies only if the dwelling that will secure a consumer credit transaction is the principal dwelling of the consumer who obtains credit.

42(b) Definitions.

Paragraph 42(b)(1).

1. *Examples of covered persons.* "Covered persons" include creditors, mortgage brokers, appraisers, appraisal management companies, real estate agents, and other persons that provide "settlement services" as defined under the Real Estate Settlement Procedures Act and implementing regulations. *See* 12 U.S.C. 2602(3).

2. *Examples of persons not covered.* The following persons are not "covered persons" (unless, of course, they are creditors with respect to a covered transaction or perform "settlement services" in connection with a covered transaction):

i. The consumer who obtains credit through a covered transaction.

ii. A person secondarily liable for a covered transaction, such as a guarantor.

iii. A person that resides in or will reside in the consumer's principal dwelling but will not be liable on the covered transaction, such as a non-obligor spouse.

Paragraph 42(b)(2).

1. *Principal dwelling.* The term "principal dwelling" has the same meaning under § 226.42(b) as under §§ 226.2(a)(24), 226.15(a), and 226.23(a). *See* comments 2(a)(24)–3, 15(a)–5, and 23(a)–3.

Paragraph 42(b)(3).

1. *Valuation.* 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.

2. *Automated model or system.* A "valuation" does not include an estimate of value produced exclusively using an automated model or system. However, a "valuation" includes an estimate of value developed by a natural person based in part on an estimate of value produced using an automated model or system.

3. *Estimate.* An estimate of the value of the consumer's principal dwelling includes an estimate of a range of values for the consumer's principal dwelling.

42(c) Valuation for consumer's principal dwelling.

42(c)(1) Coercion.

1. *State law.* The terms "coercion," "extortion," "inducement," "bribery," "intimidation," "compensation," "instruction," and "collusion" have the meanings given to them by applicable state law or contract. *See* § 226.2(b)(3).

2. *Purpose.* A covered person does not violate § 226.42(c)(1) if the person does not engage in an act or practice set forth in § 226.42(c)(1) for the purpose of causing the value assigned to the consumer's principal dwelling to be based on a factor other than the independent judgment of a person that prepares valuations. For example, requesting that a person that prepares a valuation take certain actions, such as consider additional, appropriate property information, does not violate § 226.42(c), because such request does not supplant the independent judgment of the person that prepares a valuation. *See* § 226.42(c)(3)(i). A covered person also may provide incentives, such as additional compensation, to a person that prepares valuations or performs valuation management functions under § 226.42(c)(1), 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 of the person that prepares valuations.

3. *Person that prepares valuations.* For purposes of § 226.42, the term "valuation" includes an estimate of value regardless of whether it is an appraisal prepared by a state-certified or -licensed appraiser. *See* comment 42(b)(5)–1. A person that prepares valuations may or may not be a state-licensed or state-certified appraiser. Thus a person violates § 226.42(c)(1) by engaging in prohibited acts or practices directed towards any person that prepares or may prepare a valuation of the consumer's principal dwelling for a covered transaction. For example, a person violates § 226.42(c)(1) by seeking to coerce a real estate agent to assign a value to the consumer's principal dwelling based on a factor other than the independent judgment of the real estate agent, in connection with a covered transaction.

4. *Indirect acts or practices.* Section 226.42(c)(1) prohibits both direct and indirect attempts to cause the value assigned to the consumer's principal dwelling to be based on a factor other than the independent judgment of the person that prepares the valuation, through coercion and certain other acts and practices. For example, a creditor violates § 226.42(c)(1) if the creditor attempts to cause the value an appraiser engaged by an appraisal management company assigns to the consumer's principal dwelling to be

based on a factor other than the appraiser's independent judgment, by threatening to withhold future business from a title company affiliated with the appraisal management company unless the appraiser assigns a value to the dwelling that meets or exceed a minimum threshold.

Paragraph 42(c)(1)(i).

1. *Applicability of examples.* Section 226.42(c)(1)(i) provides examples of coercion of a person that prepares valuations. However, § 226.42(c)(1)(i) also applies to coercion of a person that performs valuation management functions or its affiliate. *See* § 226.42(c)(1); comment 42(c)(1)–4.

