

# DODD-FRANK AND APPRAISALS

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# Dodd-Frank and Appraisals: The Compliance Strategy

BY JENNIFER MILLER

**W**e're buried in new federal and state regulations, pending rules and misunderstandings, and everyone is worn out from it. When it comes to compliant appraisal operations, most lenders don't know which way is up—and no one can blame them. The dust has barely settled on the new government-sponsored enterprise (GSE) appraisal submission requirements, and the Dodd-Frank Wall Street Reform and Consumer Protection Act rules are already staring us down. ■ We know the Consumer Financial Protection Bureau (CFPB) is gearing up for enforcement (from state regulators and from the Federal Financial Institutions Examination Council [FFIEC] agencies), so it's critical that lenders get policies in place now to protect against the stiff penalties. ■ The good news is that compliance with the appraisal requirements doesn't have to be difficult. A common-sense appraisal management strategy that follows industry best practices will get you in compliance very quickly, and with far less pain than you'd feel from failing an exam.

Here are the steps you should take for Dodd-Frank compliance now:

■ *Find an appraisal compliance partner or solution to help you identify the weaknesses in your current process.* There are too many regulations to go it alone. Pick a company with appraisal expertise and work with it. You don't have to sign contracts or use its services. It's nothing more than basic networking, so just form a relationship with an appraisal management expert you can ask for advice.

■ *Implement tools directly in your workflow to avoid noncompliance.* *a la mode* knows from more than 27 years' experience helping the industry's largest lenders and appraisal management companies that compliance measures won't be followed unless they are tightly integrated into the workflow of your operations. The "new way" has to become a part of your process and not just a memo from the compliance officer.

■ *Require an audit trail for every transaction for your future protection.* This is critical in case of an exam. Whether you're managing appraisals internally or using an appraisal management company (AMC), make sure

**A host of appraisal-related requirements were included in the Dodd-Frank Wall Street Reform and Consumer Protection Act. Here's the rundown on what you need to know about them.**

every transaction with your appraisal vendor is documented in an audit trail. If the audit trail catches an occasional violation from your staff, you've shown that your institution's policies are aligned with compliance.

■ *Monitor the activities of your third-party vendor.* First you must perform proper due diligence on your AMC. Monitor its policies and practices, including its appraiser selection process.

#### **Enforcement is on its way**

The Dodd-Frank Act was enacted on July 21, 2010, and the CFPB is charged with overseeing the rules. We're waiting on the final rules to figure out which pieces of the act will be implemented as written and which will change.

To mitigate risk, in most cases, you should move forward with appraisal policy now instead of waiting on specific guidance from the rules. There are a few exceptions I'll discuss, but the majority of the rules can be understood and easily adhered to now.

According to the CFPB's semi-annual report ([http://files.consumerfinance.gov/f/201207\\_cfpb\\_semi-annual\\_report.pdf](http://files.consumerfinance.gov/f/201207_cfpb_semi-annual_report.pdf)), the agency expects to finalize most

of the mortgage rules by Jan. 21, 2013 in accordance with the statutory deadlines. I believe the CFPB will not have the final rules defined for some aspects of the act, including items that impact appraisal, by the Jan. 21 deadline. The CFPB may provide clarification at a later date, but when the act goes into effect as written, you'll need to figure out what it means.

Enforcement is already under way. In its semi-annual report, the CFPB noted, "Enforcement has endeavored to focus its investigative resources on the violations of law that cause the greatest harm to consumers." The agency also said, "The investigations currently under way span the full breadth of the bureau's enforcement jurisdiction."

The CFPB is staffing up and already receiving a tremendous volume of consumer complaints. According to the report, the CFPB had 889 employees as of June 30, up from just 214 a year ago, and the agency wanted to "continue this momentum." The CFPB received 55,300 consumer complaints between July 21, 2011, and June 30, 2012—the vast majority of which were related to mortgages.

The industry must assume the CFPB is gearing up for exams and enforcement, and know that appraisal will likely be an area of focus. It's critical to examine your current policies and procedures to make changes where you can now.

