Comments of

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Minimum Requirements for Appraisal Management Companies

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We are pleased to comment on the proposed regulation.

The agencies have the unenviable task of drafting a regulation to interpret and implement DFA Section 1473 -- unenviable in that the legislative history that would be useful to elaborate on congressional intent is largely nonexistent.

Having reviewed the Congressional Record, there is an absence of floor debate, Managers' Amendment material, colloquies among Members of Congress, or even individual statements on the record by any Member of Congress elaborating on, explaining or defending Section 1473 or even explaining the public interest and public policy goals of Section 1473.

In the absence of specific legislative history on Section 1473, the agencies need to consider Section 1473 in light of the broader statements of purpose that led to the passage of DFA.

Perhaps the clearest statement of congressional intent – perhaps the only statement of congressional intent in and around Section 1473 – may be found in the statement of purpose in the preamble of the parent vehicle, DFA, itself:

To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail", to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.

We find that several of the provisions proposed in the proposed regulation actually demonstrate a lack of internal consistency between Section 1473, as interpreted by the agencies, and the stated purpose of the overall DFA statute.

We would further observe that, as sometimes happens, Congress provides broad direction for subsequent regulations, but is purposefully vague in doing so, allowing the agencies broad latitude to use their regulatory expertise to "work out the details" in the absence of clear expressions of contrary congressional intent.

Where the record is so clearly and overtly devoid of details regarding the intent of Congress on this matter, it might be assumed that Congress was vague with purpose. The agencies seem to have clear license to implement the apparent broad direction of Section 1473, but in ways that 1) are more consistent with the purposes of DFA; 2) approach the aspiration to implement a national regulation that resolves more ambiguity than it creates; 3) brings about greater uniformity, quality, reliability and compliance with good practices rather than incentivizing many AMCs to take actions that would subvert the purpose of the law and the regulation; 4) will better meet the needs of protecting consumers; and 5) will do more to avoid repeating some of the valuation poor practices that exacerbated the housing crises up that threatened the collapse of the U.S. economy in 2008.

Indeed, the agencies seem to understand that they have such flexibility to interpret the statute:

The Agencies believe that section 1124 allows the Agencies to establish more specific requirements for supervision and registration of AMCs that implement the general requirements enumerated in section 1124(a). In addition, by providing that the regulation shall "include" the requirements enumerated in section 1124, it is implied that the Agencies have the discretion to establish additional supervisory standards for State oversight of AMCs beyond the general requirements specifically enumerated in section 1124(a).

We agree. We suggest that agencies use their greater technical expertise to go beyond the bare literal reading of certain provisions in DFA that seem to run counter to the broad goals of DFA. This will achieve a successful regulatory result as well as serve the public interest and carry out the broad intent of Congress as stated on the record in the DFA preamble.

Given this approach, we suggest that the agencies should amend the proposed regulation in several respects material to achieve these purposes.

Question 1. The Agencies request comment on all aspects of the proposed definition of AMC.

Section 1473 includes the language "…oversees a network or panel of more than 15 certified or licensed appraisers in a State or 25 or more nationally within a given year".

However, there is no legislative history to explain why this language is in the bill, or the purpose that such delimiters are meant to achieve. Did Congress find special public policy benefits in "15/25", rather than "12/19", or "17/28" -- or no number at all? If so, there seems nothing in the record to indicate so.

Did Congress assume that this threshold would cover nearly all the market that affects the public interest, the lending community or the national interest? We do not know, but if Congress did make that assumption, it erred. We do not know the exact number, be we do know that a large and policy-significant number of valuation companies who consider themselves in the AMC industry would be exempted from the regulation on this criterion alone.

Was Congress intending to somehow insulate smaller AMCs from the regulation for reasons undisclosed to the record? Did Congress consider smaller AMCs as having insufficient impact on the economy? Did Congress assume that smaller AMCs lack the resources, time or impact to be considered "AMCs"?

