

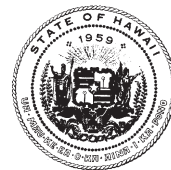
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# Sunrise Analysis: Real Estate Appraisal Management Companies

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A Report to the  
Governor  
and the  
Legislature of  
the State of  
Hawai'i

Report No. 10-07  
September 2010



**THE AUDITOR**  
STATE OF HAWAII

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## Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawai'i State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. Financial audits attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.
2. Management audits, which are also referred to as performance audits, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called program audits, when they focus on whether programs are attaining the objectives and results expected of them, and operations audits, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.
3. Sunset evaluations evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.
4. Sunrise analyses are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.
5. Health insurance analyses examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.
6. Analyses of proposed special funds and existing trust and revolving funds determine if proposals to establish these funds are existing funds meet legislative criteria.
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9. Special studies respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

Hawai'i's laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.



### THE AUDITOR

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# OVERVIEW

## *Sunrise Analysis: Real Estate Appraisal Management Companies*

Report No. 10-07, September 2010

### Summary

In Senate Concurrent Resolution No. 53, Senate Draft 1, the 2009 Legislature asked the Auditor to conduct a “sunrise” analysis of Senate Bill No. 1606 (S.B. No. 1606). The bill proposes to require real estate appraisal management companies (AMCs) to register with the Real Estate Commission of the Department of Commerce and Consumer Affairs (DCCA). The Hawai‘i Licensing Reform Act, Chapter 26H, Hawai‘i Revised Statutes (HRS), requires the Auditor to evaluate proposals to regulate previously unregulated professions or vocations prior to enactment. Although AMCs are not professions or vocations per se, we used the criteria in Section 26H-2, HRS, to evaluate the need to regulate AMCS.

Based on a strict application of the statutory criteria, we found that regulation as proposed in S.B. No. 1606 is not warranted. However, the federal Wall Street financial reform bill enacted into law in July 2010, now requires all states to register and supervise AMCs. States have 36 months *after* federal regulators promulgate final rules to comply with amendments to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), 12 U.S.C. 3331 et seq.

An appraisal management company is a business entity that, for a fee, administers a network of independent appraisers to fulfill real estate appraisal assignments on behalf of mortgage lending institutions (lenders). In recent years lenders have increasingly outsourced to AMCs the responsibility for engaging appraisers and overseeing the administrative functions involved in ordering, tracking and delivering appraisal reports to lenders. There are 200 to 350 AMCS nationwide, but none are physically located in the state. In Hawai‘i, individual appraisers are regulated under the Real Estate Appraiser Program, Chapter 466K, HRS, administered by the DCCA. Appraisers provide a written opinion (appraisal) of the market value of real estate. As of July 2010, there were 602 credentialed appraisers (41 licensed and 561 certified), of which 539 were qualified to perform residential appraisals.

Senate Bill No. 1606 does not meet the statutory criteria in Chapter 26H, HRS, for several reasons. Chief among them, we found the purpose to protect consumers is not clearly articulated; instead, the bill is primarily designed to protect appraisers. The risk of harm to consumers and evidence of abuses by AMCs in Hawai‘i are lacking. Therefore, little weight was given to three pending lawsuits against AMCs on the mainland to warrant regulation. Although required by law, the regulatory program outlined in S.B. No. 1606 would not be self-sustaining. For example, the DCCA estimates that an AMC regulatory program would cost \$201,804 in the first year and \$187,804 annually thereafter. Dividing the total cost of the program by an assumed number of registrants (75) would result in an initial fee of approximately \$2,690 and annual renewals of \$2,500.



The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 expands the purview of the Appraisal Subcommittee (part of the Federal Financial Institutions Examination Council created under Title XI of the FIRREA) to oversee state appraiser regulatory programs; oversee the registration and supervision of AMCs by states; and create a national registry of AMCs. The act requires that AMC registration programs be under a state appraiser certifying and licensing agency. In Hawai'i, this means the Real Estate Appraiser Program administered by the DCCA director in accordance with Chapter 466K, HRS. The DCCA must establish an AMC regulatory program within three years after the federal regulations are adopted that set the minimum qualifications for states to apply relating to the registration, supervision, and reporting of AMC activities. Unless registered, AMCs may not do business in the state. Senate Bill No. 1606 is not an appropriate vehicle as it places the regulation of AMCs under the Real Estate Commission, a regulatory entity within DCCA's Real Estate Branch that oversees real estate licensees statewide. Given that states must now regulate AMCs, we recommend that the federal requirements be examined and that DCCA work with appraiser and AMC interests to arrive at an appropriate vehicle for complying with the federal law.

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## Recommendations and Response

Senate Bill No. 1606 of the 2009 legislative session should not be enacted. The Legislature should ask the DCCA to submit, after federal rules are adopted, a written analysis to accompany suggested language for a new bill to comply with applicable provisions of the FIRREA. The Legislature should then pass conforming legislation.

The DCCA agreed in part, and disagreed in part, with our recommendations. The department did not believe a study comparing S.B. No. 1606 to the federal requirements was relevant and necessary. Instead, the DCCA proposed the Legislature need merely mirror language that regulates real estate appraisers in Section 466K-1, HRS. Given DCCA's response, we modified recommendation no. 2. We maintain the Legislature needs from the department supporting analysis on the impact of expanding regulation to include AMCs, the cost of implementation, and means of financing.

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# Sunrise Analysis: Real Estate Appraisal Management Companies

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A Report to the  
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Hawai'i

Conducted by

The Auditor  
State of Hawai'i  
and  
Rachel N. Hibbard,  
Consultant

Submitted by

**THE AUDITOR**  
STATE OF HAWAI'I

Report No. 10-07  
September 2010

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## Foreword

This “sunrise” report on proposed regulation of real estate appraisal management companies (AMCs) was prepared in response to a provision in the Hawai‘i Regulatory Licensing Reform Act, Chapter 26H, Hawai‘i Revised Statutes, that requires the Auditor to evaluate proposals to regulate previously unregulated professions or vocations.

In Senate Concurrent Resolution No. 53, Senate Draft 1, of the 2009 legislative session, the Legislature requested an analysis of Senate Bill No. 1606 that proposes to regulate AMCs in Hawai‘i by requiring these business entities to register with the Real Estate Commission of the Department of Commerce and Consumer Affairs.

This evaluation, conducted by consultant Rachel N. Hibbard, presents our findings and recommendations on whether the proposed regulation complies with policies in the licensing reform law and whether a reasonable need exists to regulate real estate appraisal management companies to protect the health, safety, or welfare of the public.

We wish to express our appreciation to the Department of Commerce and Consumer Affairs and other organizations and individuals whom we contacted during the course of the evaluation.

Marion M. Higa  
State Auditor

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# Chapter 1

## Introduction

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This report on the proposed regulation of real estate appraisal management companies responds to a “sunrise” provision of the Hawai‘i Regulatory Licensing Reform Act, Chapter 26H, Hawai‘i Revised Statutes (HRS). Section 26H-6, HRS, requires that bills be referred to the Auditor for analysis prior to enactment if they would subject unregulated professions or vocations to licensing or other regulatory controls. The Auditor must assess whether the proposed regulation is necessary to protect the health, safety, or welfare of consumers and whether the regulation is consistent with other regulatory policies provided in Section 26H-2, HRS. In addition, the Auditor must examine probable effects of the proposed regulation and assess alternative forms of regulation.

This report analyzes the proposed regulation set forth in Senate Bill No. 1606 (S.B. No. 1606) of the 2009 legislative session, entitled *Relating to Real Estate Appraisal Management Companies*. The bill would require real estate appraisal management companies (known as AMCs) in Hawai‘i to register with the Real Estate Commission of the Department of Commerce and Consumer Affairs (DCCA). The 2009 Legislature requested an analysis of S.B. No. 1606 in Senate Concurrent Resolution No. 53, Senate Draft 1.

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### Background on Real Estate Appraisal Management Companies

An *appraisal* is defined as a valuation of property as estimated by an authorized person. Under S.B. No. 1606, an appraisal means the act or process of developing an opinion of the value of real property in conformity with the Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation.

