



June 16, 2011

Office of the Comptroller of the Currency  
Federal Reserve Board of Governors  
Federal Deposit Insurance Corporation  
Securities and Exchange Commission  
Federal Housing Finance Agency  
Department of Housing & Urban Development

Re: Credit Risk Retention Proposed Rule

The undersigned professional appraisal organizations, representing many thousands of professional appraisers in the U.S.<sup>1</sup> appreciate the opportunity to comment on the above-referenced “Credit Risk Retention” proposed rule (published in the Federal Register of April 29, 2011). The proposal, which would implement Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, generally requires a securitizer of asset-backed securities to retain not less than five percent of the credit risk of the assets collateralizing the securities. However the rule, as proposed, contains several important exemptions to or reductions in the risk retention requirement, one of which involves collateralized residential and commercial real estate loans that meet certain strict underwriting requirements including a “qualifying appraisal” of the property securing the loans.

Our comments focus on those aspects of the proposed rule which relate to the valuation of the assets collateralizing various categories of securitized loans. All page references are to the Agencies’ joint notice of proposed rulemaking in the Federal Register of April 29, 2011.

### EXECUTIVE SUMMARY

- **OUR ORGANIZATIONS STRONGLY SUPPORT THE PROPOSED RULE’S VALUATION REQUIREMENTS FOR SECURITIZED RESIDENTIAL AND COMMERCIAL LOANS COLLATERALIZED BY REAL PROPERTY ASSETS:** Our organizations strongly support the valuation provisions of the proposed rule relating to exemptions from or reductions in the credit risk retention requirements for securitized Qualified Residential Mortgages and for securitized Commercial Real Estate Loans. We appreciate the Agencies recognition that valuations of residential and commercial real estate properties collateralizing securitized loans by credentialed professional appraisers in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP), are an indispensable component both of safe and sound lending and secondary market investor protections.

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<sup>1</sup> Each of our organizations teaches, tests and credentials its members for professional appraisal practice and appraisal review in the area of commercial and residential real property valuation. Additionally, the American Society of Appraisers (ASA) is a multi-disciplinary appraisal organization that teaches, tests and credentials its members for professional appraisal practice and appraisal review in business valuation and in personal property valuation (including machinery and equipment, fine art, antiques, gems and jewelry and the contents of homes and offices).

- **SECURITIZED LOANS COLLATERALIZED BY NON-REAL PROPERTY ASSETS OR THAT ARE DEPENDENT FOR REPAYMENT ON THE INCOME OF OPERATING BUSINESSES, APPEAR TO LACK ESSENTIAL VALUATION GUIDELINES UNDER THE PROPOSED RULE:** While we strongly support the professional appraisal requirements involving securitizations collateralized by residential and commercial real property, we are extremely troubled by the fact that the proposal fails to address the valuation of non-real property assets collateralizing securitized machinery and equipment loans, securitized Collateralized Loan Obligations (CLOs) and other securities collateralized by valuable non-real property assets. We believe that investors in securities whose loans are collateralized by valuable non-real property assets, or whose repayment is dependent on the income of operating businesses, are entitled to the protection of knowing the market value of such assets or income streams at the time the loan is made. The failure of a final rule to require such valuations by properly credentialed valuation professionals would deprive investors of critical information about the safety and soundness of those loans, and would contradict the essential public policy purposes of the Dodd-Frank statute. There are currently thousands of professional appraisers with credentials specific to the valuation of business enterprises and non-real estate categories of property and who adhere to generally-accepted uniform appraisal standards as evidenced by USPAP, that are fully qualified to provide fair market value information to securitizers, lenders and secondary market investors. Indeed, Internal Revenue Service regulations currently require the use of a Qualified Appraiser and a Qualified Appraisal for valuing both real property and non-real property for many important tax purposes under the Internal Revenue Code. The Agencies could readily apply these or similar tax-related valuation requirements to their credit risk retention rule when non-real property assets or business income are relevant to loan repayment; and, thereby, greatly enhance lender and investor protections. Our organizations would be pleased to work with the Agencies on the development of such guidance.
- **THE PROPOSED VALUATION REQUIREMENTS INVOLVING EXEMPTIONS FROM OR REDUCTIONS IN THE AGENCIES' CREDIT RISK RETENTION POLICIES SHOULD BE APPLIED TO ALL LENDING TRANSACTIONS AND SECURITIZATIONS:** Our organizations recognize that the purpose of the proposed rule is to establish rigorous underwriting requirements for securitized loans that are eligible for exemptions from or reductions in credit risk retention requirements (which some characterize as super-safe loans). We also recognize that consumer organizations and a number of other key stakeholder groups have expressed concerns about the prudence of a final risk retention rule that would require prospective borrowers to make a 20 percent down payment and have an overall debt-to-income ratio that is out-of-reach for the vast majority of potential homebuyers. We share those concerns. Nevertheless, we believe that the underwriting requirements which relate only to collateral valuations should be applied uniformly to all loans that are of consequence to borrowers or to investors in the secondary markets, entirely apart from risk retention considerations. A professional appraisal of the market value of property, or of an income stream which serves as a significant source of loan repayment in the event of borrower default, is no less important to consumers and investors than an appraisal which is required in connection with an exemption from or reduction in credit risk obligations. There is no

