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Remarks by  
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Member, Board of Governors of the  
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to the  
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Sponsored by the  
Appraisal Subcommittee of the  
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I am pleased to be with you this morning to address the role and responsibilities of the federal financial institutions regulatory agencies in implementing the provisions of Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, and to discuss the important part that the states have in improving and maintaining the quality of real estate appraisals and the professionalism of appraisers.

To begin with, no discussion of appraisal regulations or, for that matter, any other regulatory requirement affecting insured depository institutions, can ignore the special and extensive regulatory environment in which banks, thrifts, and credit unions operate. Society's reliance on the banking system and the government's deposit insurance guarantee has led to these depository institutions being treated differently from other types of financial enterprises. While I certainly would not argue that these institutions should not be held to the highest standards of safety and soundness, the fact remains that many of the laws passed by the Congress have imposed regulatory requirements and operating constraints on depository institutions, that, in general, are not imposed upon other businesses that carry out the same kinds of transactions and serve the public in many similar ways.

Even though these statutes and regulations--those related to safety and soundness and those related to other public policy goals--address legitimate concerns, they still impose significant costs on the banking system. These costs stem not only from the need for additional personnel and other resources

to insure compliance, but also from the diversion of management's attention from serving the everyday needs of the institution's depositors and borrowers. Title XI, by requiring the agencies to issue very detailed real estate appraisal regulations, is yet another example of how banks and other depository institutions are treated differently from other businesses such as insurance companies, mutual funds, and other nondepository financial institutions which are in direct competition with them.

In issuing their appraisal regulations, the agencies have, as always, complied with both the letter and the spirit of the law. Concerned about the administrative burden that these regulations would impose upon depository institutions and the increased costs of compliance that would have to be passed on to customers--particularly homeowners and small businesses--the banking agencies adopted a \$100,000 appraisal threshold. Federally related transactions below this threshold amount do not have to be documented with an appraisal prepared by a licensed or certified appraiser but must be supported by an appropriate evaluation of the real estate collateral prepared in conformance with the supervisory guidance. And, it must clearly set forth an estimate of the current market value of the underlying real estate collateral. On the other hand, those federally related transactions above the threshold require appraisals performed by state licensed or certified appraisers in accordance with the regulations.

In the agencies' experience, credit losses arising from inadequate appraisals of 1- to 4-family residential loans, which comprise the vast majority of those real estate related transactions that fall below \$100,000, have not been a significant cause of failures among depository institutions. Given that the median average sales price for existing single-family homes in 1990 was \$95,500 and for new homes \$122,900, the agencies believed that the \$100,000 limit was a reasonable threshold. I would note that while the agencies' decision to establish a threshold was controversial at the time, the authority of the agencies to establish such an appraisal threshold was recently addressed by the Congress as I will describe in a little more detail in a moment.

It has been large real estate loans for commercial and multi-family residential properties which have been the major cause of losses. But, we are also concerned about problems stemming from relatively small- or medium-size loans which result in some of the losses to individual institutions. Accordingly, the agencies have all adopted supervisory guidelines for real estate appraisals and evaluations for all sizes and types of real estate loans.

As the agencies proceed with the implementation of Title XI, we are also evaluating the impact our appraisal regulations may be having on the availability of credit to qualified borrowers. In line with the President's initiative to reduce regulatory burden to all businesses, the Federal Reserve

Board, in conjunction with the other agencies, is currently developing a proposal to amend its appraisal regulation. We want to eliminate appraisal standards that are similar to or duplicative of the Uniform Standards of Professional Appraisal Practice ("USPAP"). The proposal will simplify the regulations and make clear to appraisers and insured depository institutions that the USPAP standards are acceptable for all appraisals of federally related transactions and fulfill the requirements of Title XI. Many individuals, particularly appraisers, have mistakenly believed that two separate analyses were needed in every appraisal of a federally related transaction in order to satisfy both the requirements of the appraisal regulations and the standards set forth in USPAP. Such is not the case. Our actual experience with appraisals since the USPAP standards were issued in final form in June of 1990 appears to indicate that the USPAP standards adequately address our concerns as supervisors and the purposes of Title XI.

We are also considering permitting appraisers to use the Departure Provision of USPAP. This would allow appraisers to limit the scope of an appraisal assignment when every specific guideline prescribed in USPAP is not needed to render a reliable estimate of value. By allowing appraisers to use the Departure Provision, an appraiser will be able to modify the appraisal scope when some USPAP guidelines are not appropriate for a particular assignment or for a particular type of real estate. In addition, this proposed change would permit the use of

appraisal updates which are not presently permitted under the agencies' regulations. Both of these changes should serve to lower the costs of appraisals to the public.