An *appraiser* is a person who provides a written opinion (an appraisal) of the market value of real estate—in this case, residential real estate. Appraisers are regulated under Chapter 466K, HRS, which established the Real Estate Appraiser Program within DCCA. The director of commerce and consumer affairs administers the Real Estate Appraiser Program. As of July 2010 there were 602 credentialed appraisers in Hawai‘i (41 licensed and 561 certified), of which 539 were qualified to perform residential appraisals.

Senate Bill No. 1606 defines an *appraisal management company* (AMC) as a business entity that, for a fee, administers a network of independent appraisers to fulfill real estate appraisal assignments on behalf of



mortgage lending institutions (lenders). The functions of an AMC used to be performed in-house by lenders. However, today, many lenders have outsourced to AMCs the responsibility for engaging appraisers and overseeing the administrative functions involved in ordering, tracking, and delivering appraisal reports to lenders. AMCs in turn recruit, qualify, verify licensure, and negotiate fees and service level expectations with a network of independent appraisers (known as a “panel”). AMCs also receive, record, and assign orders to panelists; track the status of orders; deliver final appraisal reports to lenders; undertake quality control activities; pay appraisers; administer warranties for final appraisal reports; and keep records.

### ***Growth of the industry***

The AMC industry is approximately 30 years old. It began with the advent of Lender Processing Services, Inc. (known as LSI) in Pittsburgh, Pennsylvania. The business model for LSI was subsequently replicated, and a number of other AMCs have grown up around the Pittsburgh region, Texas, the Midwest, and California. Over the past 25 years, lenders have turned more and more to AMCs to help automate and manage the appraisal process. Lenders now frequently outsource the management of ordering, reviewing, and delivering quality appraisal products and services to AMCs.

AMCs are not currently regulated in Hawai‘i, nor are there any AMCs (as defined in S.B. No. 1606) physically located in the state. There are an estimated 200 to 350 AMCs nationwide. This includes small AMCs that manage appraisals in one state; regional AMCs that manage appraisals in two or three states; and national AMCs (like LSI) that manage appraisals in all 50 states. It is estimated that about 50 AMCs operate nationally. The size of an AMC is also measured by its revenue volume, as illustrated in Exhibit 1.1. Based on annual gross revenue estimates, there are approximately ten large, 15 medium, and 175 small AMCs in the country.

#### **Exhibit 1.1 Number of AMCs Nationwide**

<b>Size</b>	<b>Number</b>	<b>Annual Gross Revenue</b>
Large	10	\$25 million and up
Medium	15	\$2.5 million to \$25 million
Small	<u>175</u>	\$150,000 to \$2.5 million
Total	<u>200</u>	

Source: Title/Appraiser Vendor Management Association

***Industry organizations***

There are a number of organizations relevant to the appraisal industry. Many of these are specific advocates for appraisers, including the following:

- Appraisal Institute;
- Appraisal Foundation;
- American Society of Appraisers;
- American Society of Farm Managers and Rural Appraisers;
- National Association of Independent Fee Appraisers; and
- National Association of Real Estate Appraisers.

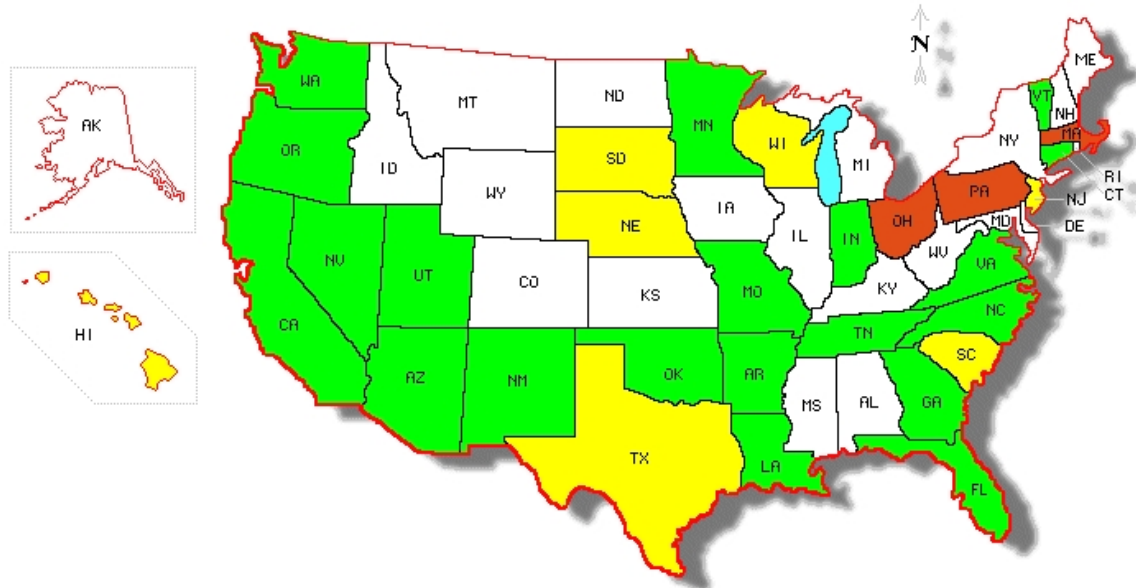
Only one trade organization serves the interests of AMCs and it includes, but does not exclusively represent, AMCs. The Title/Appraisal Vendor Management Association (TAVMA) is a national trade association of providers and consumers of real estate title reporting, title insurance, appraisal and evaluation, and closing management services. TAVMA is actively involved in working to shape legislation and regulatory proposals that affect the industry.

***Regulation in other states***

As of July 2010, 30 states (including Hawai‘i) have considered legislation regarding AMCs, and 20 states have passed laws regulating AMCs by requiring registration. Legislation is currently pending in three states and is being considered in seven more (including Hawai‘i). Exhibit 1.2 illustrates the states where legislation has passed, is pending, and has been introduced (including Hawai‘i).

### Exhibit 1.2 Map Showing Regulation of AMC's by State

- - Legislation passed
- - Legislation pending
- - Introduced or study



NOTES:  
As of July 30, 2010

Source: American Society of Appraisers, Appraisal Institute, and Office of the Auditor

Exhibit 1.3 compares state AMC regulatory laws. It shows the order in which the legislation was enacted, the entity responsible for overseeing the regulatory program, registration period and fees, and how an AMC is defined. The “model” legislation referred to is that of the Appraisal Institute (AI).

### Exhibit 1.3 Comparison of State AMC Laws

State	Administering Entity	Registration Period	Registration Fee	AMC Definition
Legislation enacted in 2009 (by order of enactment)				
1. Utah	Appraiser board	2 years	To be established	Same as AI model
2. Arkansas	Appraiser board	1 year	Not to exceed \$500	Similar to AI model; focus on what AMC does and lists activities
3. New Mexico	Appraiser board	1 year	Not to exceed \$2,000	Same as AI model
4. Nevada	Appraiser board	1 year	Not to exceed \$2,500 (initial) and \$500 (renewal); extra fee for branch offices not to exceed \$100	Similar to AI model
5. California	Appraiser board	2 years with some board discretion	To be established	Detailed definition that includes exemptions from AI model
6. Louisiana	Appraiser board	1 year	To be established	Same as AI model, but does not include reference to serving as third-party broker
Legislation enacted in 2010 (by order of enactment)				
7. Indiana	Appraiser board	2 years	Not to exceed \$500	"A person that, for compensation, acts as a third-party intermediary by contracting with independent real estate appraisers to perform appraisals for other persons"
8. Oregon	Banking commission	2 years	To be established	Similar to AI model
9. Washington	Appraiser board	2 years	To be established	Defined based on appraisal management services
10. Virginia	Appraiser board	N/A	N/A	Similar to AI model
11. Arizona	Appraiser board	1 year (initial); 2 years (renewal)	To be established	Same as AI model, plus more "regardless of name" language
12. Vermont	Appraiser board	2 years	\$125 (initial) \$500 (renewal)	"An entity that acts as a broker in acquiring finished appraisals from real estate appraisers licensed under this chapter and that supplies the appraisals to third parties"
13. Florida	Appraiser board	1 year	Not to exceed \$150	Defined based on appraisal management services
14. Minnesota	Appraiser board	1 year	\$5,000 (initial) \$2,500 (renewal)	Same as AI model
15. Connecticut	Appraiser board	2 years	\$1,000	Defined based on appraisal management services and the maintenance of an appraisal panel
16. Tennessee	Appraiser board	1 year	Not to exceed \$2,000	Defined based on appraisal management services
17. Georgia	Appraiser board	To be established	To be established	Similar to AI model
18. Oklahoma	Appraiser board	1 year	Not to exceed \$2,000	Defined based on appraisal management services, plus "regardless of name" language
19. Missouri	Appraiser commission	2 years	To be established	Defined based on appraisal management services
20. North Carolina	Appraiser board	1 year	Not to exceed \$3,500 (initial) and \$2,000 (renewal)	Defined based on appraisal management services; detailed exemptions similar to California's