2. *Specific value or predetermined threshold.* As used in the examples of actions prohibited under § 226.42(c)(1), a "specific value" and a "predetermined threshold" include a predetermined minimum, maximum, or range of values. Further, although the examples assume a covered person's prohibited actions are designed to cause the value assigned to the consumer's principal dwelling to equal or exceed a certain amount, the rule applies equally to cases where a covered person's prohibited actions are designed to cause the value assigned to the dwelling to be below a certain amount.

42(c)(2) Mischaracterization of value.

42(c)(2)(i) Misrepresentation.

1. *Opinion of value.* Section 226.42(c)(2)(i) prohibits a person that performs valuations from misrepresenting the value of the consumer's principal dwelling in a valuation. Such person misrepresents the value of the consumer's principal dwelling by assigning a value to such dwelling that does not reflect the person's opinion of the value of such dwelling. For example, an appraiser misrepresents the value of the consumer's principal dwelling if the appraiser estimates that the value of such dwelling is $250,000 applying the standards required by the Uniform Standards of Professional Appraisal Standards but assigns a value of $300,000 to such dwelling in a Uniform Residential Appraisal Report.

42(c)(2)(iii) Inducement of mischaracterization.

1. *Inducement.* A covered person may not induce a person to materially misrepresent the value of the consumer's principal dwelling in a valuation or to falsify or alter a valuation. For example, a loan originator may not coerce a loan underwriter to alter an appraisal report to increase the value assigned to the consumer's principal dwelling.

42(d) Prohibition on conflicts of interest.

42(d)(1)(i) In general.

1. *Prohibited interest in the property.* A person preparing a valuation or performing valuation management functions for a covered transaction has a prohibited interest in the property under paragraph (d)(1)(i) if the person has any ownership or reasonably foreseeable ownership interest in the property. For example, a person who seeks a mortgage to purchase a home has a reasonably foreseeable ownership interest in the property securing the mortgage, and therefore is not permitted to prepare the valuation or perform valuation management functions for that mortgage transaction under paragraph (d)(1)(i).

2. *Prohibited interest in the transaction.* A person preparing a valuation or performing valuation management functions has a prohibited interest in the transaction under paragraph (d)(1)(i) if that person or an affiliate of that person also serves as a loan officer of the creditor, mortgage broker, real estate broker, or other settlement service provider for the transaction and the conditions under paragraph (d)(4) are not satisfied. A person also has a prohibited interest in the transaction if the person is compensated or otherwise receives financial or other benefits based on whether the transaction is consummated. Under these circumstances, the person is not permitted to prepare the valuation or perform valuation management functions for that transaction under paragraph (d)(1)(i).

42(d)(1)(ii) Employees and affiliates of creditors; providers of multiple settlement services.

1. *Employees and affiliates of creditors.* In general, a creditor may use employees or affiliates to prepare a valuation or perform valuation management functions without violating paragraph (d)(1)(i). However, whether an employee or affiliate has a direct or indirect interest in the property or transaction that creates a prohibited conflict of interest under paragraph (d)(1)(i) depends on the facts and circumstances of a particular case, including the structure of the employment or affiliate relationship.

2. *Providers of multiple settlement services.* In general, a person who prepares a valuation or perform valuation management functions for a covered transaction may perform another settlement service for the same transaction, or the person's affiliate may perform another settlement service, without violating paragraph (d)(1)(i). However, whether the person has a direct or indirect interest in the property or transaction that creates a prohibited conflict of interest under paragraph (d)(1)(i) depends on the facts and circumstances of a particular case.

42(d)(2) Employees and affiliates of creditors with assets of more than $250 million for both of the past two calendar years.