### **The Dodd-Frank appraisal issues**

Dodd-Frank's appraisal rules can be found in subtitle F of Title XIV of the act, titled "Appraisal Activities." Subtitle F (hereafter, the "act") makes a number of amendments to the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), Truth in Lending Act (TILA), Real Estate Settlement Procedures Act (RESPA) and Equal Credit Opportunity Act (ECOA) that affect appraisals.

#### ***Section 1471—property appraisal requirements***

This section of the act largely deals with what the CFPB considers "higher-risk mortgages." The act could impose a requirement that would necessitate a second appraisal by a licensed or certified appraiser for loans secured by a principal dwelling that meet the CFPB's criteria for a higher-risk loan. A final ruling is coming (see [http://files.consumerfinance.gov/f/201208\\_cfpb\\_hrm\\_proposed\\_rule.pdf](http://files.consumerfinance.gov/f/201208_cfpb_hrm_proposed_rule.pdf)), but the basic idea is to require a second appraisal on riskier loans and/or types of loans where fraud has been an issue in the past, such as with investment properties or flips.

In addition, the CFPB wants a copy sent to the borrower at least three days prior to closing. Because this was a requirement of the Home Valuation Code of Conduct (HVCC), many lenders already comply. But realize that the CFPB will be looking for proof.

You can easily integrate this practice with your current workflow now. Most appraisal management software platforms should have a function to send the report to the borrower, and some lenders rely upon their

appraisal management companies to perform this function. If your AMC sends a copy of the appraisal to the borrower, the lender is not off the hook. As with every other aspect of this act, it's up to the lender to ensure that any vendor is complying—which means you need to have proof on every transaction that the appraisal was provided at least three days prior to closing.

Section 1471 also adds a consumer notification that an appraisal has been ordered for the sole use of the creditor, and the notice should include language about receiving a free copy of the resulting report. It would be a good idea to bundle a notice about the borrower's rights to a copy of the appraisal and include it in your disclosure package.

Part of a compliance strategy for this section must also include the monitoring of your fee panel's licensure status. If you're using an AMC, you either have to monitor this yourself or have thorough documentation on how each of your AMCs is monitoring licensure.

Fortunately, there is a central database for all appraisal licenses at [www.asc.gov](http://www.asc.gov), and you are allowed to download the entire database to run a comparison. Again, vendor management software can automate this task by scrubbing your fee panel against the Appraisal Subcommittee's list of licensed appraisers daily.

At \$2,000 per violation (see [www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf](http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf)), the penalties in this section aren't as drastic as in other sections, but there's no burden of proof for damages, either.

According to the act, "A creditor that willfully fails to obtain an appraisal as set forth above (i.e., either the original appraisal or a second appraisal, where applicable) is liable to the applicant or borrower in the amount of \$2,000. The liability under this new provision is in addition to any other liability under TILA (i.e., civil liability, administrative liability and criminal liability).

#### ***Section 1472—appraisal independence requirements***

This section establishes new appraisal independence requirements (AIR). There are several requirements listed, but most are common sense in a compliance strategy designed to prevent collusion, and most of these were also required by HVCC.

Of course, you can't say or imply to an appraiser that current or future work depends on the amount at which the appraiser values a principal dwelling. You can't tell an appraiser a minimum reported value of a consumer's principal dwelling that is needed to approve the loan. You also cannot fail to compensate, or threaten to fail to compensate, an appraiser because she/he does not value the dwelling at or above a certain amount. And as with HVCC, production loan staff (or mortgage brokers) cannot be involved in the appraiser selection process.

There has been a lot of talk in the industry about AIR, but most have made their peace with these requirements and compliance has become second nature. If you aren't

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yet in compliance, look around and adopt one of the strategies your neighbor is using.

There are many solutions available, from outsourcing everything to an AMC to employing the use of software to act as a firewall between the appraiser and your production loan staff.

Keep in mind that one of the most important aspects of AIR, and one that is often overlooked, is that your production loan staff cannot select appraisers. If you're still allowing production to push appraisers to you, you need to make changes immediately.