Source: American Society of Appraisers and Appraisal Institute and Office of the Auditor

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## Proposal to Regulate Real Estate Appraisal Management Companies

### **Senate Bill No. 1606**

Senate Bill No. 1606 of the 2009 legislative session and its companion, House Bill No. 1577, entitled *Relating to Real Estate Appraisal Management Companies*, propose to regulate real estate appraisal management companies in Hawai‘i. Although the measures are identical, we refer only to S.B. No. 1606, as requested by the 2009 Legislature in Senate Concurrent Resolution No. 53, Senate Draft 1.

Senate Bill No. 1606 only applies to residential appraisals. The bill requires AMCs to register with the state Real Estate Commission within DCCA and establishes standards and violations. Registration would require, among other things:

- Basic information about each AMC, with office address and contact person(s);
- Hiring and training controls and certifications for AMC employees, including a requirement that each of an AMC’s appraisers working in Hawai‘i be licensed in Hawai‘i;
- An annual registration fee (amount unspecified);
- Consent to service of process for litigation purposes; and
- Disclosure of an appraiser fee schedule, if the AMC has one.

The bill also prohibits attempts to influence the outcome of an appraisal; requires payment to appraisers within 60 days; and prohibits arbitrary removal of appraisers from panels after 30 days. The bill has approval standards for owners and “controlling persons” of AMCs and contains requirements for AMC certification as to Uniform Standards of Professional Appraisal Practice compliance, appraiser panel management and quality control generally by AMCs. The state Real Estate Commission would have authority to review and publish AMC fee schedules and adjudicate complaints regarding removal of appraisers from AMC panels. A copy of S.B. No. 1606 is available at [http://www.capitol.hawaii.gov/session2009/Bills/SB1606\\_.pdf](http://www.capitol.hawaii.gov/session2009/Bills/SB1606_.pdf).

### ***Impetus for the proposed regulation***

Senate Bill No. 1606 was developed by the national Appraisal Institute and introduced at the request of its Hawai‘i chapter. The bill is nearly identical to the AI’s model legislation as of early 2009.

Seven entities submitted testimony on the proposed regulation. All but one was in favor of regulation:

- The Hawai‘i Chapter of the Appraisal Institute testified in favor of regulation, stating that the growth of the industry has resulted in numerous instances of abuse, as evidenced by several mainland lawsuits (discussed later in this report). Three private firms of appraisers also testified in favor of regulation for many of the same reasons.
- The Hawai‘i Real Estate Commission, attached to DCCA and responsible for regulating real estate agents under Chapter 467, HRS, testified in favor of a sunrise review. However, the commission opposed being held responsible for regulating AMCs on the basis that its board—comprised of real estate brokers and public members—lacks the expertise to provide adequate oversight.
- The Hawai‘i Association of Realtors testified in favor of the sunrise review but did not specify its position on the need to regulate AMCs.
- The Hawai‘i Financial Services Association opposed the measure, stating that regulation of AMCs at the state level was neither necessary nor recommended.

Although the AMC community did not testify in Hawai‘i, it has supported the vast majority of final legislation regulating AMCs and intends to collaborate with states to support other AMC regulatory bills.

### ***Prior reports***

This is our first study regarding appraisal management companies. However, we have conducted two prior studies involving appraisers.

In 1988 we published a *Sunrise Analysis of Proposals to Regulate Real Estate Appraisers and Real Property Appraisals* (Report No. 88-10). In it we reported there was insufficient evidence of consumer complaints and cases of damage by real estate appraisers in Hawai‘i to impose regulation, there were no widely accepted qualification standards for the profession, and the proposed legislation would not have enhanced public protection sufficiently to warrant its costs. The following year, 1989, federal legislation was passed requiring all states to regulate appraisers and appraisals connected with federally related transactions.

In 1998 we issued an *Analysis of a Proposal to Expand the Regulation of Real Estate Appraisers and Appraisals* (Report No. 98-13). Primarily for consistency in state and federal regulation, we recommended passage of the legislation requiring appraisals in both federally and non-federally related real estate transactions to be performed by state-licensed or state-certified appraisers as recommended under the Uniform Standards of Professional Appraisal Practice. We also suggested the Legislature consider the costs, benefits, and legal issues in relation to granting exemptions and other matters associated with the proposal expanding regulation of appraisers.

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## Objectives of the Analysis

1. Determine whether there is a reasonable need to regulate real estate appraisal management companies to protect the health, safety, or welfare of Hawai‘i’s public.
2. Assess the probable effects of the regulation and the appropriateness of alternative forms of regulation.
3. Make recommendations as appropriate.

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## Scope and Methodology

To assess the need to regulate real estate appraisal management companies as proposed in S.B. No. 1606, we applied the criteria set forth in Section 26H-2, HRS, of the Hawai‘i Regulatory Licensing Reform Act, despite the fact that the statute is intended to apply to professions and vocations rather than business entities. The Legislature established these policies to ensure that regulation of an occupation—or, in this case, a business entity—occurs only when needed to protect consumers. Since regulation is an exercise of the State’s police power, it should not be imposed lightly. Its primary purpose is not to benefit the occupation—or, in this case, the business type—which often seeks regulation for reasons that go beyond consumer protection. For example, members of a profession sometimes believe regulation will enhance their profession’s status or reputation.

## *Regulatory policy in Hawai‘i*

Hawai‘i’s “sunrise” law requires the Auditor to assess new regulatory proposals that would subject unregulated professions and vocations to licensing or other regulatory controls against the regulation policies set forth in Section 26H-2, HRS. These policies clearly articulate that the primary purpose of such regulation is to protect consumers, stating that:

- The State should regulate only where it is reasonably necessary to protect consumers;
- Regulation should protect the health, safety, and welfare of consumers and not the occupation;
- Evidence of abuses by practitioners of the occupation should be given great weight in determining whether a reasonable need for regulation exists;
- Regulation should be avoided if it artificially increases the costs of goods and services to consumers, unless the cost is exceeded by the potential danger to consumers;
- Regulation should be eliminated when it has no further benefit to consumers;
- Regulation should not unreasonably restrict qualified persons from entering the profession; and
- Aggregate fees for regulation and licensure must not be less than the full costs of administering the program.

We were also guided by *Questions a Legislator Should Ask*, a publication of the national Council on Licensure, Enforcement and Regulation (CLEAR). According to CLEAR, the primary guiding principle for legislators is whether the unregulated occupation presents a clear and present danger to the public's health, safety, and welfare. If it does, regulation may be necessary; if not, regulation is unnecessary and wastes taxpayers' money.

In addition to the regulatory policies in Chapter 26H, HRS, and the guidance from CLEAR, we considered other criteria for this analysis, including whether or not:

- The incidence or severity of harm based on documented evidence is sufficiently real or serious to warrant regulation;
- Any other alternatives provide sufficient protection to consumers (such as federal programs, other state laws, marketplace constraints, private action, or supervision); and
- Most other states regulate the occupation for the same reasons.