1. *Safe harbor.* A person who a prepares valuation or performs valuation management functions for a covered transaction and is an employee or affiliate of the creditor will not be deemed to have an interest prohibited under paragraph (d)(1)(i) on the basis of the employment or affiliate relationship with the creditor if the conditions in paragraph (d)(2) are satisfied. Even if the conditions in paragraph (d)(2) are satisfied, however, the person may have a prohibited conflict of interest on other grounds, such as if the person performs a valuation for a purchase-money mortgage transaction in which the person is the buyer or seller of the subject property. Thus, in general, in any covered transaction in which the creditor had assets of more than $250 million for both of the past two years, the creditor may use its own employee or affiliate to prepare a valuation or perform valuation management functions for a particular transaction, as long as the conditions described in paragraph (d)(2) are satisfied. If the conditions in paragraph (d)(2) are not satisfied, whether a person preparing a valuation or performing valuation management functions has violated paragraph (d)(1)(i) depends on all of the facts and circumstances.

Paragraph 42(d)(2)(ii).

1. *Prohibition on reporting to a person who is part of the creditor's loan production function.* To qualify for the safe harbor under paragraph (d)(2), 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 (as defined in paragraph (d)(4)(ii) and comment 42(d)(4)(ii)–1). For example, if a person preparing a valuation is directly supervised or managed by a loan officer or other person in the creditor's loan production function, or by a person who is directly supervised or managed by a loan officer, the condition under paragraph (d)(2)(ii) is not met.

2. *Prohibition on reporting to a person whose compensation is based on the transaction closing.* To qualify for the safe harbor under paragraph (d)(2), the person preparing a valuation or performing valuation management functions may not report to a person whose compensation is based on the closing of the transaction to which the valuation relates. For example, assume an appraisal management company performs valuation management functions for a transaction in which the creditor is an affiliate of the appraisal management company. 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.

Paragraph 42(d)(2)(iii).

1. *Direct or indirect involvement in selection of person who prepares a valuation.* In any covered transaction, the safe harbor under paragraph (d)(2) is available if, among other things, no employee, officer or director in the creditor's loan production function (as defined in paragraph (d)(4)(ii) and comment 42(d)(4)(ii)–1) is directly or indirectly involved in selecting, retaining, recommending or influencing the selection of the person to prepare a valuation or perform valuation management functions, or to be included in or excluded from a list or panel of approved persons who prepare valuations or perform valuation management functions. For example, if the person who selects the person to prepare the valuation for a covered transaction is supervised by an employee of the creditor who also supervises loan officers, the condition in paragraph (d)(2)(iii) is not met.

42(d)(3) Employees and affiliates of creditors with assets of $250 million or less for either of the past two calendar years.

1. *Safe harbor.* A person who prepares a valuation or performs valuation management functions for a covered transaction and is an employee or affiliate of the creditor will not be deemed to have interest prohibited under paragraph (d)(1)(i) on the basis of the employment or affiliate relationship with the

creditor if the conditions in paragraph (d)(2) are satisfied. Even if the conditions in paragraph (d)(2) are satisfied, however, the person may have a prohibited conflict of interest on other grounds, such as if the person performs a valuation for a purchase-money mortgage transaction in which the person is the buyer or seller of the subject property. Thus, in general, in any covered transaction in which the creditor had assets of $250 million or less for either of the past two calendar years, the creditor may use its own employee or affiliate to prepare a valuation or perform valuation management functions for a particular transaction, as long as the conditions described in paragraph (d)(3) are satisfied. If the conditions in paragraph (d)(3) are not satisfied, whether a person preparing valuations or performing valuation management functions has violated paragraph (d)(1)(i) depends on all of the facts and circumstances.

42(d)(4) Providers of multiple settlement services.

Paragraph 42(d)(4)(i).

1. *Safe harbor in transactions in which the creditor had assets of more than $250 million for both of the past two calendar years.* A person preparing a valuation or performing valuation management functions in addition to performing another settlement service for the same transaction, or whose affiliate performs another settlement service for the transaction, will not be deemed to have interest prohibited under paragraph (d)(1)(i) as a result of the person or the person's affiliate performing another settlement service if the conditions in paragraph (d)(4)(i) are satisfied. Even if the conditions in paragraph (d)(4)(i) are satisfied, however, the person may have a prohibited conflict of interest on other grounds, such as if the person performs a valuation for a purchase-money mortgage transaction in which the person is the buyer or seller of the subject property. Thus, in general, in any covered transaction with a creditor that had assets of more than $250 million for the past two years, a person preparing a valuation or performing valuation management functions, or its affiliate, may provide another settlement service for the same transaction, as long as the conditions described in paragraph (d)(4)(i) are satisfied. If the conditions in paragraph (d)(4)(i) are not satisfied, whether a person preparing valuations or performing valuation management functions has violated paragraph (d)(1)(i) depends on all of the facts and circumstances.

