January 12, 2009

Office of the Comptroller of the Currency, Treasury (OCC)
Docket ID OCC-2008-0021
regs.comments@occ.treas.gov.
250 E Street, S.W., Mail Stop 1-5, Washington, DC 20219.

Board of Governors of the Federal Reserve System (FRB);
Docket No. OP-1338
regs.comments@federalreserve.gov
Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW., Washington, DC 20551

Federal Deposit Insurance Corporation (FDIC)
Comments@FDIC.gov.
Robert E. Feldman, Executive Secretary, Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW., Washington, DC 20429.

Office of Thrift Supervision, Treasury (OTS);
ID OTS-2008-0012
Chief Counsel's Office, Office of Thrift Supervision
1700 G Street, NW., Washington, DC 20552

National Credit Union Administration (NCUA).
"Durkin Comments on Proposed Interagency Appraisal and Evaluation Guidelines,"
regcomments@ncua.gov
Mary F. Rupp, Secretary of the Board
National Credit Union Administration
1775 Duke Street, Alexandria, Virginia 22314-3428.

Please consider the following recommendations. The window of opportunity is open to enable your agencies to create and enforce a clear concise remediation to the decades of mismanaged collateral valuation.

I have included a statement of qualifications at the end of these comments. My experience includes appraising real estate and other assets for over 35 years.

1. **Adopt USPAP for All Asset-Based Lending**. Recognize USPAP as the generally accepted appraisal standards for machinery, equipment, inventory, all asset appraisals, including its common application to real estate as required by state licensing. Adopt USPAP without interagency agency interpretations, e.g. '*scope of work rule, the word 'estimate' was dropped in 2002, purpose was dropped in 2006, departure rule dropped in 2006, etc.*' Some of the words in the 'new' guidelines are no longer applicable, e.g. 'estimate'. Remove otherwise ambiguous guidelines from the new proposed guidelines. USPAP is amended every two years. It would be an undue burden on the federal financial regulatory agencies to rewrite and upgrade the guidelines every two years. In addition to the overall problem of rewriting guidelines, there is a tendency by scriveners to interpret USPAP wording. The great majority of appraisers, including machinery, equipment, and inventory appraisers, are required by their associations to remain current with USPAP. In the proposed guidelines

    a. Save extensive rewrites by adopting or otherwise copying the IRS application of USPAP. In October 2008, the IRS completed its guideline update of defining a *qualified appraisal* and *qualified appraiser*. *§1.170A-17*.

        i. **Qualified Appraisal**. A*n appraisal document that is prepared by a qualified appraiser in accordance with generally accepted appraisal standards. Generally accepted appraisal standards are defined in the proposed regulations as the substance and principles of the Uniform Standards of Professional Appraisal Practice (USPAP), as developed by the Appraisal Standards Board of the Appraisal Foundation*

        ii. **Qualified Appraiser**. In August 2008, the IRS amended Notice 2006-96 and adopted USPAP as the generally accepted appraisal standards for <u>ALL</u> property types. In addition, the IRS defined a qualified appraiser as "*an individual with verifiable education and experience in valuing the relevant type of property for which the appraisal is performed.*" The IRS removed the presumed qualification of an appraiser designation in favor of the designation being evidence of education and experience.

    b. USPAP is vitally applicable to all *asset based lending*. Without generally accepted appraisal standards, the risk management function of financial institutions is open to arbitrary valuation of a significant asset group. Ambiguity in appraisal standards leads to uncertainty. Uncertainty in the interpretation of the standards leads to an *anything-goes-rule.*

    c. "*Independent and reliable collateral valuations are core to a regulated institution's [*replace *real estate* with collateral*] credit decisions. Therefore, the proposed Guidelines are intended to re-enforce the importance of sound collateral valuation practices that the Agencies' appraisal regulations mandate*" [Page 10 of Proposed Guidelines].

   d. The credit culture should require USPAP for UCC Article 9 Collateral as well as for real estate collateral.

2. **Adopt a Form of Enforcement to Insure Compliance**. Create an interagency enforcement by the use of fines, penalties, or removal of the appraiser from employment consideration. This would enforce compliance with USPAP <u>for all property appraisal types</u>. Without enforcement, there is passive compliance.