Was this provision meant to constitute an intrusion into the marketplace to work a hardship on large AMCs and somehow protect smaller AMCs? We do not know.

Was Congress attempting to limit the regulatory burden of the states by limiting the number of AMCs that each state will register and supervise? We do not know.

Was Congress incentivizing AMCs to operate using smaller networks and panels? We do not know.

If this provision was, in fact, designed somehow to insulate or protect smaller AMCs, is this a mechanism to accomplish that purpose? Some larger, multistate AMCs who wish to operate beneath the regulatory radar may simply pare their appraisal networks and panels, and/or find some way to use employees rather than independent contractors, and/or contract with other appraisal entities in a state to avoid the impacts of this regulation. These are rational and available options for any AMC, even larger multistate AMCs, to skirt the bare requirements of the regulation – and defeat the purpose of the law and the regulation.

Would <u>any</u> of these purposes help Section 1473 meet the overall goals of DFA? Almost certainly not. DFA was passed to protect the taxpayers of the United States, the consumers of the United States, and the U.S. economy. In no way was DFA enacted to protect certain AMCs, or advance the interests of certain market segments over others within the AMC marketplace, nor was it passed to insulate "smaller" appraiser panels on the assumption that their impact on these public interests is somehow negligible or unmanageable by the states.

Congress left ambiguity as to the intent or purpose of the 15/25 provision.

In sum, the proposed regulation, as drafted, provides both the incentives to skirt the regulation (nonfederal AMCs will be barred from providing appraisals on federally related transactions in states that fail to enact a regulatory scheme, a very strong tactical reason to avoid definition as an AMC) as well as the means to skirt the regulation – in this case, by gerrymandering networks and panels to operate just below the 15/25 thresholds.

We do not know how many policy-relevant, market-relevant AMCs would respond in this way. But we have to assume that many/most will at least weigh their options, and many will implement a plan to do so.

Within the proposed regulation, the agencies indicate that they are aware of approximately 500 AMCs across the country; it is not clear whether this figure means AMCs that meet the 15/25 threshold or is rather an aggregate estimate of all AMC-like entities. In preparation of the cost and "reg flex" requirements for the proposed regulation, the agencies indicate they have had some contact with 9 of the approximately 500, or approaching 2 percent, to ascertain some idea about the cost impact of the proposed regulation. Apparently the agencies did have some manner of contact with a number of AMCs to prepare other aspects of the proposed regulation, but we have few details. We do not know on the record whether the agencies made any inquiry as to network or panel size to the extent that the agencies could make any reliable determination as to the percentage of AMCs that would be exempted by the 15/25 threshold.

Further, the relevant factor in determining whether an appraiser should "count" toward the size of a network or panel should not be that the appraiser has agreed to do work with the AMC, but rather, whether the appraiser accepts and completes an assignment from an AMC. AMCs often have larger lists of available appraisers, but only actually engage a limited number of them. To that end, this element of the AMC definition should be reformulated so that it is based on the number of appraisers in a given state to whom an AMC offers an assignment and who accept such assignments.

We recommend the following:

1) that the agencies conduct a survey of the AMCs that are potentially subject to the proposed regulation, their current network or panel sizes, to ascertain what portion of the AMC market would be exempted immediately or soon from coverage under the regulation, and also the portion that might feasibly be close enough to the thresholds to alter their business operations solely to avoid coverage under the regulation; some due diligence to estimate what portion of the AMC market would be exempted immediately, or soon, by the 15/25 threshold is required for the agencies to have some objective data as to how much or how little of the AMC market will be affected by the regulation. To the extent that any AMCs escape this regulation, the impact and protections afforded by the regulation will be diminished, perhaps to a significant extent, defeating the utility of Section 1473, whatever its purpose may be.

2) we recommend that the agencies broadly interpret the 15/25 provision to be only an arbitrary benchmark that is of lesser importance than the overall function of Section 1473, which, after all, it intended to register and supervise AMCs -- not because of their panel size but because of their

impact on taxpayers, consumers and the U.S. economy. In that sense, the 15/25 threshold and the overall function of Section 1473 appear to be in conflict.