One aspect of this section that is controversial is the mandatory reporting requirement. All entities, including AMCs, lenders and appraisers, are required to report perceived violations to their state boards. This means if a reviewer or underwriter identifies something in an appraisal that is not, for instance, compliant with the Uniform Standards of Professional Appraisal Practice (USPAP), your organization is required to report the appraiser.

Many in the industry are unclear on the reporting procedure because state appraisal boards are typically not equipped to follow up on the complaints received. In light of the industry confusion, your compliance strategy should include a full audit trail of your appraiser selection process, including communications with your appraiser. I always recommend automatic documentation in a full audit trail anyway, but it's even more necessary in light of the reporting requirement.

Vendor management software will automatically create audit trails for you, and it's well worth looking into these tools so you are covered in case of an exam. Remember, the audit trail is also prudent because it may uncover violations that you can correct before an audit, and its existence is evidence of a corporate policy designed to follow the law.

Finally, this is the section that mentions that creditors and their agents are required to compensate fee appraisers "at a rate that is customary and reasonable for appraiser services performed in the market area" of the property being appraised. This is a tough requirement, and I know many organizations have struggled with the task of defining customary and reasonable fees.

The act makes mention of studies, but there's a lack of recently published data. I think appraisers are under-compensated and this provision was added as a protection, but it's not clearly defined and needs clarification. Meanwhile, you need to evaluate the law and have your compliance advisers determine and document how you're going to comply.

According to Michael Simmons, senior vice president of business development with AXIS Appraisal Management Solutions, San Rafael, California, there is a difficult struggle between basing appraiser compensation on the two current perspectives: Presumption 1 (basically calculated from historical AMC-driven fees) or Presumption 2 (which excludes AMC fees and relies on independent studies).

Simmons says, "At AXIS, we employ Presumption 2, which sets a higher bar for compensating appraisers by excluding historical AMC fees. Given the ever-increasing demand for quality and depth of data being

required from appraisers, we believe the industry should and will be driven to move to Presumption 2 and, ultimately, to a cost-plus model—which means the 'customary and reasonable' fee would be based on Presumption 2, and then the AMC would collect a management fee that covers all of the services that a management company employs."

In light of all the uncertainty, it's unwise to choose a solution or AMC solely on the basis of lowering cost.

"Underfunding the appraisal management process creates more underwriting conditions, risk and exposure, but there is now inherent risk in underpaying appraisers to attract more borrowers," cautions Mark Backonen, chief executive officer of Troy, Michigan-based Class Appraisal Inc., a national AMC.

He adds, "When you weigh the potential cost savings against the risk and the penalties, it's clear lenders should err on the side of having a prudent compliance process in place."

Whereas penalties in the previous section of the Dodd-Frank Act were relatively mild, violations in this section are severe and can add up quickly. According to the act, violators are subject to a civil penalty of up to \$10,000 per day for the first violation and up to \$20,000 per day for subsequent violations. That doesn't include the civil penalties or the associated penalties for violations of TILA.

In my opinion, because the penalties are so severe and as the technology is readily and affordably available, it's reckless not to institute these practices as part of your compliance strategy now. The guidelines make good sense from a risk perspective anyway, so it's unwise not to protect your institution when it's easy to do so.

### *Section 1473—various amendments*

This section has been largely undecided and will undoubtedly be expanded upon through the rulemaking process.

Currently, this section of the act sets a \$250,000 loan threshold for necessitating an appraisal, and bans the use of a broker price opinion (BPO) on any first-mortgage loan on a principal dwelling. Most investor requirements are far below that \$250,000 mark, so it shouldn't be an issue with most institutions.

In addition, this section requires the Appraisal Subcommittee (the federal agency within the FFIEC charged with overseeing The Appraisal Foundation) to provide an annual report. It also requires AMCs to register with their state appraisal boards, and requires the Appraisal Subcommittee to create a national registry of AMCs. This section also sets up an appraisal compliance hotline, but as mentioned before, the regulations implementing this provision had not yet been adopted at the time of this writing.

The state-level requirement to enact AMC legislation is an interesting one. In theory, it's a good idea. However, the act was fairly weak when it came to outlining the minimum requirements the state should impose and silent when it comes to maximum requirements.