2. *Reporting.* The safe harbor under paragraph (d)(4)(i) is available if the condition specified in paragraph (d)(2)(ii), among others, is met. Paragraph (d)(2)(ii) prohibits a person preparing a valuation or performing valuation management functions from reporting to a person whose compensation is based on the closing of the transaction to which the valuation relates. For example, assume an appraisal management company performs both valuation management functions and title services, including providing title insurance, for the same covered transaction. If the appraisal management company employee in charge of valuation management functions for the transaction is supervised by the title insurance agent in the transaction, whose compensation depends in whole or in part on whether title insurance is sold at the loan closing, the condition in paragraph (d)(2)(ii) is not met.

Paragraph 42(d)(4)(ii).

1. *Safe harbor in transactions in which the creditor had assets of $250 million or less for either of the past two calendar years.* A person preparing a valuation or performing valuation management functions in addition to performing another settlement service for the same transaction, or whose affiliate performs another settlement service for the transaction, will not be deemed to have an interest prohibited under paragraph (d)(1)(i) as a result of the person or the person's affiliate performing another settlement service if the conditions in paragraph (d)(4)(ii) are satisfied. Even if the conditions in paragraph (d)(4)(ii) are satisfied, however, the person may have a prohibited conflict of interest on other grounds, such as if the person performs a valuation for a purchase-money mortgage transaction in which the person is the buyer or seller of the subject property. Thus, in general, in any covered transaction in which the creditor had assets of $250 million or less for either of the past two years, a person preparing a valuation or performing valuation management functions, or its affiliate, may provide other settlement services for the same transaction, as long as the conditions described in paragraph (d)(4)(i) are satisfied. If the conditions in paragraph (d)(4)(i) are not satisfied, whether a person preparing valuations or performing valuation management functions has violated paragraph (d)(1)(i) depends on all of the facts and circumstances.

42(d)(5) Definitions.

Paragraph 42(d)(5)(i).

1. *Loan production function.* One condition of the safe harbors under paragraphs (d)(3) and (d)(4)(ii), involving transactions in which the creditor had assets of more than $250 million for both of the past two calendar years, is that the person who prepares a valuation or performs valuation management functions must report to a person who is not part of the creditor's "loan production function." A creditor's "loan production function" includes retail sales staff, loan officers, and any other employee of the creditor with responsibility for taking a loan application, offering or negotiating loan terms or whose compensation is based on loan processing volume. A person is not considered part of a creditor's loan production function solely because part of the person's compensation includes a general bonus not tied to specific transactions or a specific percentage of transactions closing, or a profit sharing plan that benefits all employees. A person solely responsible for credit administration or risk management is also not considered part of a creditor's loan production function. Credit administration and risk management includes, for example, loan underwriting, loan closing functions (*e.g.,* loan documentation), disbursing funds, collecting mortgage payments and otherwise servicing the loan (*e.g.,* escrow management and payment of taxes), monitoring loan performance, and foreclosure processing.

42(e) When extension of credit prohibited.

1. *Reasonable diligence.* A creditor will be deemed to have acted with reasonable diligence under § 226.42(e) if the creditor extends credit based on a valuation other than the valuation subject to the restriction in § 226.42(e). A creditor need not obtain a second valuation to document that the creditor has acted with reasonable diligence to determine that the valuation does not materially misstate or misrepresent the value of the consumer's principal dwelling, however. For example, assume an appraiser notifies a creditor before consummation that a loan originator attempted to cause the value assigned to the consumer's principal dwelling to be based on a factor other than the appraiser's independent judgment, through coercion. If the creditor reasonably determines and documents that the appraisal does not materially misstate or misrepresent the value of the consumer's principal dwelling, for purposes of § 226.42(e), the creditor may extend credit based on the appraisal.