Based on factors already discussed and more to be discussed below, we urge the agencies to resolve the conflict by requiring as many AMCs as possible – perhaps all – to be subject to the regulation to bring as much registration and supervision to the AMC market as possible.

3) We have already mentioned that the size of the network or panel is not necessarily a reliable indicator of size of the AMC. If it is assumed that the 15/25 provision is designed to insulate small AMCs from regulation and is meant to be a small business provision, this may well be a faulty assumption.

Even so, truly "small" AMCs and the appraisers they engage are nonetheless required to meet the same standards of professionalism as other appraisal entities. Certainly, small-panel AMCs impact taxpayers, consumers and the economy too.

Further, the agencies' reg flex analysis found that the cost and hardship that would be required of AMCs under this regulation would be acceptable, perhaps negligible. Any entity that can operate in the U.S. economy as a responsible AMC should be able to meet the bare requirements of this AMC regulation.

Nonetheless, if the agencies determine that some lower limit threshold is necessary or appropriate, we would recommend that the 15 instate threshold be lowered to 5 or fewer, and the 25 multistate threshold be reduced similarly.

4) that the definition of AMCs be redrafted so that the size of networks or panels are based on the number of appraisers in a given state to whom an AMC offers an assignment and who accept/complete such assignments.

Question 2. The Agencies request comment on the proposed definition of "appraiser network or panel" and on the alternative of defining this term to include employees as well as independent contractors. The Agencies also request comment on whether the term "independent contractor" should be defined, and if so why and how, including whether it should be defined based upon Federal law (e.g., using the standards issued by the Internal Revenue Service n20 or standards adopted in other Federal regulations, such as those issued under the Secure and Fair Enforcement for Mortgage Licensing Act n21 (S.A.F.E. Act)), n22 or left to State law (so as to be consistent with existing AMC laws).

With regard to whether to use a federal definition of "independent contractor": we recommend that the agencies do require a federal definition rather than subject AMCs to, potentially, 50 different definitions, and further, the need monitor potential changes in definitions in 50 separate legislatures.

This is a national regulation with national impact; some uniformity in the federal minimums being established here is reasonable and should be the goal.

We recommend that, where necessary, the agencies adopt a federal definition of independent contractor rather than leave open the potential for 50 different definitions and modifications in the future.

Question 3. The Agencies request comment on the distinction the Agencies have drawn between employees and independent contractors as a basis for exclusion of appraisal firms from the definition of an AMC.

We suggest that the proposed approach of limiting the panel "count" to include only independent contractors is the wrong approach.

While the proposed regulation says that this approach is the majority view among the states, which it may be, it is not the only valid approach from which the agencies can draw precedent. And in fact, a valid minority of states to consider some mix of independent contractors and employees in the panel "count".

The acceptance of the "mix" approach in a minority of states certainly renders it feasible for the agencies to adopt in this regulation.

We recommend a theme that will be recurrent in these comments -- that the agencies use "performance-based" criteria rather than "prescriptive-base, business-model-delimited" criteria. We suggest that the public interest and the goals sought by DFA are much better served by this approach.

If an individual state-licensed/certified appraiser is conducting an appraisal or review, that person is having a material impact on the validity of an appraisal. It is that activity that gives rise to the need for regulatory oversight, not the employment status of the individual. The employment status of the individual is an ancillary consideration that should not be determinant of whether that individual is relevant to coverage under this regulation. Dividing the regulated entities versus the non-regulated entities based upon business model criteria that have little or no impact on the appraisal services being rendered is a distinction without a difference that does little to advance the public interest.

Section 1473 does not appear to express clear congressional intent with respect to independent contractors versus employees. Based upon the statute, it would appear that the agencies have wide latitude to apply the minimum standards to the broader class of individuals who impact appraisals.

