

Outside Counsel

Expert Analysis

After the Banks, FDIC Pursues Appraisers

After the dust settled on all the actions the FDIC brought against the banks involved in the mortgage crisis and the FDIC established receiverships of these failed institutions, it began looking for other parties that may have contributed to the financial crisis. As receiver for the failed institutions, the FDIC has the ability to sue any professionals that may have played a role in the failure of the institutions now in receivership.¹ Beginning in 2009, the FDIC did just that and commenced suing the directors, officers and other professionals of the financial institutions that failed.² Among the professionals the FDIC began pursuing are the appraisers that valued the houses that defaulted to the banks during the housing crisis. The FDIC has begun suing these appraisers for their allegedly negligent appraisals in order to augment its recoveries for the banks for which it is a receiver.

In May 2011, the first big appraiser suits were the FDIC's simultaneous actions against two appraisal management companies (AMC), CoreLogic Inc. and Lender Processing Services (LPS).³ The role of the AMCs was to function as a middleman between the banks and the appraisers. The FDIC continued actively pursuing these professional liability cases. By August 2011, the FDIC had approximately "172 pending mort-

gage malpractice and fraud lawsuits against mortgage brokers, appraisers, attorneys, closing agents and title companies."⁴ As to appraisers specifically, since Jan. 1, 2007, the FDIC had identified approximately 500 individual appraisers that had submitted allegedly negligent appraisals.⁵ The FDIC alleged that these appraisals overvalued the subject properties and failed to use appropriate comparable sales for their evaluation.

The FDIC is candid that it is filing a large number of these lawsuits and that the main purpose of these lawsuits is to maximize recoveries.⁶ The FDIC states, however, that "[p]rofessional liability suits are only pursued if they are both meritorious and cost-effective," and that prior to pursuing any action against these professionals, "the FDIC conducts a thorough investigation into the causes of the failure." In addition, the FDIC claims that it will try to settle the matter by reaching out to the professionals prior to filing the claim. Whether the FDIC has adhered to these statements has yet to be seen and, as discussed

below, the appraiser community does not seem to agree.

On Aug. 3, 2012, the assistant general counsel to the FDIC gave a presentation to the Appraisal Institute to address these lawsuits.⁷ The presentation provided a general overview of the bank failures and the relevant Dodd-Frank provisions, but also focused on the Professional Liability Program, which is what the FDIC has termed its efforts for recoveries against the attorneys, accountants, appraisers, brokers, and other professionals involved with the FDIC's banks in receivership. The FDIC explained that it looks to recover against these various professionals through negligence, malpractice, breach of contract, and securities claims against professionals such as appraisers.

In its presentation, the FDIC highlighted the various allegations against appraisers for which it has sought recovery: a) failing to follow uniform standards of professional appraisal practice (USPAP); b) inappropriate comparables/unsupported adjustments; c) failing to report recent sales of appraised property; d) inadequate research; e) failing to perform a site visit when required; and f) tying compensation/employment to appraisal results. It then went on to discuss particular cases that are pending and again emphasized that it favored pre-litigation settlement or settlement at any stage of the litigation.

In summary, the FDIC maintains that it is pursuing meritorious, cost-effective



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claims against professionals that have some liability in the failure of the banks for which the FDIC is receiver, and it is doing so in order to maximize recoveries for these banks.

How Appraisers Are Affected

Appraisers have been following the current developments in the professional liability claims of the FDIC and have been active in making others aware of the current FDIC initiative.⁸ In addition, appraisal organizations have started hosting seminars to help appraisers deal with the current lawsuits and protect themselves from future liability.⁹ These forward-looking measures, however, do not resolve the pending actions for those appraisers already affected.

Appraisers have been affected in two ways. First, many of them have been directly sued by the FDIC as receiver¹⁰ and, second, others have been named in the AMC litigations as providing negligent appraisals for larger appraisal companies.¹¹ Notably, the FDIC has not filed any complaints against appraisers with state regulatory agencies but, rather, solely has been suing appraisers for money damages, in the average of about \$450,000.¹² At least one appraiser believes that the strategy here is to extract quick settlements from the appraisers' insurance carriers, which want to avoid the costs of litigation.¹³ And he notes that one of the law firms hired by the FDIC to pursue these claims has focused solely on appraisers with current errors and omissions (E&O) policies.

The second way appraisers have been affected is that many were named in the AMC litigations for providing negligent appraisals. These appraisers were sent a notice of claim informing them that they had been named during the litigation and could be subject to negligence actions by the AMC or another party, and further advising the appraisers to notify their E&O insurance carriers.¹⁴ While not being sued directly, these appraisers are still being accused of conducting negligent

appraisals, a claim that is being tracked by some potential employers.