### ***Burden of proof***

In assessing the need for regulation and the specific regulatory proposal, we placed the burden of proof on proponents of the measure to



demonstrate the need for regulation. We evaluated their arguments and data against the above criteria. We examined the regulatory proposal and assessed whether the proponents provided sufficient evidence for regulation. In accordance with sunrise criteria, even if regulation *may* have *some* benefits, we recommend regulation only if it is *demonstrably* necessary to protect the public.

### **Types of regulation**

As part of our analysis, we assessed the appropriateness of the specific regulatory approach put forth in the proposed legislation. There are three common approaches to occupational regulation:

- *Licensing* is the most restrictive form of occupational regulation and confers a legal right to practice to individuals who meet certain qualifications. Penalties may be imposed on those who practice without a license. Licensing laws usually authorize a board that includes members of the profession to establish and implement rules and standards of practice.
- *Certification* restricts the use of certain titles (for example, social worker) to persons who meet certain qualifications, but it does not bar others from offering such services without using the title. Certification is sometimes called *title protection*. Government certification should be distinguished from professional certification, or credentialing, by private organizations. For example, social workers may gain professional certification from the National Association of Social Workers.
- *Registration* is used when the threat to the public's health, safety or welfare is relatively small or when it is necessary to determine the impact of the operation of an occupation on the public. A registration law simply requires practitioners to register their details onto the State roster so the State can keep track of practitioners. Registration can be mandatory or voluntary.

In addition to assessing the need for regulation and the specific legislative proposal, we considered the appropriateness of other regulatory alternatives. We also assessed the impact on the proposed regulatory agency and industry to be regulated.

Our analysis involved reviewing literature on real estate appraisal management companies, appraisers and appraisals, national bodies and professional standards, the Home Valuation Code of Conduct, litigation involving real estate appraisal management companies, and other relevant materials; state and federal laws; the proposed state legislation, other model laws, and federal legislation; regulation in other states; and regulation provided by private organizations. We also examined the estimated cost of the regulatory program and its fees.

We requested information on complaints from the Department of Commerce and Consumer Affairs' Office of Consumer Protection, Regulated Industries Complaints Office, Professional and Vocational Licensing Division (PVL), Hawai'i Real Estate Commission (REC), and Division of Financial Institutions; the state Ombudsman; the state Department of the Attorney General; and the Hawai'i Better Business Bureau (BBB) and its national BBB counterpart.

We conducted interviews with state legislators and relevant stakeholders from the Appraisal Institute (the national association and its Hawai'i chapter); TAVMA; the Association of Appraiser Regulatory Officials and other states that regulate real estate appraisal management companies; the Hawai'i Financial Services Association; the Department of Commerce and Consumer Affairs, including the REC and PVL; appraisal management companies; and appraisers and lenders doing business in Hawai'i. We also contacted the American Society of Appraisers; the Hawai'i Association of Realtors; the American Society of Farm Managers and Rural Appraisers; the National Association of Independent Fee Appraisers; and the national Appraisal Foundation for their input.

The assessment was conducted from June 2010 to August 2010.

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# Chapter 2

## Regulation Is Not Warranted, But Federal Mandate Now Requires This of All States

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This chapter presents our findings and recommendations on Senate Bill No. 1606 proposing to regulate real estate appraisal management companies (AMCs) as requested by the 2009 Legislature in Senate Concurrent Resolution No. 53, Senate Draft 1.

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### Summary of Findings

1. Regulation of AMCs is not warranted under Chapter 26H, Hawai‘i Revised Statutes.
2. However, federal law now requires all states to register and supervise AMCs within three years after federal regulators promulgate rules setting minimum qualifications.
3. The current state regulatory proposal is not an appropriate vehicle for complying with the federal mandate.

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### Regulation of AMCs in Hawai‘i Is Not Warranted Under Chapter 26H, HRS

As described in Chapter 1, Hawai‘i has strict criteria for determining when regulation is required. Chapter 26H, Hawai‘i Revised Statutes (HRS), provides that regulation should be imposed only where it is reasonably necessary to protect consumers; be implemented to protect the health, safety, and welfare of consumers and not the occupation (in this case, industry); be avoided if it artificially increases the cost of goods and services to consumers, unless the cost is exceeded by the potential danger to consumers; and not unreasonably restricts qualified persons (in this case, business entities) from entering the field. Moreover, policies regarding the regulation of certain professions and vocations require that evidence of abuses be given great weight in determining whether a reasonable need for regulation exists; and that fees cover the administration costs of the regulatory program. Even if regulation *may* have some benefits, we would recommend enactment only where it is *demonstrably* necessary to protect the public.

Senate Bill No. 1606 (S.B. No. 1606) does not convincingly meet any of the statutory criteria in Chapter 26H, HRS. Specifically, the purpose to protect consumers is not clearly articulated; instead, the bill is primarily designed to protect appraisers. The risk of harm to consumers and evidence of abuses by AMCs in Hawai‘i are lacking. The cost that lenders typically pass on to consumers may rise because of regulation;

and the high regulatory fees that are anticipated will more than likely discourage small AMCs from registering, thus disproportionately precluding such businesses from entering the market in Hawai‘i. Moreover, the regulatory program outlined in S.B. No. 1606 would not be self-sustaining, as is required under Section 26H-2(7), HRS.

**An AMC is a business entity, not a profession or vocation**

By definition, appraisal management companies (AMCs) are business entities that manage a panel of independent appraisers for mortgage lending institutions. The Hawai‘i Regulatory Licensing Reform Act, codified under Chapter 26H, HRS, sets out the Legislature’s “policies regarding the regulation of certain professions and vocations.” Since an AMC is neither a profession nor a vocation, but a business entity, Senate Bill No. 1606 does not meet a strict application of the criteria under Section 26H-2, HRS, to warrant enactment.

The purpose of regulation is to protect the public welfare and not the profession or vocation to be regulated. Section 26H-2(1), HRS, stipulates that regulation is to be undertaken only where it is reasonably necessary to protect the health, safety, or welfare of consumers of the services; and that the purpose of regulation is to protect the public’s welfare. Although “consumers of the services” usually equate to the general public, in this case, consumers of AMC services are actually lenders—that is, financial institutions, such as banks or savings and loan companies in the business of providing home mortgage loans. For the purposes of our analysis, however, we took “consumers” to mean the general public—specifically, home buyers who have applied for a mortgage, which requires an appraisal report. Exhibit 2.1 illustrates the relationship between home buyers, lenders, appraisers, and AMCs.

**Exhibit 2.1  
Relationship Between Home Buyers, Lenders, Appraisers, and AMCs**

1. Home buyer applies to lender (usually a bank) for a mortgage.
2. Bank requires, as part of the mortgage approval process, that an appraisal of the subject property be conducted; bank contacts AMC to request that an appraisal of the subject property be conducted.
3. AMC contacts one of its panelists, a licensed appraiser, to perform the appraisal.
4. Appraiser conducts the appraisal, writes appraisal report, and submits it to AMC for payment.
5. AMC ensures the appraisal meets with lender’s requirements as to subject address, timeliness and other factors (excluding the price of the property) and provides finalized appraisal report to lender.

Note: Home buyers are not entitled to the appraisal report *per se*, although in practice they are often given a copy and charged for the report on the closing sheet at time of settlement.

Source: Office of the Auditor

***Purpose of proposed regulation has not been articulated***

The purpose of regulating AMCs is not clearly articulated in S.B. No. 1606. Regulation should not be arbitrarily enacted, and its purpose should be clear. We examined S.B. No. 1606 and all its associated committee reports to determine what harm, or potential harm, would be averted if AMCs were regulated.

Four committee reports and S.B. No. 1606 itself describe what the bill would do—namely, it would regulate AMCs—but none states the harm to consumers that would be averted should regulation be enacted. At most, the reports refer to the importance of AMCs being held to high standards of professionalism and ethical behavior, which does not in itself merit the need for state regulation. The Senate Ways and Means Committee, in its Standing Committee Report No. 1369, alluded to deceptive practices by commenting that:

[D]uring the national rise in housing prices... some real estate and financial companies used deceptive tactics to sell mortgages to people who could not afford home ownership. These activities contributed to the subprime mortgage disaster.... In some cases, real estate appraisals were prepared in such a way as to meet lender requirements rather than reflect the actual value of the property being financed.