With respect to the exclusion of appraisal firms from the regulation: we disagree that the focus of Congress was on the business models rather than the impact that appraisal entities have on taxpayers, consumers, and the U.S. economy. Rather than look to the perceived and assumed differences in business models, we suggest that the more rational and policy-sensitive delimiter is to focus on the activities of the entities and whether those valuation activities affect taxpayers, consumers, and the U.S. economy. Again, a performance-based approach is preferable.

While the business models may be different in terms of legal status, their performance can be similar in important functional respects. For example, both AMCs and appraisal firms have a strong impact on taxpayers, consumers and the U.S. economy. Both can and do impact federally-related transactions. Both can and do perform appraisal reviews. Notwithstanding the bare difference in legal forms, their functional similarities are greater than their differences.

Section 1473 does not appear to express clear congressional intent for a categorical exemption of appraisal firms from coverage under this regulation. Again, the agencies appear to have wide latitude include appraisal firms under the regulation.

If the agencies determine to maintain the distinction between AMCs and appraisal firms, this distinction will be dispositive of the issue. Any distinction between AMCs and appraisal firms will be of crucial importance not only in determining which companies are regulated as AMCs but also how certain appraisal entities perform their activities to avoid crossing lines. The agencies cite AMCs as unique because DFA describes AMCs as "contracting with State-certified or State-licensed appraisers to perform appraisal assignments". This description is purported to be unique and exclusive to the AMC model and something which appraisal firms do not do; this theme is the only basis for distinction cited in the proposed regulation. Therefore, if this aspect of AMC practice is crucial, the agencies need to make it clear that any instance of “contracting out” assignments may be sufficient to convert appraisal firms to AMCs for the purposes of this regulation.

Parenthetically, we suspect that it will be important for the agencies and ASC to monitor industry developments on this subject area closely. This proposed regulation is not the only government action that will impact how companies manage employees versus independent contractors. At this writing, the Affordable Care Act provides an incentive for companies near the small business exemption thresholds to manage individuals as non-full-time employees, whereas this regulation could incentivize some AMCs to manage individuals as employees rather than independent contractors. The operation of both government actions simultaneously could generate significant pressures to classify individuals as part-time employees in the appraisal industry, which in itself is an unintended outcome driven by non-market factors.

We recommend that:

1) the agencies adopt the view already held by some states that both independent contractor and employee – both full-time and part-time – state-licensed or state-certified appraisers "count" for the purposes of this regulation;

2) the agencies take a performance-based, policy-impact-based approach that includes both AMCs and appraisal firms due to the relative immateriality of the business model distinction, based upon the more important fact that both AMCs and appraisal firms perform similar work and have similar impacts on taxpayers, consumers and the U.S. economy whose interests DFA seeks to protect; and

3) if the agencies do not adopt the approach set forth in 2) above, that they state clearly that the practice of retaining state-licensed or state-certified appraisers as anything other than full-time employees in appraisal firms is a factor that could trigger heightened scrutiny by the states for possible failure to comply with state AMC registration law, and which could be the subject of further action by the agencies (inasmuch as the agencies note that they will be monitoring such developments and that the agencies have authority to implement further additions to the state requirements).

Question 6. The Agencies request comment on the proposed minimum requirements for State registration and supervision of AMCs.

The proposed minimum requirements raise many questions with regard to purpose, scope, and how the states are intended to administer some of the requirements. In the absence of clear direction from either DFA Section 1473 or the proposed regulation, the states may interpret their authority so broadly as to cause concern among the regulated community of AMCs, and possibly among state personnel themselves.

Further, in the absence of clear direction on scope and purpose, the proposed regulation could incite pressures on state legislatures and regulatory enforcement personnel to take action for political/economic reasons other than the stated purposes of DFA.

We are particularly concerned about the lack of material regarding the purpose and scope of the following requirement: *(3) Examine the books and records of an AMC operating in the State and require the AMC to submit reports, information, and document…*

What is the narrowly defined purpose of examining "the books?"