more cost-effective consumer and investor protection in connection with extensions of credit and the securitization of credit than the performance of a valuation of collateral by a professional appraiser, including the viability of an operating business' stream of income to repay its loan.

## DISCUSSION

### **I. Valuation Issues Relative To Risk Retention Exemptions For Qualified Residential Mortgages (QRM)**

Our organizations strongly support the valuation provisions of the proposed rule relating to the qualified residential mortgages exemption based on our understanding of the meaning of the term "Qualifying Appraisal," both as defined in the Text of the Proposed Common Rules and as described in the Agencies' Commentary on the rule. The text of the rule (found at pages 24165 and 24167) states:

Qualifying appraisal means an appraisal that meets the requirements of Sec. \_\_.15(d)(11) of this part." Sec. \_\_.15(d)(11) states, "Appraisal. The creditor obtained a written appraisal of the property securing the mortgage that was performed not more than 90 days prior to the closing of the mortgage transaction by an appropriately state-certified or state-licensed appraiser that conforms to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP) promulgated by the Appraisal Standards Board (ASB) of the Appraisal Foundation, the appraisal requirements of the Federal banking agencies, and applicable laws.

The Agencies' commentary (page 24125) states, as follows:

Qualifying Appraisal. After considering a variety of valuation information sources, the Agencies are proposing that a QRM [a Qualified Residential Mortgage that is exempt from the risk retention requirements] be supported by a written appraisal that conforms to generally accepted appraisal standards, as evidenced by the Uniform Standards of Professional Appraisal Practice, the appraisal requirements of the Federal banking agencies, and applicable laws. The Agencies' believe these requirements will help ensure that the appraisal is prepared by an independent third party with the experience, competence and knowledge necessary to provide an accurate and objective valuation based on the property's actual physical condition. These requirements are intended to ensure the integrity of the appraisal process and the accuracy of the estimate of the market value of the residential property.

Based on the text of the proposal and the accompanying commentary, we have concluded that reliance on a broker price opinion, an automated valuation model or an "evaluation" to establish the market value of a property collateralizing a securitized residential mortgage loan would not meet the definition of a "Qualifying Appraisal" and would prevent a mortgage from being considered a Qualified Mortgage Loan.

If our understanding is correct, our organizations stand in strong support of the proposal as it relates to mortgage-backed securities; and, we congratulate the rulemaking Agencies on recognizing that valuations of residential properties collateralizing securitized loans by a credentialed professional appraiser in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP) are an indispensable component both of safe and sound lending and secondary market investor protections.