For that reason, the state laws that have been passed are wildly inconsistent. There are states that require all

principals to get fingerprinted and have a background check. There is a state that charges the AMC every time an appraiser is added or removed from a fee panel. And there is at least one state that has language directing the AMC to “ensure the appraiser’s competence.”

Joan Trice, founder and chief executive officer of Clearbox LLC, Salisbury, Maryland, a data repository for appraiser and AMC rosters, estimates that annual fees will likely be approximately \$350,000 to cover the cost of registration in each state. “It’s a crazy mess,” she says.

“There are 523 unique AMCs already registered in 23 states. Many don’t appear to be legitimate businesses. It will be interesting to see if the states step up and properly monitor the activities of the AMCs,” Trice says.

So until then, it needs to be part of your due diligence to keep up with these state regulations and never do business with an AMC that isn’t registered. This will become easier once that national database is available.

#### **Section 1474—Equal Credit Opportunity Act amendment**

This section relates to the creditor’s obligation to provide copies of appraisals and valuations to the loan applicant, even in the case where the application is withdrawn or the loan is denied.

In general, you are required to provide a copy of all written appraisals and valuations that are developed in connection with an application for a loan to be secured by a first lien on a dwelling. The copy is to be furnished upon completion, but in no event later than three days before loan closing.

Again, most institutions routinely provide the appraisal anyway. The key to compliance here is to incorporate that step into the appraisal desk workflow. Vendor management software can handle this, or an AMC can do it for you. But under either circumstance, demand a full audit trail to document your compliance. Get a date-and-time stamp on when the appraisal was sent to the applicant and when the applicant opened the file.

This section also mandates a notification to an applicant of his or her right to receive the appraisal, but you should be doing that automatically when the applicant applies, so that you’re in compliance with section 1471 as discussed earlier.

Note that this section specifically defines a valuation to also include an automated valuation model (AVM), a BPO or other methodology or mechanism. This is controversial.

I’m not sure if lending institutions are routinely providing AVMs to borrowers. But in reviewing the law, it appears the intent is that any valuation used to secure the loan must be provided to the borrower, and it seems this would also include desk and field reviews.

#### **Section 1475—appraisal fees**

This section suggests HUD-1 and HUD-1A disclosure forms associated with appraisals handled by an AMC contain two fields for the appraisal fee. One field would show the fee paid directly to the appraiser, and a separate field would show the administration fee charged by the AMC.

Interestingly, the latest sample forms released for comment in July do not contain the two separate fee fields, but the appraisal trade associations are pushing hard for this consideration (see Richfield, Ohio-based October Research LLC’s *Dodd-Frank Update* at <http://doddfrankupdate.com/dfu/articlesdfu/commenters-share-divergent-views-on-proposed-cfpb-55766.aspx>).

Some states took the AMC provisions in their respective state acts as an opportunity to require AMCs to publish their fee to the borrower and lender. Right now, there are many AMCs that have to do this on a case-by-case basis, depending on the state. I think it will actually ease the burden if this just becomes a standard rule.

#### **Compliance may not be as difficult as you thought**

I hope this practical review of Dodd-Frank’s appraisal requirements takes some of the stress off your shoulders. I can’t overemphasize the importance of

working with—or at least networking with—an appraisal workflow expert. An expert has to understand these regulations because he or she works with hundreds of lenders and AMCs, so building a relationship is a great way to give your institution a shortcut to full and easy compliance.

And remember, the CFPB isn’t the only focus. “In addition to the CFPB enforcement, there are several layers of exposure for lenders. They have to navigate agency rules, state exams and their AMC’s state audits,” notes Class Appraisal’s Backonen. “Since the coming audits are largely unknown in scope and complexity, it’s important that lenders select vendor management partners with significant compliance expertise.”

As the January deadline approaches, we’ll see more proposed rules and opportunities for comment. I urge you to participate by watching proposed rules and adding your comments at [www.consumerfinance.gov/notice-and-comment](http://www.consumerfinance.gov/notice-and-comment). You can rest assured others are commenting, so let your voice be heard while the CFPB is finalizing these provisions. **MB**

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