In terms of scope and determining whether an AMC is complaint with a demand for the same, what constitutes "the books?"

May states demand access to any material they consider "the books" of an AMC? What are the limits of this authority? Is some demonstration of cause required to support such a demand? Will a complaint by a competitor, a partner, a contractor or other private parties be sufficient to compel a production of "the books" of a company?

What about the handling of proprietary information? May this information be released to the public or to competing AMCs, or others in the appraisal industry? May such material be posted at will by the states on the Internet?

The requirement for examination of "the books" does not appear in DFA Section 1473. We see no bill language to apply nor congressional intent to interpret. The sole source material seems to be the proposed regulation itself, which does not address these points.

Further, we are concerned about the purpose and scope of potential disciplinary and enforcement actions – what would trigger them and what disciplinary and enforcement actions might encompass. What about the guidance to prevent selective enforcement?

What are the legitimate bases for states to refuse or subsequently rescind registration?

What about procedural due process issues – notice, hearings, appeal?

It seems possible that all of these questions could be subject to 50 different interpretations, which is inconsistent with any uniformity that might be helpful to the states and the regulated community, and which we would anticipate in a federal scheme.

The uncertainty regarding these issues is one of the leading reasons why the proposed regulation could have the negative unintended consequence of spurring unhelpful political and lobbying activity within the states, and why many companies would be highly motivated to gerrymander their operations in any way possible to avoid being subject to this regulation; such a result would work against the apparent purposes of Section 1473, to expand registration and supervision of AMCs.

We recommend that:

1) the agencies provide substantive, detailed guidance, to both the states and the regulated community, regarding the issues mentioned above, to avert a highly and predictably variable application of the minimum standards in which none of the parties throughout the country know what to expect – and do so for all of the proposed minimum standards, but especially with regard to the sensitive provisions affecting "the books" and the disciplinary and enforcement actions;

2) if the agencies are not able to articulate purpose, scope, limits, procedural elements and more, that the elements of the minimum standards that cannot be articulated in a satisfactory manner be redrafted or omitted from the final rule.

Question 7. The Agencies request comment on the proposed approach to the appraisal review issue.

We agree with the agencies that the appraisal review issue should be addressed in a separate rulemaking.

Question 8. What barriers, if any, exist that may make it difficult for a State to implement the proposed AMC rules?

We would refer to the answer to Question 6 regarding the need for guidance on particularly sensitive issues in the proposed minimum standards, but all of the questions addressed in detail above could serve as barriers unless the agencies provide the states additional guidance and the modifications suggested.

Question 9. What aspects of the rule, if any, will be challenging for States to implement within 36 months? To the extent such challenges exist, what alternative approaches do commenters suggest that would make implementation easier, while maintaining consistency with the statute?

As drafted, the proposed rule creates tangible lobbying incentives for the competitors and opponents of the AMC industry to generate organized political opposition and employ dilatory tactics to prevent enactment of a new registration and supervision law in the 12 states that have yet to enact such a scheme.

The motive for AMC opponents and competitors is clear: if the non-participating states fail to enact a scheme that meets the requirements of the proposed regulation, no AMC in such states may perform services related to a federally related transaction in those states.

In such states, AMCs would be utterly barred from conducting any business related to federally related transactions, through no fault of their own, despite their capability and willingness to comply with the proposed minimum standards, despite demonstrated professionalism, a track record of success, and the capability to serve the interests of consumers and lenders alike in a way anticipated by Section 1473 and this proposed regulation. AMC owners can carry registration papers to the statehouse steps with registration fee checks in hand.

None of this will matter. In such states, AMCs will be barred. Without recourse.

The instant regulatory prohibition on AMCs in such states will be limited only to federally related transactions. But we would expect the uncertainty in lending transactions prior to acceptance and closing, and the general stigma that will attach to AMCs, will work an effective bar on most or all types of AMC transactions. At the least, this is a foreseeable consequence that the proposed regulation should anticipate.