   a. At present, there is literally no USPAP compliance enforcement.
      i. State real estate appraisal licensing boards are staffed by a mixture of one licensed real estate appraiser, one certified residential real estate appraiser, one certified general appraiser, one banker, one broker and one lay person. The majority of the board lack USPAP competence to professionally Review or critique appraisals. There is no requirement to have a USPAP Appraisal Foundation Certified Instructor on any board.
      ii. The various appraisal association Peer Review Committees similarly lack competence in USPAP. Where they exist, the peer review is fraternal in the approach to performance remediation.
      iii. Only the IRS has in place fines, penalties, and disbarment. The IRS has for over 20 years had fines and penalties for appraisers who negligently or intentionally provide faulty appraisals. This past year the IRS increased the penalties.
   b. The federal financial regulatory agencies, by adopting a form of enforcement, can significantly improve the quality of appraisal in both real estate and other asset based lending.
   c. Federally chartered banks are subject to periodic audit by the Office of the Comptroller of the Currency (OCC). These examinations once included a review of trust account compliance with valuation guidelines to ensure the proper, periodic valuation of trust assets. The periodic audit of underlying appraisals supporting asset based lending would help insure better quality of risk management.
   d. The perception of enforcement would by itself threat improve appraisals.

3. **Encourage or Mandate Financial Institution Risk Managers to Become USPAP Competent and Appraisal Review Competent for <u>All</u> Asset-Based Lending**.
   a. An appraisal is a professionally researched opinion about the economic exchange value of the rights inherent in the ownership of property. An appraisal is an argument where the credibility and competence of the messenger is as important as the logic of the message.
   b. Train in-house appraisal reviewers for asset based lending and/or subcontract to independent competent USPAP Reviewers. [USPAP Standard Rule 3].
   c. The material is available by either subcontracting USPAP review and course work or employing USPAP Certified instructors sponsored by local banking

associations, by the bank itself, or through groups like Risk Management Associates. In addition, the American Society of Appraisers (ASA) has an extensive series of courses in *appraisal review and management*. ASA awards an *appraisal review* designation to people completing the requirements. Under the impetus of Basal II, this ASA material is currently being taught in Russia, Australia, Mexico, and the U.S.

d. And if that availability is not sufficient, there are many USPAP Appraisal Foundation Certified Instructors all over the U.S. available to provide the training.

The passage of FIRREA Title XI in 1989 [Pub. L. 101-73, 103 Stat. 183 (1989)] was intended to improve and protect financial institutions by providing educated, tested, and licensed independent appraisers. It mandated state licensing of real estate appraisal and required all appraisals to be performed in accordance with USPAP. FIRREA created the Appraisal Subcommittee to oversee state licensing and the Appraisal Foundation.

Twenty years have passed since FIRREA and Title XI. Why is the subject of improved regulation of appraisal and banks a continuing problem? There are many reasons. Leaving aside the easy credit and ephemeral securitization issues, there is (1) the advent of unregulated mortgage broker-salespeople parading as bankers and then bankers owning mortgage broker subsidiaries, (2) overt pressure on underpaid URAR/Fannie Mae/Freddie Mac form appraisers, (3) Mortgage brokers selling easy credit Ninja loans (i.e. no income, no job, no asset loans), (4) Drive by appraisals, (5) Low fee Uniform Residential Appraisal Report (URAR) form filling that require little analysis and that include disclaimer on environmental issues, unsupported adjustments, ten minute inspections, automatic clauses, no study of the deed, a fee split on an average $350 gross, and a push to get 10 to 20 form appraisals done in a week.

Residential appraisers, regardless of the number of USPAP courses, were performing and continue to perform like the rest of their peers; quick turn-around, self-deception, and simplification. All of which led to routine negligence and group-think incompetence. Encouraged by the Fannie Mae market there was little oversight. The residential appraiser mantra continues to be "everyone does it that way." Commercial appraisal reports too have fault. The reports are generally a rambling elongated jumble of disjointed unsupported statements and assertions, filled with boilerplate appraisal jargon, idiomatic expressions, and professional society dogma, all wrapped in a weighty package. It is common humor among commercial real estate appraisers that a gorged report is sold by the pound. Benign negligence, their adherence to traditional appraisal dogma, an inability to present an argument with sufficient evidence to support the valuation assertion continues.

Mandating USPAP for all asset-based lending combined with objective professional USPAP review and the threat of penalties for non conformance will significantly improve the risk associated with institution's loan collateral.

The federal financial regulatory agencies that oversee the process of collateral appraisal are in a unique position to improve this condition.

Bank management is ultimately responsible for the valuation quality of collateral appraisals. Bank management would be well served by breaking with the old way of relying on *designated real estate appraisers* and insisting on USPAP compliant appraisals and competent appraisers for all asset based lending will. The new emphasis is on Risk Management. Basal II, IFRS, IVS, and change require a fresh look at the three Cs of know your borrower's character, know your borrower's capacity to repay, and know your collateral. Reduce the collateral risk by insisting on USPAP compliant appraisals. Mimic the IRS Rules where possible. Include USPAP training for bank risk managers

Sincerely,

Roger P. Durkin, Esq.