**Agencies Request For Comment:** In connection with the proposed definition of a “Qualifying Appraisal,” the Agencies’ request comment on whether “other valuation approaches [should] be considered in determining the value of the real property pledged on the mortgage transactions.” Our answer is a resounding **no**. Reliance on any valuation approach other than a professional appraisal in adherence with USPAP would defeat the essential public policy purposes of Dodd-Frank and the implementing rule. Reliance, for example, on broker price opinions would interject into the valuation process issues of potential conflict-of-interest as well as the absence of proper experience, training and accountability by those performing the BPOs. Similarly, automated valuation models are, at best, blunt instruments with which to determine fair market value of individual properties underpinning securitized mortgage loans because of the inability of AVMs to determine a property’s condition and to utilize appropriate comparable properties in anything other than “cookie-cutter” neighborhoods; and because generally-recognized best practices for designing and utilizing AVMs have not yet been developed.

## **II. Valuation Issues Relative To Reduced Risk Retention Requirements For Securitized Commercial Loans Collateralized By Real Estate (CRE)**

In the commentary on their proposed underwriting requirements for securitized commercial loans collateralized by real estate (CRE loans), the Agencies state:

Because the credit risk of a CRE loan is closely linked with the commercial real estate collateralizing the loan, the proposed rules include several conditions relating to the collateral. For example, under Sec \_\_.19(b) of the proposed rules, the originator of a qualifying CRE loan must determine whether the purchase price for the CRE property that secures the loan reflects the current market value of the property, so as to ensure that the collateral is sufficient to recover any unpaid principal in the event of default, and that the borrower has sufficient equity in the property to incent continued performance of all loan obligations during an economic downturn or when the CRE property’s NOI [Net Operating Income] may not be sufficient to cover loan payments. (See page 24133).

In order to determine the value of the CRE property, the proposed rules:

...require the originator to obtain an appraisal prepared not more than six months before the origination date for the loan, in accordance with the Uniform Standards of Professional Appraisal Practice and the appraisal requirements of the Federal banking agencies for the CRE property securing the loan. The appraisal report must provide an ‘as is’ opinion of the current market value of the CRE property, which includes an income approach that uses a discounted cash flow analysis based on the CRE property’s actual NOI. These requirements are intended to help ensure that the appraisal is prepared by an independent third party with the

experience, competence, and knowledge necessary to provide an accurate and objective valuation based on the CRE property's actual physical condition.

The proposal also calls on the originator of the CRE loan to conduct an environmental risk assessment of the CRE property securing a qualifying CRE loan and, based on this assessment, take appropriate measures to mitigate any risk of loss to the value of the CRE property, including a reduction in the loan amount sufficient to reflect potential losses. The proposal does not specify who should conduct the environmental risk assessment or establish any qualifications for doing so. Nor does the rule, as proposed, provide guidance on whether or how the findings of a risk assessment should be reflected in the appraiser's opinion of the value of the collateral property.

We note, approvingly, that Sec \_\_.19 (b)(ii) of the text of the proposed rule establishes underwriting standards of "qualifying CRE loans" that include valuation requirements similar to those established for qualified residential loans – that is, a written appraisal of the real property securing the loan that was performed "...by an appropriately state-certified or state-licensed appraiser" and which conforms to "generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP) promulgated by the Appraisal Standards Board and the appraisal requirements of the Federal banking agencies...".

Accordingly, we strongly support the proposed valuation requirements relating to "qualifying" CRE loans and commend the Agencies for their recognition of the importance of objective and reliable appraisals of property collateralizing such loans. the Agencies' commentary on this issue could be expanded and tightened to make clear that the proposed rule's valuation requirements pertaining to property collateralizing CRE loans are substantially the same as those that pertain to Qualified Residential Mortgages.

**Recommendation:** We recommend that the Agencies' commentary on this issue be clarified to make absolutely clear that the proposed rule's valuation requirements pertaining to property collateralizing CRE loans are substantially the same as those pertaining to Qualified Residential Mortgages.