Without substantial changes, the proposed regulation could become one of the most overtly local-protectionist government actions in recent memory.

Under the proposed regulation, non-participating states may continue to operate without a registration and supervision law, without recourse and without penalty. The agencies recognize that a significant number of states – at present time in the range of 10 to 12 states – have not enacted legislation on this issue (we are unclear whether all states that have some manner of registration and supervision law have laws that meet all the minimum requirements set forth in the proposed regulation).

For the purposes of conducting the reg flex analysis, "the Bureau assumed States that have not yet passed an AMC licensing and registration law (14 States, as of July 2013; this number is expected to decrease by the time the Agencies adopt a final rule) would all elect to pass such a law and establish an AMC licensing and supervision program that satisfies the standards of the proposed rule. This assumption is taken to establish an outer bound. Because the proposed rule does not require States to adopt the minimum requirements in the proposed rule, however, it is possible that not all 14 States would do so."

Given the scenario set forth below, it is quite possible that many of the non-participating states will not meet the enactment deadline, with or without the 12-month extension that ASC is allowed to grant in certain circumstances.

In fact, the proposed rule could incite lobbying activity in participating states to rescind their existing schemes. The proposed rule does not address potential backsliding by participating states, but the possibility seems to exist.

It would be difficult to envision a more attractive incentive for AMC opponents and competitors to contact their state legislators to thwart passage of a new law, or repeal of an existing law.

While the legislative history and congressional intent of Section 1473 is thin, we are confident that Congress did not intend to encourage state legislatures to either avoid enacting new AMC registration and supervision laws – or repeal existing laws.

The following scenario in the non-participating states seems both clear and quite possible, perhaps likely:

a) Appraisal-related companies will take the purposeful business actions necessary to avoid coverage under the proposed regulation, using the afore-mentioned provisions that many in the business community will regard as loopholes to avoid classification as an AMC.

To accomplish this purpose, AMCs or similar companies will attempt to --

1) adjust their appraisal networks or panels to operate under the 15/25 threshold, or

2) attempt to classify independent contractors as temporary employees to achieve the same purpose, or

3) attempt to operate as and classify themselves as appraisal firms, possibly by using the independent-contractor-to-temporary-employee-method, or

4) engage in any combination of the above.

b) Once such companies have avoided classification as an AMC, they and similarly situated non-AMC companies will prevail upon their state legislators to thwart passage of new registration and supervision laws -- and possibly seek repeal of existing laws in participating states – all to eliminate competition from AMCs that cannot avoid or will not engage in activity to avoid classification as an AMC.

Clearly, the solution to avert this problem before it starts is to amend the proposed regulation to allow an alternate mechanism for willing AMCs to comply with the minimum requirements and continue to operate in states that fail to enact a registration and supervision statute within the time frames set forth.

The most attractive, efficient and feasible mechanism would be for AMCs that operate in non-participating states after 36/48 months to register with ASC and submit to supervision by ASC.

The ASC registration alternative would:

a) allow willing AMCs to continue operating in non-participating states, avoiding the unintended harsh result that would occur otherwise achieving a much more equitable solution, and allowing AMCs to continue to serve consumers and lenders in such states, paying registration and renewal fees and adding to a more accurate and complete reporting database of AMC registrants; and

b) neutralize much of the political incentive to thwart the enactment of registration and supervision statutes in the non-participating states. In this sense, the provision for the ASC registration alternative would likely help non-participating states move forward with legislation and help achieve the Section 1473 goal of promoting registration and supervision of AMCs; and

c) forestall any possible efforts to repeal existing registration and supervision laws in participating states before such discussions can begin.

We recommend that the agencies amend the proposed regulation to provide for an alternate means for AMCs to continue operating in non-participating states that fail to meet the 36/48 month enactment deadlines, based on registering with, submitting to supervision under, and paying fees to, ASC.

Thank you for the opportunity to comment.

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