Additionally, it is possible that some appraisers have been named as defendants by the FDIC without knowing it. In 2011, the FDIC filed a number of lawsuits against appraisers, but then never served the documents. The FDIC then had the cases dismissed without prejudice in case it wanted to re-file later.¹⁵ And despite the individual appraisers never being made aware of the complaint against them, the lawsuit will still show up in some credit and/or background checks.

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Appraisers have been critical of the way the FDIC has handled these claims. Appraisers note that while some bad appraisals were probably made during this time period, for some, if not most, the divergent property values likely stem from the 30-40 percent drop in real estate over the period, not any negligence in conducting the appraisal. In general, the appraiser community seems to believe that most of the allegations are meritless and is not pleased with the FDIC's professional liability claims against them and the resulting adverse effects.

Are Appraisers to Blame?

The courts have not yet decided whether the appraisers had a significant hand in the financial crisis. While they have found no merit to some of the FDIC's claims,¹⁶ they are not prepared to find that the appraisers are blameless.¹⁷ In particular, courts have rejected the FDIC's claims for gross negligence, because courts have found that there was no "special relationship" between the appraiser and the bank, and the duties alleged by the

FDIC "merely restate[d] contractual obligations."¹⁸ However, in these same cases courts have refused to dismiss breach of contract and negligence claims, because more information was needed before determining if these claims had any merit.¹⁹

Some individual appraisers have also had breach of contract claims dismissed where the appraisal contract in question was with their company and not with the individual appraiser.²⁰ In these cases the court found that the individual appraiser was not a party to the agreement and, accordingly, could not have breached the agreement. The courts have also been receptive to allowing the defendant appraisers to assert affirmative defenses for comparative fault and contributory negligence.²¹ These defenses are based on the fact that appraisers claim that the allegedly inflated appraisals were done at the urging of the banks that the FDIC is now suing on behalf of as receiver.

Most of these cases have not gone to judgment yet and have only been tested in a handful of jurisdictions; therefore, it is hard to say whether the courts will find that these appraisals were inflated and the appraisers were at fault. A more immediate effect that will be felt, however, is that this recent wave of litigation has sparked reform to the Dodd-Frank Act that will require U.S. mortgage lenders to implement new appraisal standards for higher risk loans.²²

The court of public opinion has been equally unable to determine conclusively if appraisers really are to blame. The media has chiefly been covering the director and officer liability claims and tends to address the other professional lawsuits only in passing.²³ The few articles that have been written addressing the appraiser lawsuits tend to defend the appraisers.

While most articles are willing to concede that there were inflated appraisals, they do not believe these were the sole, or even a significant, cause of the financial crisis. One article argues that even though the appraisers were propagating inflated real estate values, the real perpetrators were the brokers

and lenders pushing the appraisers to submit inflated reports.²⁴ The article, by David Callahan of PolicyShop.net, an online blog dedicated to promoting minority economic and political points of view, contends it was not merely shoddy work that led to these allegedly negligent appraisals, but the banks' complaining that the appraisals were not high enough and the banks' preference for only selecting appraisers known to give high appraisals. According to the article, the FDIC should not be able to pass off the banks' elaborate financial frauds as the incompetence of appraisers. Here is where appraisers contend the courts should accept an affirmative defense of comparable fault, because the FDIC should not be able to recover in the shoes of a bank for the bank's own misconduct.

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Another article, on Tommy's Blog, a "mortgage compliance weblog" aimed at providing mortgage compliance information, focuses on the detrimental effect that these aggressive litigations against appraisers are having on the housing recovery.²⁵ The article puts forth that the FDIC's lawsuits are causing appraisers to low-ball their appraisals, hurting lenders and borrowers alike and slowing the housing recovery. The article contends that it was not the appraisals that caused borrowers to default on housing payments, it was sloppy loan underwriting and misrepresentations by originating lenders and borrowers. The article alleges that the FDIC is not filing any form of disciplinary action against these appraisers, but seeks only to recover money from the defendants, because the FDIC knows that the dis-

ciplinary board would find many of its claims meritless. The FDIC's aggressive litigation tactics are raising E&O policy rates and causing other appraisers to leave the profession altogether to avoid this unforeseen liability. In summary, some are of the opinion that the FDIC is causing considerable harm to professionals that are not accountable for the damage caused by the financial collapse.

Conclusion

The FDIC, in its role as receiver for various banks, has begun a campaign to recover money from appraisers and other professionals for their alleged hand in the financial collapse. It is clear that the appraisers are surprised and defensive and disagree with the FDIC's allegations. What remains unclear is, first, whether the appraisals during the financial crisis were purposefully inflated by the accused appraisers, second, whether courts will be able to find sufficient evidence of this inflation if it really did occur, and third, whether these inflated appraisals were done at the behest of the banks, the very parties that seek to be compensated for this alleged harm.



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