42(f) Customary and reasonable compensation.

42(f)(1) Requirement to provide customary and reasonable compensation to fee appraisers.

1. *Agents of the creditor.* Whether a person is an agent of the creditor is determined by applicable law; however, a "fee appraiser" as defined in paragraph (f)(4)(i) is not an agent of the creditor for purposes of paragraph (f), and therefore is not required to pay other fee appraisers customary and reasonable compensation under paragraph (f).

2. *Geographic market.* For purposes of paragraph (f), the "geographic market of the property being appraised" means the geographic market relevant to compensation levels for appraisal services. Depending on the facts and circumstances, the relevant geographic market may be a state, metropolitan statistical area (MSA), metropolitan division, area outside of an MSA, county, or other geographic area. For example, assume that fee appraisers who normally work only in County A generally accept $400 to appraise an attached single-family property in County A. Assume also that *very few or no* fee appraisers who work only in contiguous County B will accept a rate comparable to $400 to appraise an attached single-family property in County A. The relevant geographic market for an attached single-family property in County A may reasonably be defined as County A. On the other hand, assume that fee appraisers who normally work only in County A generally accept $400 to appraise an attached single-family property in County A. Assume also that *many* fee appraisers who normally work only in contiguous County B will accept a rate comparable to $400 to appraise an attached single-family property in County A. The relevant geographic market for an attached single-family property in County A may reasonably be defined to include both County A and County B.

3. *Failure to perform contractual obligations.* Paragraph (f)(1) does not prohibit a creditor or its agent from withholding compensation from a fee appraiser for failing to meet contractual obligations, such as

failing to provide the appraisal report or violating state or federal appraisal laws in performing the appraisal.

4. *Agreement that fee is* "*customary and reasonable.*" A document signed by a fee appraiser indicating that the appraiser agrees that the fee paid to the appraiser is "customary and reasonable" does not by itself create a presumption of compliance with § 226.42(f) or otherwise satisfy the requirement to pay a fee appraiser at a customary and reasonable rate.

5. *Volume-based discounts.* Section 226.42(f)(1) does not prohibit a fee appraiser and a creditor (or its agent) from agreeing to compensation based on transaction volume, so long as the compensation is customary and reasonable. 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 assignments from the creditor.

42(f)(2) Presumption of compliance.

1. *In general.* A creditor and its agent are presumed to comply with paragraph (f)(1) if the creditor or its agent meets the conditions specified in paragraph (f)(2) in determining the compensation paid to a fee appraiser. These conditions are not requirements for compliance but, if met, create a presumption that the creditor or its agent has complied with § 226.42(f)(1). A person may rebut this presumption with evidence that the amount of compensation paid to a fee appraiser was not customary and reasonable for reasons unrelated to the conditions in paragraph (f)(2)(i) or (f)(2)(ii). If a creditor or its agent does not meet one of the non-required conditions set forth in paragraph (f)(2), the creditor's and its agent's compliance with paragraph (f)(1) is determined based on all of the facts and circumstances without a presumption of either compliance or violation.

42(f)(2)(i) Presumption of compliance.

1. *Two-step process for determining customary and reasonable rates.* Paragraph (f)(2)(i) sets forth a two-step process for a creditor or its agent to determine the amount of compensation that is customary and reasonable in a given transaction. First, the creditor or its agent must identify recent rates paid for comparable appraisal services in the relevant geographic market. Second, once recent rates have been identified, the creditor or its agent must review the factors listed in paragraph (f)(2)(i)(A)–(F) and make any appropriate adjustments to the rates to ensure that the amount of compensation is reasonable.

2. *Identifying recent rates.* Whether rates may reasonably be considered "recent" depends on the facts and circumstances. Generally, "recent" rates would include rates charged within one year of the creditor's or its agent's reliance on this information to qualify for the presumption of compliance under paragraph (f)(2). For purposes of the presumption of compliance under paragraph (f)(2), a creditor or its agent may gather information about recent rates by using a reasonable method that provides information about rates for appraisal services in the geographic market of the relevant property; a creditor or its agent may, but is not required to, use or perform a fee survey.