### **III. Valuation Issues Relative To Reduced Risk Retention Requirements For Securitized Commercial Loans That Are Not Real Estate Collateralized**

The proposed rule permits securitizers to retain less than five percent of the credit risk of securitized commercial loans and automobile loans if the loans meet the underwriting standards established by the banking agencies for the purpose of ensuring that the assets pose a low credit risk. Indeed, billions of dollars in asset backed securities are sold into the marketplace that are either not collateralized by real estate or that do involve real estate but where the value of the underlying real estate collateral is not considered by the lender, during underwriting, to be a significant repayment factor. Machinery and equipment loans or leases and collateralized business loan obligations that are dependent for repayment on the operating incomes of businesses, often form the basis of securities sold to investors. We are troubled by the fact that the rule fails to properly address and provides little or no guidance on valuation issues for asset-backed securities whose loans are not collateralized by real estate or real property.

Because the American Society of Appraisers – a principal signatory to this comment letter – is a multidisciplinary professional appraisal organization which teaches, tests and credentials its members in business valuation and the valuation of machinery and technical specialties and other personal property, we are acutely aware of the critical importance that the valuation of non real estate assets plays in ensuring the integrity of many loan transactions and in protecting ABS investors. Our organizations are convinced that if investors in ABS have access to detailed and standardized loan-level information about asset-backed securities – specifically including the value of the assets whether or not they are real estate related – their financial risk will be significantly reduced. Based on rulemaking proposed in 2010 by the Securities and Exchange Commission relative to ABS issuance and due diligence requirements, we believe the Commission shares this basic philosophy. Moreover and importantly, Internal Revenue Service regulations currently require the use of a Qualified Appraiser and a Qualified Appraisal for valuing both real property and non-real property for many important tax purposes under the Internal Revenue Code. The Agencies could readily apply these or similar tax-related valuation requirements to their credit risk retention rule.

**Recommendation:** We strongly urge the Agencies to modify the proposed rule to include specific language (1) requiring the valuation of non-real estate assets that are relevant to the safety and soundness of a securitization and (2) establishing qualifications (including education, training and credentialing) for those valuing such assets, as a condition for a securitizer’s receiving either an exemption from or a reduction in its credit risk retention obligations. IRS regulations currently impose such requirements for a series of tax-related valuation purposes. We do not believe there is any public policy justification for differentiating, in the final rule, between real property assets and non-real property assets that enhance the likelihood of repayment of securitized loans in the event of borrower default.

#### **IV. The Agencies Should Apply Their Valuation-Related Underwriting Requirements Which Relate To Exemptions From Or Reductions In Risk Retention Requirements To All Collateralized Lending and Asset-Backed Securities**

Our organizations understand that the rule’s underwriting requirements for “qualifying loans” seek to carve out what some have referred to as “super safe” loans. However, we see no reason why the valuation requirements incorporated into the proposal should not apply to all lending and not just to a category of loans deemed to be “super safe.” We believe that federal requirements which pertain to all lending by regulated institutions and all federally-related securitizations should be designed to foster safety and soundness and protection for consumers and investors. With respect to valuations of collateral properties, we believe this means that the appraisals should always be performed by the most highly qualified and credentialed individuals who adhere to generally accepted appraisal standards (i.e., USPAP). Loan underwriting is either done in a manner which promotes safety and soundness or it is not. From a public policy perspective, we believe that the proposed rule’s valuation requirements for qualifying loans should apply to all lending. There is no more cost-effective consumer and investor protection in connection with extensions of credit and the securitization of credit, than the performance of an appraisal of collateral or the viability of an operating business by a professional appraiser.

Thank you for considering our views. If you have questions or need additional information, please contact the American Society of Appraisers' Director of Government Relations, John Russell at 703-733-2103 ([jrussell@appraisers.org](mailto:jrussell@appraisers.org)), or Peter Barash, Government Relations Consultant to the American Society of Appraisers, and on behalf of the National Association of Independent Appraisers at 202-466-2221 ([peter@barashassociates.com](mailto:peter@barashassociates.com)).

Sincerely,

American Society of Appraisers  
National Association of Independent Fee Appraisers