We asked stakeholders to substantiate these claims. Except for three lawsuits pending on the mainland, discussed below, we did not find any particulars to support these statements.

According to Title/Appraisal Vendor Management Association (TAVMA), the trade organization representing AMCs' interests, S.B. No. 1606 was developed by the Appraisal Institute, a national organization of appraisers, in response to a concern that de-licensed appraisers had subsequently re-established themselves as AMCs. TAVMA believes that although this scenario is possible, instances of occurrence are negligible. TAVMA reports that in 2009 there were approximately 113,000 appraisers nationwide; in the same year, 449 certifications/licenses were revoked or suspended, or 0.4 percent. There were no revocations or suspensions in Hawai'i in either 2009 or 2008, and only one in 2007. TAVMA concedes that this low rate of revocation could be because states dedicate too few resources to investigating and prosecuting poorly performing appraisers; or because there are very few offenses warranting suspension or revocation.

***Proposed regulation is primarily designed to protect appraisers, not the general public***

Contrary to Section 26H-2(1), HRS, some provisions of S.B. No. 1606 are specifically geared toward protecting the earning power of appraisers rather than protecting the general public. The requirements in Sections –H, –J, and –L in particular are aimed at protecting appraisers' incomes. For example, Section –H of S.B. No. 1606 sets forth onerous

requirements regarding appraiser fee schedules. The section would require that any AMC that uses an appraiser fee schedule to develop it based on one or more surveys of the market rates paid to independent real estate appraisers in the state; and the surveys must use statistically valid methodologies and techniques and reliable data sources, including representative samples of independent appraisers. Furthermore, every AMC that uses a fee schedule would be required to disclose it to the Hawai'i Real Estate Commission (REC), which would be given the power to review any fee schedule and its methodologies, techniques and data sources, after which its findings must be made public. The requirements only apply to AMCs that use fee schedules.

Section –J, requiring that appraisers be paid within 60 days upon submission of an appraisal to an AMC, is also designed to protect appraisers rather than the general public. Likewise, Section –L, prohibiting an AMC from removing an appraiser from its panel or refusing to assign an appraisal request if the appraiser has been on its panel for more than 30 days (unless the AMC gives the appraiser notification and an opportunity to respond), is designed to protect appraisers as a group.

In the case of disputes involving alleged illegal conduct such as violations of the Uniform Standards of Professional Appraisal Practice, which appraisers must follow, appraisers may complain to the REC. The REC is given wide powers to adjudicate all complaints within six months; if the REC fails to concur with an AMC, the appraiser must be reinstated and the AMC may not refuse to assign appraisals to that appraiser.

### ***Little evidence of abuses***

Proponents of this regulation, mainly appraisers or appraisal organizations, claim that AMCs are “a scourge,” which are strictly concerned with timeliness and cost at the expense of quality in appraisal reports. Proponents argue that AMCs impose short timeframes and pay low fees to appraisers, resulting in compromised quality of appraisal reports, which can lead a lender to make an ill-informed decision. On a larger scale, a lender may end up making many bad mortgage decisions, which can lead to the lender’s collapse and the subsequent suffering of its customers. On a national scale, regulation proponents claim that mediocre appraisal reports are one of the factors that led to the recent financial meltdown. Proponents believe this cycle could repeat itself if AMCs continue unregulated.

Advocates for the AMC industry do not oppose regulation. However, they counter that in the industry’s 35-year history that only three lawsuits have been brought against AMCs. Furthermore, they told us, there are very few—if any—consumer cases against AMCs, and we would

be unlikely to find any complaints against AMCs. According to one interviewee, “AMCs are the most dreaded entity that consumers have never encountered.”

### **No evidence of abuses in Hawai‘i**

We were unable to find any evidence of abuses by, or even complaints against, AMCs operating in Hawai‘i. Section 26H-2(3), HRS, requires that evidence of abuses by providers of the service be accorded great weight in determining the need for regulation. Since there are no AMCs physically located in Hawai‘i, our inquiries covered complaints about out-of-state operators. Neither the State’s Ombudsman, Attorney General, nor divisions and offices within the Department of Commerce and Consumer Affairs (DCCA), including the Office of Consumer Protection, Regulated Industries Complaints Office, Professional and Vocational Licensing Division (PVL), Real Estate Commission, and the Division of Financial Institutions reported receiving any complaints against AMCs. The Hawai‘i Better Business Bureau found in its national database only one complaint made against an AMC within the last three years, and that was by an appraiser against an AMC in Texas for failing to pay.

### **Three lawsuits pending on the mainland**

There are currently three major lawsuits pending against national AMCs in New York, Washington, and Arizona (all of which now regulate AMCs). In 2007, the New York attorney general sued an AMC, eAppraisIt, for falsely inflating house values. The attorney general is trying to recover for “misrepresentations and other deceptive conduct allegedly perpetrated on the consuming public,” claiming the AMC was pressured by a lender, Washington Mutual, to use a list of “proven appraisers” who could be counted on to inflate appraisals. According to an AMC industry representative, this lawsuit followed a two-year investigation of the entire AMC industry that resulted in the discovery of a single questionable email.

In 2009, a Seattle-based law firm filed two separate class-action lawsuits involving AMCs. In January 2009, a group of Washington homeowners filed a lawsuit against Countrywide, a wholly owned subsidiary of Bank of America, and Countrywide’s appraisal subsidiary, the AMC LandSafe, Inc. The suit claims the bank illegally rigged the appraisal process in a scheme to boost profits at the expense of homeowners and appraisers by forcing homeowners to use LandSafe for appraisals, subcontracting the work to independent appraisers for as little as \$140 per appraisal, and then charging homeowners as much as \$410 for the appraisal. The suit also claims that if appraisers do not accept Countrywide’s fee structure or appraisal guidelines, they risk being blacklisted for further work. The suit seeks to represent all homeowners who purchased or refinanced



their home through Countrywide and LandSafe and cites violations of the federal Racketeer Influenced and Corrupt Organizations Act (RICO) and the Real Estate Settlement Procedures Act (RESPA). Other claims include unjust enrichment, breach of fiduciary duty, and violation of California unfair competition laws.

In May 2009, the same Seattle law firm lodged a suit against Wells Fargo Bank and its AMC subsidiary, Rels Valuation, also for alleged home appraisal rigging. The suit was filed on behalf of an Arizona couple alleging that the bank and its AMC subsidiary collected more than \$100 million by requiring homeowners to use the AMC for overpriced appraisals. The AMC then allegedly farmed out the work to subcontracted appraisers and billed homeowners at a higher rate. The lawsuit claims that both companies violated the federal RICO Act and RESPA, that the bank breached its fiduciary duty and violated California's unfair competition laws, and that the AMC was unjustly enriched. The plaintiffs' lawyers say they believe the bank and AMC are operating the alleged scheme on a national level, potentially affecting tens if not hundreds of thousands of homeowners.

As there is no evidence of abuses by AMCs in Hawai'i, little weight was given to the three pending lawsuits on the mainland to warrant regulation in Hawai'i.

***Cost of goods and services may rise under regulation***

We found mixed opinions on whether the cost of goods and services to consumers—that is, whether the price of an appraisal passed on to a home buyer—would increase in Hawai'i if AMCs are regulated. Section 26H-2(4), HRS, provides that regulation must be avoided if it increases the cost of goods and services to the consumer, except where increased cost is exceeded by potential danger to the consumer.

One representative of a large national AMC stated that he did not think there would be an impact to consumers. In his opinion, large AMCs would not raise their fees to lenders, so there would be no additional cost ultimately passed on to the consumer. He stated that unless local appraisers refused to work for AMCs, there would be no change in the cost to consumers. The AMC he represents has not experienced a problem so far in the states where regulation has been implemented; however, he acknowledged that Hawai'i is a special case because of its geographic isolation and small number of local appraisers.