3. *Accounting for factors.* Once recent rates in the relevant geographic market have been identified, the creditor or its agent must review the factors listed in paragraph (f)(2)(i)(A)–(F) to determine the appropriate rate for the current transaction. For example, if the recent rates identified by the creditor or its agent were solely for appraisal assignments in which the scope of work required consideration of two comparable properties, but the current transaction required an appraisal that considered three comparable properties, the creditor or its agent might reasonably adjust the rate by an amount that accounts for the increased scope of work, in addition to making any other appropriate adjustments based on the remaining factors.

Paragraph 42(f)(2)(i)(A).

1. *Type of property.* The type of property may include, for example, detached or attached single-family property, condominium or cooperative unit, or manufactured home.

Paragraph 42(f)(2)(i)(B).

1. *Scope of work.* The scope of work may include, for example, the type of inspection (such as exterior only or both interior and exterior) or number of comparables required for the appraisal.

Paragraph 42(f)(2)(i)(D).

1. *Fee appraiser qualifications.* The fee appraiser qualifications may include, for example, a state license or certification in accordance with the minimum criteria issued by the Appraisal Qualifications Board of the Appraisal Foundation, or completion of continuing education courses on effective appraisal methods and related topics.

2. *Membership in professional appraisal organization.* Paragraph 42(f)(2)(i)(D) does not override state or federal laws prohibiting the exclusion of an appraiser from consideration for an assignment solely by virtue of membership or lack of membership in any particular appraisal organization. *See, e.g.,* 12 CFR 225.66(a).

Paragraph 42(f)(2)(i)(E).

1. *Fee appraiser experience and professional record.* The fee appraiser's level of experience may include, for example, the fee appraiser's years of service as a state-licensed or state-certified appraiser, or years of service appraising properties in a particular geographical area or of a particular type. The fee appraiser's professional record may include, for example, whether the fee appraiser has a past record of suspensions, disqualifications, debarments, or judgments for waste, fraud, abuse or breach of legal or professional standards.

Paragraph 42(f)(2)(i)(F).

1. *Fee appraiser work quality.* The fee appraiser's work quality may include, for example, the past quality of appraisals performed by the appraiser based on the written performance and review criteria of the creditor or agent of the creditor.

Paragraph 42(f)(2)(ii).

1. *Restraining trade.* Under § 226.42(f)(2)(ii)(A), creditor or its agent would not qualify for the presumption of compliance under paragraph (f)(2) if it engaged in any acts to restrain trade such as entering into a price fixing or market allocation agreement that affect the compensation of fee appraisers. For example, if appraisal management company A and appraisal management company B agreed to compensate fee appraisers at no more than a specific rate or range of rates, neither appraisal management company would qualify for the presumption of compliance. Likewise, if appraisal management company A and appraisal management company B agreed that appraisal management company A would limit its business to a certain portion of the relevant geographic market and appraisal management company B would limit its business to a different portion of the relevant geographic market, and as a result each appraisal management company unilaterally set the fees paid to fee appraisers in their respective portions of the market, neither appraisal management company would qualify for the presumption of compliance under paragraph (f)(2).

2. *Acts of monopolization.* Under § 226.42(f)(2)(ii)(B), a creditor or its agent would not qualify for the presumption of compliance under paragraph (f)(2) if it engaged in any act of monopolization such as restricting entry into the relevant geographic market or causing any person to leave the relevant geographic market, resulting in anticompetitive effects that affect the compensation paid to fee appraisers. For example, if only one appraisal management company exists or is predominant in a particular market area, that appraisal management company might not qualify for the presumption of compliance if it entered into exclusivity agreements with all creditors in the market or all fee appraisers in the market, such that other appraisal management companies had to leave or could not enter the market. Whether this behavior would be considered an anticompetitive act that affects the compensation paid to fee appraisers depends on all of the facts and circumstances, including applicable law.

42(f)(3) Alternative presumption of compliance.

