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Appraisal Subcommittee

Federal Financial Institutions Examination Council

Testimony on the Current State of the Appraisal Industry Oversight and Regulation
by

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Chairman, Appraisal Subcommittee
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Housing and Transportation Subcommittee

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Introduction and Background

Good afternoon, Chairman Allard and members of the Subcommittee. Thank you for the opportunity to discuss the current state of the appraisal industry and its Federal and State oversight. On behalf of the Appraisal Subcommittee (“ASC”), I commend your Subcommittee’s initiative to understand the current state of the industry and assess the current regulatory structure and its ability to ensure that Federal financial and public policy interests in real estate related financial transactions are protected, consistent with Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, as amended (“Title XI”).

I am the Chairman of the Appraisal Subcommittee. The Chairmanship of the Appraisal Subcommittee, which was created on August 9, 1989, pursuant to Title XI, rotates bi-annually among the Subcommittee membership. I also serve as Associate Director at the FDIC, where my responsibilities involve safety and soundness of bank examination policy.

In general, the ASC oversees the real estate appraisal process as it relates to federally related transactions – any real estate related financial transaction entered into on or after August 9, 1990, that a Federal banking agency or any regulated depository institution engages in or contracts for,

and requires the services of an appraiser. The ASC membership includes representatives from each of the five members of the Federal Financial Institutions Examination Council, and from the Department of Housing and Urban Development.

Following the financial crisis of the 1980's, Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"). Title XI of FIRREA addressed the identified weaknesses regarding real property appraisals used in connection with federally related transactions. Prior to FIRREA, appraisals for federally related transactions and the appraisers who performed them, were, for the most part, unregulated at either the Federal or State level. In most States, the only legal requirement to become an appraiser was that the individual obtain a business license from the county or other local jurisdiction. During the financial crisis of the 1980's, poor quality appraisals were a contributing factor to the numerous bank and savings and loan failures. Title XI sought to address this situation.

Title XI created a unique system. As noted in the General Accounting Office ("GAO") May 2003 report titled, *Opportunities to Enhance Oversight of the Real Estate Appraisal Industry*, Title XI created a complex oversight structure for real estate appraisals and appraisers that involves private, State, and Federal entities. Two private entities within the Appraisal Foundation establish uniform rules for real estate appraisals (*i.e.*, the Uniform Standards of Professional Appraisal Practice ("USPAP")) and set minimum criteria for certifying appraisers (*i.e.*, The Real Property Appraiser Qualification Criteria). The Appraisal Standards Board and the Appraiser Qualifications Board, respectively, establish these rules and criteria. State regulatory agencies (*i.e.*, 50 States, the District of Columbia, and five territories) certify appraisers based on these

criteria. The Federal financial regulatory agencies (“Agencies”) oversee financial institutions’ use of appraisals.

Responsibilities of the Appraisal Subcommittee

Title XI sets out the ASC’s general responsibilities:

- Monitor the requirements established by the States, Territories, and the District of Columbia and their appraiser regulatory agencies (“State agencies”) for the certification and licensing of appraisers. The ASC reviews each State’s compliance with the requirements of Title XI and is authorized by Title XI to take action against noncomplying States;
- Monitor the requirements established by the Agencies regarding appraisal standards for federally related transactions and determinations of which federally related transactions will require the services of State licensed or State certified appraisers;
- Maintain a national registry of State licensed and certified appraisers who may perform appraisals in connection with federally related transactions;
- Monitor and review the practices, procedures, activities, and organizational structure of the Appraisal Foundation; and
- Transmit an annual report to Congress regarding the activities of the ASC during the preceding year.

The ASC is funded by a \$25 per year fee for an appraiser to be listed on the National Registry of State Certified and Licensed Appraisers (“Registry”). States collect these fees as part of their licensing, certification, and renewal activities and remit the Registry fees to the ASC. Although the ASC has the authority to increase the fee up to \$50, we have maintained the Registry fee at the same \$25 that was established in 1989. The annual operating budget of the ASC is \$2.1 million. Through automation and contracting out, the ASC has reduced staffing from nine employees to seven over the last 15 years and has attempted to maintain a high level of operating efficiency.