Board staff and staff of the other agencies have just begun discussing these changes so I cannot give you a timetable for implementation, but we intend to move as quickly as possible.

Now, I would like to discuss briefly some recent Congressional actions pertaining to our joint responsibilities in the area of appraisals. In the closing days of the last Congress, several bills were passed that impact Title XI. They are awaiting the President's signature. The first is an amendment to the Housing Bill which would confirm the agencies' authority to establish a threshold below which an appraisal performed by certified or licensed appraisers would not be required for federally related transactions. Some of the federal financial institutions regulatory agencies have been sued by an appraiser organization challenging the agencies' authority to establish such thresholds. This amendment to Title XI confirms the agencies' authority to establish such a threshold.

This recent Congressional action draws attention to the fact that some states have incorporated the agencies' \$100,000 threshold and the federal agencies' appraisal requirements for federally related transactions into state laws governing appraiser licensing and certification. This is causing a considerable amount of confusion among federally regulated institutions in those states where the state requirements differ

from the federal regulations. Consistency between federal and state standards will not only reduce the costs and burden of compliance, but will insure better appraisals and more informed credit decisions by lenders. I believe it would be better for the states to defer to the federal agencies on these matters. Rather than pass state laws that attempt to quote federal appraisal standards in detail--standards which will change over time creating inconsistency between state and federal requirements--it would be far more efficient to simply defer to the federal regulations. Furthermore, I think it would be better for all interested parties if states did not attempt to define federally related transactions in their statutes or regulations. The determination of what constitutes a federally related transaction is the province of the federal financial institutions regulatory agencies as specifically set forth in Title XI. If a state chooses to define federally related transactions differently, it can only lead to unnecessary confusion and inefficiency in the appraisal process.

The Congress recently also passed the Depository Institutions Disaster Relief Act which in part deals with the appraisal requirements for regulated institutions regarding real property located in federally designated disaster areas. The Act amends Title XI to provide the agencies with the ability to waive appraisal requirements for areas in which the President has determined a major disaster exists. While the Disaster Relief Act was intended to assist those areas struck by Hurricanes

Andrew and Iniki, the amendment was structured to allow the agencies to grant, if they so determine, appraisal relief in future disasters as well.

As I said at the beginning of my remarks, the states have a very important role in improving and maintaining the quality of real estate appraisals and professionalism in the appraisal industry. In that regard, the agencies will be looking to the states to establish strong and effective regulatory programs for the supervision of certified and licensed appraisers. This is a critical component of Title XI and one which is key to strengthening the appraisal process. Moreover, regulated institutions depend on the states to ensure that individuals awarded state appraiser certifications or licenses have met minimum qualification requirements.

In my view, such qualification requirements depend not only on minimum standards for testing, education, and experience, but also on the enforcement of a professional code of conduct. Appraisers as well as the users of appraisal services should be able to depend on the states to take appropriate disciplinary action against disreputable and unethical appraisers.

I also want to touch briefly on another state matter which affects many federally regulated institutions. Appraisers should be able to practice on a multi-state basis. Many of our larger regulated institutions lend in more than one state and have commented on the differences among the states respecting temporary practice privileges for appraisers. In this



connection, it should be recalled that Title XI specifically included a provision which directed the states to recognize on a temporary basis an appraiser license or certification from another state when the appraiser is conducting an appraisal for a federally related transaction. I encourage you to consider the needs of multi-state lenders in establishing reasonable temporary certification and licensing privileges. I understand that many states have entered into reciprocity agreements with other states and I believe that approach would help to meet the needs of both lenders and borrowers.

In conclusion, while I believe Title XI has contributed to strengthening appraisal procedures, I also believe that the appraisal process is not an exact science and, thus, should not be the sole basis upon which regulated institutions make real estate loans. Work still must be done on refining the appraisal process to avoid the use of dubious assumptions that contribute to exaggerated valuations in both the upside and downside phases of the real estate cycle as well as general business cycles. For these reasons, the principal factors in assessing the quality of a real estate loan include not only the value of the underlying real estate collateral, but also the borrower's willingness and capacity to repay the loan.

As we proceed in implementing Title XI, I want to assure you that the agencies will continue to monitor the effectiveness and impact of our regulations. As is true of any new regulation, we recognize adjustments may have to be made in

order to accomplish the desired objectives. We appreciate the efforts the states have made to implement Title XI, especially given the budgetary constraints many of you face. In this regard, the Federal Reserve, the other agencies, and the Appraisal Subcommittee look forward to continued cooperation between the federal and state levels of government to insure the orderly implementation of Title XI and to further the professional development of the appraisal industry and the quality of appraisals.

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