A representative of another large national AMC, however, stated that as soon as regulation is implemented, home buyers will have to pay twice as much for an appraisal, assuming that AMCs would be required to pay appraisers "reasonable and customary" fees—meaning full retail fee, or the fee an appraiser could previously command in the absence of AMC

involvement. We note that S.B. No. 1606 does not require AMC's to pay appraisers fees that are "reasonable and customary." Furthermore, as discussed above, Sections –H, –J, and –L in particular appear to have the same or similar effect of protecting appraisers' incomes. However, the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act (discussed below) does require lenders and their agents (meaning AMC's) to pay appraisers at a rate that is reasonable and customary for the market in which the appraisal is performed.

***Regulatory fees will likely preclude smaller AMC's from registering***

We found the registration fees DCCA will need to charge to make the program self-sustaining are likely to disproportionately cause smaller AMC's to avoid registering in Hawai'i, unnecessarily restricting their entry into the field. Furthermore, paradoxically, the fewer registrants there are, the higher each registration fee will be; and the higher the registration fee, the fewer AMC's are likely to register. Sunrise criteria preclude recommending regulation if it would unreasonably restrict entry into the profession or vocation (in this case, the business field) by qualified entrants. Hawai'i law also requires regulatory programs to be self-sustaining—that is, fees must cover the cost of administering the program.

**Regulatory program will be expensive to operate**

The regulatory program outlined in S.B. No. 1606 will be expensive to operate. Based on a figure of 75 anticipated AMC registrants, the DCCA's Professional and Vocational Licensing Division estimates that administering and enforcing the regulatory program will cost \$201,804 in the first year and \$187,804 annually thereafter. According to PVL, it will also require three new positions—an administrative assistant and two office assistants—in order to administer the program. Dividing the total cost of the program by the expected number of registrants, the cost for initial applications would be approximately \$2,690 and annual renewals thereafter \$2,500.

In comparison, other states that regulate AMC's charge registration fees ranging from \$0 (Virginia) to \$5,000 (Minnesota, initial fee). A number of states have yet to specify their registration fees. Exhibit 2.2 compares the fees, in declining order, for all AMC regulatory programs to date. The fees proposed by PVL fall at the high end of states' regulatory fees.

**Exhibit 2.2  
Comparison of Fees for State AMC Regulatory Programs**

<b>State</b>	<b>Registration Fee</b>
Minnesota	\$5,000 (initial) and \$2,500 (renewal)
North Carolina	Not to exceed \$3,500 (initial) and \$2,000 (renewal)
Nevada	Not to exceed \$2,500 (initial) and \$500 (renewal); extra fee for branch offices not to exceed \$100
<i>Hawai'i (proposed)</i>	<i>\$2,690 (initial) and \$2,500 (renewal)</i>
New Mexico	Not to exceed \$2,000
Oklahoma	Not to exceed \$2,000
Tennessee	Not to exceed \$2,000
Connecticut	\$1,000
Arkansas	Not to exceed \$500
Indiana	Not to exceed \$500
Florida	Not to exceed \$150
Vermont	\$125 (initial) and \$500 (renewal)
Arizona	To be established
California	To be established
Georgia	To be established
Louisiana	To be established
Oregon	To be established
Utah	To be established
Washington	To be established
Missouri	To be established
Virginia	No fee

Source: American Society of Appraisers and Office of the Auditor

**High fees will discourage registrants, especially small AMCs**

The department made its fee estimate based on 75 anticipated AMC registrants. Other stakeholders believe there will be significantly fewer registrants, variously estimating Hawai'i can expect approximately 50, 25, or even a dozen or fewer AMCs to register. Exhibit 2.3 illustrates that such small numbers would make the already relatively high registration fee skyrocket.

**Exhibit 2.3  
Calculation of Fees Based on Expected Number of Registrants**

<b>Expected No. Registrants</b>	<b>Initial Fee</b>	<b>Renewal Fee</b>
75	\$ 2,691	\$ 2,504
50	\$ 4,036	\$ 3,756
25	\$ 8,072	\$ 7,512
12	\$16,817	\$15,650
10	\$20,180	\$18,780

Source: Office of the Auditor

Stakeholders agree that a small percentage of AMCs nationwide control a vast majority of the AMC industry’s business. TAVMA suggests that the 20 largest AMCs in the country represent 80 percent to 85 percent of the AMC industry’s market share nationwide; a representative of a large AMC estimates that there are 50 national AMCs that do 80 percent of all appraisals; and the Appraisal Institute’s Hawai‘i chapter estimates that fewer than a dozen AMCs control 80 percent of the appraisal business in Hawai‘i. According to TAVMA, AMCs work on volume; because of this, if regulatory fees are high, AMCs with smaller volumes (and therefore smaller profit margins) will avoid registering and doing business in Hawai‘i. To illustrate this, TAVMA developed a projection table to help states estimate the number of AMCs they might expect to register based on the fee they impose. Exhibit 2.4 shows TAVMA’s projection table. (“Large,” “Medium” and “Small” AMCs are defined by revenue volume, as shown in Chapter 1 at Exhibit 1.2.)

**Exhibit 2.4**  
**Estimated No. of AMC Registrants and Revenues in Hawai‘i**

Registration Fee	Large AMCs			Medium AMCs			Small AMCs			Total Estimated No. Registrants	Total Estimated Revenues
	% AMCs That Will Register	No. AMCs That Will Register	Revenue	% AMCs That Will Register	No. AMCs That Will Register	Revenue	% AMCs That Will Register	No. AMCs That Will Register	Revenue		
\$5,000	100%	10	50,000	30%	5	22,500	0%	0	-	15	\$72,500
\$4,000	100%	10	40,000	40%	6	24,000	0%	0	-	16	\$64,000
\$3,000	100%	10	30,000	50%	8	22,500	0%	0	-	18	\$52,500
\$2,000	100%	10	20,000	60%	9	18,000	0%	0	-	19	\$38,000
\$1,000	100%	10	10,000	80%	12	12,000	5%	9	8,750	31	\$30,750
\$500	100%	10	5,000	100%	15	7,500	30%	53	26,250	78	\$38,750
\$250	100%	10	2,500	100%	15	3,750	40%	70	17,500	95	\$23,750
\$100	100%	10	1,000	100%	15	1,500	50%	88	8,750	113	\$11,250

Source: TAVMA. For illustration purposes only; TAVMA assumes no liability for contents. All rights reserved.

Using TAVMA’s projections, if Hawai‘i charges between \$2,000 and \$3,000 for its registration fee, it can expect about 18 or 19 AMCs to register, and between \$38,000 and \$52,500 in revenue from those registrations. If Hawai‘i’s regulatory program costs \$201,804 in the first year and \$187,804 annually thereafter, then under this projection it will not be self-sustaining.

Using TAVMA’s projections, we examined several different registration and fee scenarios. We found that even if there are 300 AMCs in the country (which is debatable), and all of them decide to register with the State (which is highly unlikely), in order to be self-sustaining, Hawai‘i’s fee would still need to be more than \$600 per year. According to TAVMA’s projections, at \$600 per year, Hawai‘i should expect between 31 and 78 registrants—well below the 300 registrants that would be needed to make the program self-sustaining at that fee level. TAVMA’s projections illustrate that the relationship between fees charged and number of registrants is unlikely to be a one-to-one correlation.

Under any of the scenarios above, we find that the regulatory program outlined in S.B. No. 1606 would not be self-sustaining, and therefore does not meet the criteria in Section 26H-2(7), HRS.

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## **Federal Legislation Now Requires States to Regulate AMCs**

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 is a massive piece of financial reform legislation (HR 4173) that President Obama signed into law on July 21, 2010. In its final form the bill is 848 pages. Title XIV, Subtitle F, entitled Appraisal Activities, amends the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (known as FIRREA), 12 United States Code §3331 et seq.

The act expands the purview of the Appraisal Subcommittee (ASC), which is part of the Federal Financial Institutions Examination Council (FFIEC) created in 1989 under Title XI of FIRREA to:

- Oversee state appraiser regulatory programs;
- Oversee the registration and supervision of AMCs by states; and
- Create a national registry of AMCs.

Section 1473 of the act requires that states, in addition to an existing mandate to regulate appraisers, also regulate appraisal management companies. States must now require that AMCs doing business in their state to register with and be supervised by an appraiser regulatory program.