1. *In general.* A creditor and its agent are presumed to comply with paragraph (f)(1) if the creditor or its agent determine the compensation paid to a fee appraiser based on information about customary and reasonable rates that satisfies the conditions in paragraph (f)(3) for that information. Reliance on information satisfying the conditions in paragraph (f)(3) is not a requirement for compliance with paragraph (f)(1), but creates a presumption that the creditor or its agent has complied. A person may rebut this presumption with evidence that the rate of compensation paid to a fee appraiser by the creditor or its agent is not customary and reasonable based on facts or information other than third-party information satisfying the conditions of this paragraph (f)(3). If a creditor or its agent does not rely on information that meets the conditions in paragraph (f)(3), the creditor's and its agent's compliance with paragraph (f)(1) is determined based on all of the facts and circumstances without a presumption of either compliance or violation.

2. *Geographic market.* The meaning of "geographic market" for purposes of

paragraph (f) is explained in comment (f)(1)–1.

3. *Recent rates.* Whether rates may reasonably be considered "recent" depends on the facts and circumstances. Generally, "recent" rates would include rates charged within one year of the creditor's or its agent's reliance on this information to qualify for the presumption of compliance under paragraph (f)(3).

42(f)(4) Definitions.

42(f)(4)(i) Fee appraiser.

1. *Organization.* The term "organization" in paragraph 42(d)(4)(i)(B) includes a corporation, partnership, proprietorship, association, cooperative, or other business entity and does not include a natural person.

42(g) Mandatory reporting.

42(g)(1) Reporting required.

1. *Reasonable basis.* A person reasonably believes that an appraiser has materially failed to comply with the Uniform Standards of Professional Appraisal Practice established by the Appraisal Standards Board of the Appraisal Foundation (as defined in 12 U.S.C. 3350(9) (USPAP) or ethical or professional requirements for appraisers under applicable state or federal statutes or regulations if the person possesses knowledge or information that would lead a reasonable person in the same circumstances to conclude that the appraiser has materially failed to comply with USPAP or such statutory or regulatory requirements.

2. *Material failure to comply.* For purposes of § 226.42(g)(1), a material failure to comply is one that is likely to affect the value assigned to the consumer's principal dwelling. The following are examples of a material failure to comply with USPAP or ethical or professional requirements:

i. Mischaracterizing the value of the consumer's principal dwelling in violation of § 226.42(c)(2)(i).

ii. Performing an assignment in a grossly negligent manner, in violation of a rule under USPAP.

iii. Accepting an appraisal assignment on the condition that the appraiser will report a value equal to or greater than the purchase price for the consumer's principal dwelling, in violation of a rule under USPAP.

3. *Other matters.* Section 226.42(g)(1) does not require reporting of a matter that is not material under § 226.42(g)(1), for example:

i. An appraiser's disclosure of confidential information in violation of applicable state law.

ii. An appraiser's failure to maintain errors and omissions insurance in violation of applicable state law.

4. *Examples of covered persons.* "Covered persons" include creditors, mortgage brokers, appraisers, appraisal management companies, real estate agents, other persons that provide "settlement services" as defined under the Real Estate Settlement Procedures Act and implementing regulations. *See* 12 U.S.C. 2602(3); § 226.42(b)(1).

5. *Examples of persons not covered.* The following persons are not "covered persons" (unless, of course, they are creditors with respect to a covered transaction or perform "settlement services" in connection with a covered transaction):

i. The consumer who obtains credit through a covered transaction.

ii. A person secondarily liable for a covered transaction, such as a guarantor.

iii. A person that resides in or will reside in the consumer's principal dwelling but will not be liable on the covered transaction, such as a non-obligor spouse.

6. *Appraiser.* For purposes of § 226.42(g)(1), an "appraiser" is a natural person who provides opinions of the value of dwellings and is required to be licensed or certified under the laws of the state in which the consumer's principal dwelling is located or otherwise is subject to the jurisdiction of the appraiser certifying and licensing agency for that state. *See* 12 U.S.C. 3350(1).

By order of the Board of Governors of the Federal Reserve System, October 18, 2010.

Jennifer J. Johnson,

Secretary of the Board.

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