

FEDERAL RESERVE BANK OF SAN FRANCISCO
101 MARKET STREET, SAN FRANCISCO, CALIFORNIA

November 5, 2003

**BANKING SUPERVISION AND REGULATION:
REAL ESTATE-RELATED FINANCIAL
TRANSACTIONS AND COMMENT REQUESTED
ON NEW BASEL CAPITAL ACCORD**

To State Member Banks, Bank
Holding Companies, U.S. Branches
and Agencies of Foreign Banks,
and Others Concerned,
in the Twelfth Federal Reserve District

Independent Appraisal and Evaluation Functions (SR 03-18)

The Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision, and National Credit Union Administration (the agencies) are jointly issuing the attached statement on the independence of the collateral valuation process. The purpose of the statement is to remind regulated institutions that there needs to be an effective, independent real estate appraisal and evaluation program for all of their lending functions. This includes all real estate-related financial transactions originated or purchased by a regulated institution for its own portfolio or as assets held for sale. The statement should be reviewed in conjunction with each agency's appraisal and real estate lending regulations and the Interagency Appraisal and Evaluation Guidelines.¹

The agencies' appraisal regulations address appraiser independence and require that an institution, or its agent, directly engage the appraiser. The only exception to this requirement is that an institution may use an appraisal prepared for another financial services institution, provided that the regulated institution determines that the appraisal conforms to the agencies' appraisal regulations and is otherwise acceptable. It is also important to ensure that the program is safeguarded from internal influence and interference from an institution's loan production staff. Individuals independent from the loan production area should oversee the selection of appraisers and individuals providing evaluation services.

To foster control and accountability, the agencies encourage a banking institution to use written engagement letters when ordering appraisals, especially for large, complex, or out-of-area commercial real estate properties. Even in small institutions when absolute lines of independence cannot be achieved, effective internal controls should be implemented to ensure that no single person has sole authority to render credit decisions involving loans on which they ordered or reviewed the appraisal or evaluation.

Proposed Treatment of Expected and Unexpected Losses Under the New Basel Capital Accord

The Basel Committee is requesting comment on the attached document, which describes a modification to its proposed international capital standards. The modification deals with the

¹ For the real estate lending regulation, refer to 12 CFR 208 subpart E and Appendix C on the Federal Reserve website at the http://www.federalreserve.gov/regulations/title12/sec208/12cfr208_01.htm page. For the appraisal regulation, refer to 12 CFR 225 subpart G at the http://www.federalreserve.gov/regulations/title12/sec225/12cfr225_01.htm page. For the guidelines, refer to SR letter 94-55 at the <http://www.federalreserve.gov/boarddocs/SRLETTERS/1994/SR9455.HTM> page.

treatment of expected and unexpected losses. The Basel Committee will accept comments from all interested parties until December 31, 2003.

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Additional Information

All circulars and documents are available on the Internet through the Federal Reserve Bank of San Francisco's Internet site, at <http://www.frbsf.org/banking/letters>.

For additional information about independent appraisals and evaluation functions, please contact our Banking Supervision and Regulation Department at (415) 974-2112.

For additional information on the New Basel Accord, please contact our Banking Supervision and Regulation Department at (415) 974-2936.

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Attachments:

[Independent Appraisal and Evaluation Functions](#)

[Proposed Treatment of Expected and Unexpected Losses Under the
New Basel Capital Accord](#)