Under the act, an “AMC” applies only to entities that oversee a panel of more than 15 certified or licensed appraisers in a state, or 25 or more nationally, within a given year. AMCs that are wholly owned subsidiaries of financial institutions regulated under a federal financial institution regulatory agency (meaning federally regulated banks) are exempt from registering with states. This means that some of the largest AMCs in the country—for example, Rels Valuation, LandSafe, and Countrywide—will not be required to register with any state.

### ***Regulatory program must be in place within three years of federal rules***

The act charges a host of federal regulators (the Federal Reserve System’s Board of Governors, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau of Consumer Financial Protection) with the responsibility to jointly promulgate rules setting the minimum qualifications for states to apply relating to the registration, supervision, and reporting of AMC activities.

States have 36 months after the promulgation of final rules by federal regulators within which to implement an AMC regulatory program, and may request a 12-month extension to be granted by the Appraisal Subcommittee if a state can demonstrate it has made substantial progress toward establishing its AMC registration and supervision system in

a manner that conforms to the act. The rules will provide minimum qualifications for states to follow as part of their AMC regulatory laws, including that:

- AMCs register with and be subject to supervision by a state appraiser certifying and licensing agency;
- States verify that only licensed or certified appraisers are used for federally related transactions;
- States require that appraisals coordinated by an AMC comply with USPAP; and
- States require that appraisals are conducted independently and free from inappropriate influence and coercion pursuant to the appraisal independence standards established under the federal Truth in Lending Act.

Federal regulators may decide to adopt additional requirements. The federal law also specifically permits states to establish requirements in addition to those listed above.

***Regulation must be under an appraiser regulatory program***

The federal law requires that AMC registration programs be under a state appraiser certifying and licensing agency. In Hawai‘i, this means the Real Estate Appraiser Program within the Department of Commerce and Consumer Affairs’ Professional and Vocational Licensing Division, administered by the director in accordance with Chapter 466K, HRS. The act expands the existing authority of state appraiser regulatory programs to include the registration and supervision of AMCs.

AMCs may not register with a state or be included on the national registry if they are owned, in whole or in part, by anyone who has had an appraiser license or certificate refused, denied, cancelled, or revoked in any state. Every person who owns 10 percent or more of an AMC must also be of good moral character, as determined by the State’s appraiser regulatory program.

***Federal grants for complaints, investigation, and enforcement processes to be made available***

Under the act, states are required to report to the national registry of the Appraisal Subcommittee on a timely basis regarding the issuance and renewals of AMC registrations, investigations, sanctions, disciplinary actions, revocations, and suspensions. The ASC will provide grants to state appraiser regulatory programs to support compliance efforts such as developing a complaint process, investigating complaints, enforcing minimum qualification requirements, and submitting data to the national registry, including information affirming that an AMC meets the required

qualification criteria, and formal and informal disciplinary actions. Grants are to be made in accordance with policies to be developed by the ASC, so the criteria upon which such grants will be based are currently unknown.

As part of the ASC's oversight of states' AMC regulatory programs, and as is currently the case with appraisers, the ASC must audit every state on a yearly basis and report its findings to Congress. The ASC is given the power to monitor, audit, and sanction states regarding their appraiser (which includes AMC) regulatory programs.

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## **Current State Proposal Is Not Appropriate**

Despite the new federal requirement that states regulate AMCs, the proposal laid out in S.B. No. 1606 is not an appropriate vehicle. Senate Bill No. 1606 does not comply with federal law in relation to the regulatory oversight agency, and reflects an outdated model law which differs from the federal law in several key ways. Furthermore, states will have three years after federal rules are finalized in which to implement their AMC regulatory programs. It may be prudent, therefore, to wait until such rules are adopted before enacting state legislation to regulate AMCs. In the event that the current federal law is amended or interim federal rules are issued but subsequently changed (both of which are likely), this would avoid the need for additional state legislation to comply with such changes.

## ***Senate Bill No. 1606 does not comply with new federal law***

Senate Bill No. 1606 places the regulation of AMCs under the Real Estate Commission, a licensing and regulatory entity within PVL's Real Estate Branch. The commission is a consumer protection body appointed by the governor and established under Chapter 467, HRS, to oversee real estate licensees statewide. It also oversees the registration of condominium hotel operators and condominium associations pursuant to Chapters 514A and 514B, HRS. As stated in its testimony relating to S.B. No. 1606, the REC is comprised of seven licensed real estate brokers and two public members; commissioners do not have the industry knowledge of appraisers or AMCs to appropriately administer the regulation of AMCs.

We found that the REC is not only an inappropriate entity to regulate AMCs, but this provision does not comply with federal law. States must require AMCs to register with and be subject to supervision by a state appraiser certifying and licensing agency such as Hawai'i's appraiser program established under Section 466K-2, HRS, and overseen by DCCA's PVL and its advisory committee of seven members: three appraisers, two representatives from financial institutions (e.g., banks) and two public members. The composition of the appraiser advisory



committee appointed by the director under Section 16-114-13, Hawai'i Administrative Rules, may need to be reconsidered following enactment of a bill to regulate AMCs as mandated by federal law and regulations. Given the potential that a board weighted with appraisers could favor the interests of appraisers over AMCs, the director may need to consider changing the composition of the appraiser advisory committee to include AMC interests.

**Senate Bill No. 1606 reflects an outdated model law**

Senate Bill No. 1606 and its companion, House Bill No. 1577, were introduced in January 2009 and were virtually identical to the Appraisal Institute's model bill at the time. Since then, the AI has updated its model; federal law has been enacted; and AMCs have sponsored a model bill that complies with the new federal law.

Given that states must now regulate AMCs, we recommend that the federal requirements be examined and that DCCA work with appraiser and AMC interests to arrive at an appropriate vehicle for complying with the federal law.

**AMC definition differs in S.B. No. 1606 from both the updated AI model and federal law**

Senate Bill No. 1606 and the January 2009 version of the AI model bill define an appraisal management company as any business entity that "receives requests for residential real estate appraisal services... and, for a fee..., enters into an agreement with *one or more* independent appraisers to perform the residential real estate appraisal services...." [emphasis added].

By October 2009 the AI had modified its definition by removing references to the number of appraisers involved and describing an AMC as any business entity that:

[D]irectly or indirectly performs appraisal management services, regardless of the use of the term appraisal management company, mortgage technology provider, lender processing services, lender services, loan processor, mortgage services, real estate closing services provider, settlement services provider, real estate closing services provider, vendor management company or any other term.

The new federal law defines an appraisal management company as any external third party that "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" [emphasis added]. The definition in the AMC-sponsored model bill reflects this federal definition for ease of compliance.

There has been some argument that if AMCs are worthy of regulation, then the number of appraisers involved should not be a factor. Although the revised AI definition of AMCs is not inconsistent with federal law, its application means that more entities would be subject to state regulation than under the federal minimum qualifications. As previously noted, states are free to impose greater regulation than that stipulated in the federal law; however, we reiterate that if more entities are subject to regulation (particularly small AMCs), they are less likely to decide to register with and do business in the state.

We submit that it may be more efficient to adopt the federal definition for AMCs for ease of compliance, instead of either the revised AI definition or the older one proposed in S.B. No. 1606.

### **Fee disclosure is onerous and unnecessary**

As discussed above, Section –H of S.B. No. 1606 requires AMCs using fee schedules to develop those schedules based on one or more surveys of market rates paid to appraisers in the state; the surveys must use statistically valid methodologies; and all fee schedules must be disclosed to the regulating body, with the power to review and publish any fee schedule and its underlying methodology. In contrast, the federal law does not require the use of fee schedules or disclosure of fees. It states merely that:

The standard form... *may* include, in the case of an appraisal coordinated by an appraisal management company, a clear disclosure of the fee paid directly to the appraiser by such company and the administration fee charged by such company [emphasis added].