Status of State Compliance with Title XI

Generally, States do a good overall job of enforcing compliance with Title XI, given the resource limitations facing most States. Although some States have areas that need improvement, we have found most States generally compliant with Title XI.

Our primary tool for evaluating State compliance with Title XI is a three-year on-site review cycle. Given Title XI’s 56 jurisdictions, ASC staff performs on-site reviews of approximately 18 States per year, plus conducting several follow-up reviews. Once we have completed the field review and formally transmitted our findings to the State, we work with the State to ensure correction of noted areas of concern. Most States address our concerns in a timely manner. Currently, the most problematic area involves complaint investigation and resolution. Because this area requires specialized personnel and expertise, it is one of the more complex and costly functions for State appraiser regulatory agencies. Consequently, some States are not as timely in

their complaint investigation and resolution efforts as they should be. Each year, we provide a summary of significant areas of concern identified during our field reviews in our annual report to Congress.

National Registry of State Certified and Licensed Appraisers

One of the ASC's primary responsibilities is maintenance of the Registry. During the past several years, the ASC has made the Registry available via the Internet to States and the public. We added sections reserved for State-only access to facilitate State efforts in areas such as researching the license history of appraisers and determining whether an appraiser is in "good standing" in another State. We have added automated email notification to States, lenders, and other parties when appraiser credentials are revoked or suspended and when they expire. We continue to evaluate the Registry to add features that improve its value to the States, lenders, and the general public.

Appraisal Foundation

The ASC monitors the activities of the Appraisal Foundation and its Appraiser Qualifications Board and Appraisal Standards Board to ensure that their actions are reasonable, not arbitrary or capricious, and otherwise consistent with law. As authorized by Title XI, the ASC also provides funding, via annual grants, to the Foundation and its boards to support their Title XI-related activities.

Challenges Ahead for the Appraiser Industry

In many cases, it is difficult for appraisers licensed or certified in one State to appraise properties in other States. Title XI requires that States issue temporary practice permits to appraisers on a single assignment basis, but imposes this requirement only for federally related transactions. Also, the appraiser must apply each time he or she wishes to perform an assignment in that State. Often, delays in completing the temporary practice approval process conflict with the timing needs of the parties involved in the real estate transactions.

While Title XI requires States to offer temporary practice for federally related transactions, it only encourages States to offer license and certification credentials via reciprocity agreements with other States. To enter into such agreements, some States require formal written agreements with other States, while other States' laws prohibit them from entering into such formal agreements. Some States have developed methods of informally offering reciprocity to appraisers. Nonetheless, impediments to interstate movement of appraisers are a concern repeatedly expressed to us by lenders and appraisers with regional or national operations.

With 56 Title XI jurisdictions issuing implementing statutes and regulations, there is a considerable amount of conflict and overlap among the States. For example, appraisers who hold appraiser credentials in multiple States might have to take the same continuing education course multiple times to meet the continuing education requirements of various States. Additionally, a continuing education course that is acceptable to one State might not be acceptable to another.

Another issue, which was raised in the GAO report, is the applicability of Title XI to residential mortgage transactions handled by mortgage brokers. These entities were not captured by Title XI as most mortgage brokers are not regulated at the Federal or State level. The ASC raises this issue as we have received a number of comments on appraisal abuse by mortgage brokers. Many estimates indicate that mortgage brokers originate as much as 50 percent of all residential mortgage loans.

Other issues that the industry and regulators are grappling with include the appropriateness of automated evaluation methodologies and the rapidly increasing market values of residential properties in some markets.

Conclusion

Some contend that the need for Federal law and Federal oversight of the appraiser regulatory system no longer exists. Given the difficulties we have experienced in achieving some level of consistency among States to better facilitate interstate lending and appraising activities, we believe that a lack of Federal law and oversight would allow the system to become increasingly fragmented to the overall detriment of the appraisal industry.

Considering the complexity inherent in the appraiser regulatory structure and the weaknesses discussed above, the system functions reasonably well. At 15 years, the appraiser regulatory system is relatively young. We expect continued adjustments and challenges as the system matures.

This concludes my testimony. I will be happy to answer any questions the Subcommittee might have.

Sincerely,

Steven D. Fritts

Chairman