We found that the fee disclosure requirements proposed under S.B. No. 1606 are onerous to both AMCs and the regulating body, and may constitute an “interference of trade.” According to an AMC representative, the requirements would be extremely difficult to implement. To comply with fee disclosure requirements would be burdensome for AMCs, which could potentially avoid the requirements by not having fee schedules. In the event that the regulating agency is asked to review a schedule, it would be a huge amount of work to evaluate the data, and may constitute a conflict of interest if a member of the advisory committee also works for AMCs. In addition, such a requirement may constitute an interference of free trade because AMCs and their contractors and appraisers are in the private market. The AMC representative informed us this argument has successfully been made in several states, where a similar fee disclosure requirement was introduced but subsequently struck out of the proposed regulatory bill.

Furthermore, we found that the fee disclosure proposed under S.B. No. 1606 is unnecessary. According to one AMC representative,

most appraisers in Hawai‘i who work for AMCs are already paid market rates because they are a small group and geographically isolated, and therefore able to command such rates. We did not verify this claim; but regardless, federal law now requires AMCs to pay appraisers market rates:

Lenders and their agents shall compensate appraisers *at a rate that is customary and reasonable for appraisal services performed in the market area of the property being appraised*. Evidence for such fees may be established by objective third-party information, such as government agency fee schedules, academic studies, and independent private sector surveys. Fee studies shall exclude assignments ordered by known appraisal management companies [emphasis added].

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## Conclusion

We conclude that the proposed bill regulating AMCs is not warranted under Hawai‘i’s strict sunrise criteria. However, sweeping changes to federal law now require all states, at a minimum, to register and supervise AMCs within three years after federal regulations are promulgated. We also conclude that Senate Bill No. 1606 is not an appropriate vehicle for implementing such regulation.

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## Recommendations

1. Senate Bill No. 1606 of the 2009 legislative session should not be enacted.
2. The Legislature should consider asking the Department of Commerce and Consumer Affairs to submit, after the adoption of federal rules, a written analysis of its then-proposal to comply with applicable provisions of Title XIV, Subtitle F (Appraisal Activities) of the Dodd-Frank Wall Street Reform and Consumer Protection Action, 12 United States Code §3331 et seq., and its final rules. The written analysis should accompany suggested language for a new bill for the Legislature’s consideration to effectuate compliance with the federal mandate. The analysis should also include the cost of implementation and means of financing.
3. The Legislature should pass conforming legislation upon receipt of DCCA’s analysis.

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## Response of the Affected Agency

### Comments on Agency Response

We transmitted a draft of this report to the Department of Commerce and Consumer Affairs (DCCA) on February 10, 2010. A copy of the transmittal letter to the department is included as Attachment 1. The response of the department is included as Attachment 2.

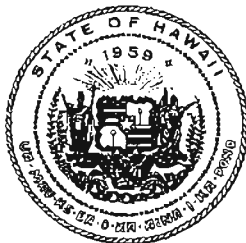
The department commented on two recommendations in our report. The department agreed that Senate Bill No. 1606 should not be enacted because a new bill should reflect federal rules yet to be adopted. However, the department disagreed that a study is necessary. It contends the State will be required to implement nothing less than the federal requirements and a study comparing Senate Bill No. 1606 to the federal law and rules is irrelevant. Instead of a study, the department recommends proposing language to regulate Appraisal Management Companies (AMCs) by expanding its regulation of real estate appraisers. That is, the department maintains the Legislature need merely mirror the language in Section 466K-1, Hawai‘i Revised Statutes, by referencing the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which amends Title XIV, Subtitle F, (Appraisal Activities) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, 12 U.S.C. § 3331 et seq.

We agree a study comparing Senate Bill No. 1606 to the federal requirements may be irrelevant. However, after federal rules are adopted, the Legislature would need from the department supporting analysis on the impact of expanding regulation of individual appraisers to regulating their management companies and the cost of implementation. Even though the federal rules will provide minimum qualifications for states to follow as part of their AMC regulatory laws, federal regulators are allowed to adopt additional requirements. Moreover, the federal law specifically permits states to establish additional state requirements as well. Moreover, cost information on whether expanding the Real Estate Appraiser Program can be self-sustaining would be useful to the Legislature given the AMCs exempted from the new legislation and DCCA’s special-funded means of financing.

Recommendation 2 has been modified to reflect our position.

ATTACHMENT 1

STATE OF HAWAII  
OFFICE OF THE AUDITOR  
465 S. King Street, Room 500  
Honolulu, Hawaii 96813-2917



MARION M. HIGA  
State Auditor

(808) 587-0800  
FAX: (808) 587-0830

September 10, 2010

*COPY*

The Honorable Ronald Boyer, Director  
Department of Commerce and Consumer Affairs  
King Kalākaua Building  
335 Merchant Street  
Honolulu, Hawaii 96813

Dear Mr. Boyer:

Enclosed for your information are three copies, numbered 6 to 8, of our confidential draft report, *Sunrise Analysis: Real Estate Appraisal Management Companies*. We ask that you telephone us by Tuesday, September 14, 2010, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Monday, September 20, 2010.

The Governor and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

A handwritten signature in cursive script, appearing to read "Marion M. Higa".

Marion M. Higa  
State Auditor

Enclosures



LINDA LINGLE  
GOVERNOR  
JAMES R. AIOA, JR.  
LT. GOVERNOR

STATE OF HAWAII  
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DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS  
335 MERCHANT STREET, ROOM 310  
P.O. Box 541  
HONOLULU, HAWAII 96809  
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RONALD BOYER  
DIRECTOR  
RODNEY A. MAILE  
DEPUTY DIRECTOR

September 14, 2010

RECEIVED

Ms. Marion M. Higa  
State Auditor  
Office of the Legislative Auditor  
465 S. King Street, Room 500  
Honolulu, HI 96813-2917

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OFC. OF THE AUDITOR  
STATE OF HAWAII

Dear Ms. Higa:

Thank you for providing the Department of Commerce and Consumer Affairs ("Department") the opportunity to comment on your draft report entitled, "Sunrise Analysis: Appraisal Management Companies". We will comment on the recommendations as they are listed on page 28 of the draft report.

1. *Senate Bill 1606 of the 2009 legislative session should not be enacted.*

The Department agrees that this bill needs to reflect the future federal regulations and thus is not appropriate at this time.

2. *The Legislature should consider asking the Department of Commerce and Consumer Affairs to submit a report after federal rules are adopted, which:*
  - a. *Compares Senate Bill No. 1606's provisions to federal requirements set out in Title XIV, Subtitle F (Appraisal Activities) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and its associated rules; and*
  - b. *Suggests language for a new bill for the Legislature's consideration to effectuate compliance with the federal mandate.*

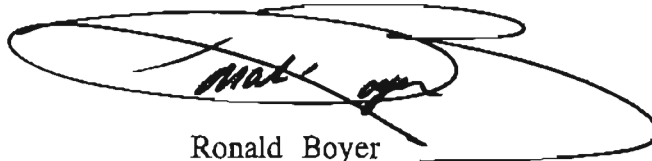
The Department believes that a study is not necessary because the State will be required to implement nothing less than the federal requirements as a result of Title XIV, Subtitle F (Appraisal Activities) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and

Ms. Marion M. Higa  
September 14, 2010  
Page 2

any comparison to Senate Bill 1606 is irrelevant. Also, the suggested language of (b) should reference the specific United States Code. As an example, the Department is mandated by federal requirements to regulate appraisers under 12 United States Code §3301 et seq. The corresponding Hawaii Revised Statute ("HRS") section §466K-1 states "The purposes of this chapter are to implement the requirements of 12 United States Code §3301 et seq....". The rationale of this language allows for any future federal amendments without necessitating changes to the HRS. Any proposed language to regulate Appraisal Management Companies would mirror the language in §466K-1, HRS. The Department believes all that is essential is a bill to implement the federal requirements. A study is not necessary.

Thank you for the opportunity to comment. If you have any questions or comments, please call me at 586-2850.

Very truly yours,

A handwritten signature in black ink, appearing to read "Ronald Boyer", is written over a horizontal line. The signature is enclosed within a large, hand-drawn oval.

Ronald Boyer  
Director

RB:at:ln

cc: Celia Suzuki, Acting Licensing Administrator, PVL