

## THE INDEPENDENCE OF VALUERS

### Introduction -

Valuers can be individual professionals working on their own, or they may belong to Valuation entities. These can be external to their main customers, the Mortgage Lenders or be part of a Lending Institution. External Valuation entities may have a close relationship with particular lending entities, these generating a substantial share of their revenues. Conversely, they may have a well diversified customer base. The individual valuers may be part of Credit institutions therefore, exercising their valuation activity exclusively for their employer. Valuation entities may be single purpose companies or belong to broader organizations engaged on related activities such as Real Estate Agents or intermediaries.

Many different possibilities and business approaches, therefore, exist in the market for valuers, all of them perfectly acceptable. However, in order for valuers to be valid in a modern mortgage market they must be **independent**. A very common error is being made by a number of constituencies equalling the concepts of independence and being external to the lender. Everyone and all of the possibilities in the business approaches mentioned in the precedent paragraph, internal and external, permit an independent professional behaviour. Internal valuers can perfectly act independently if proper internal rules are adequately established and monitored. Conversely, it is also very possible to find cases in which external valuers are not acting independently: A particular bank branch commercial employee asking for a valuation to an external valuer could eventually put pressure on him to inflate the value if proper internal rules and adequate supervision are not in place. Furthermore, a valuer **not only must act** independently, he/she **must** also be free of any circumstances which might affect his neutrality. A Real Estate agent, professionally well equipped to effect a valuation could in theory be asked to value a property for which he/she is intermediating. These are but only a few instances in which external valuers are or may not be considered independent.

There are countries in the Union with stringent regulations that ensure a strict enforcement of independent behaviour by valuers. Other countries approach is self regulating. In principle, it is not necessary to have a regulatory environment to be able to have professional and independent performance.

### Definition -

A definition of independent valuer might be as follows: A valuer is independent when he/she is and appears to be free of any undue influence from any person or entity having an interest in the final value and the content of the valuation report.

### External vs. Internal Valuers -

External Valuers: An individual valuer can be considered external to one particular lender when his/her professional activity as valuer cannot be influenced by the lender due to other business and/or personal relationship, or when the valuation business obtained from that lender is a substantial portion of his/her total business.

A valuation company is considered external to a particular lender when the lender has no substantial economic interest in the valuation company which would permit the lender to have an influence on this company. The economic interest may be in the form of a substantial portion of the company's shares, a significant proportion of its business and so on.

All other valuers, for the sake of control measures, should be treated as internal to the lender.

### **Measures to ensure valuers Independence.-**

It is in the best interest of both lenders and investors to ensure that valuations of mortgaged properties are effected in a highly professional way. Different measures however should be implemented depending on whether the valuer is internal or external.

#### 1. External Valuers. –

- a. Conflicts of Interest.-It is highly advisable that external valuers are members of professional bodies with clearly established membership rules with respect to conflicts of interest between their valuation and other activities (e.g. Real Estate intermediation, relation with buyer or seller etc.). These Valuation professional bodies should be able to supervise and, if needed, to establish corresponding penalties. In countries where there are such bodies, lenders, in principle, should only use the services of external valuers that are members of these bodies. In those countries where no such bodies exist, lenders should ensure that external valuers that effect valuations for them have strict internal rules to avoid conflicts of interest; compliance should be able to be supervised. One clear rule that should exist in all cases is that the professional that effects valuations should not have responsibilities on Real Estate intermediation nor should he/she directly or indirectly benefit economically or otherwise from this business. In principle, there should be well established “Chinese Walls” between both activities and professional transfers from one activity to the other should be done with great care.
- b. Commercial Influence.- Lenders should establish internal rules so that valuers are protected from influence both from lenders' internal commercial units or from units that have an interest in the RE transaction. Ideally, lenders should have a certification procedure authorizing external valuers to work with the lender. This procedure should be managed exclusively within the Risk Management Units of the lender. These units should also be responsible for supervising the abnormal use of single valuers (excessive or too little). Lenders' Internal Audit Units should be responsible to uncover eventual undue influence on Valuers. There are a number of lenders that keep within their Risk Management Units the responsibility to validate all valuations.

#### 2. Internal valuers.-

Valuation Companies which are part of a lending group or, as a result of shareholding or revenue dependence, have a link with a lending entity, should

establish internal guidance rules to be applied when performing valuations for that lending entity. These guidance rules should, at least, contain internal Code of Conducts establishing incompatibility rules when necessary. Supervision authorities should ensure that the lending entity frequently monitors the existence and compliance of the Code of Conduct.

As a general rule, Internal Valuation activity by lenders should be the responsibility of Lenders' Risk Management Units. It is of paramount importance for Lenders using the internal valuation approach to ensure that Valuers are protected from influence from the Commercial Units.

Lenders should have clearly established internal rules that prevent internal valuers from undue pressure from Commercial units/officers. For instance, having Valuation figures and reports a central validation system. Frequent corrections to individual valuers would be centrally monitored / investigated.

Selection and supervision of individual internal valuers should be the Responsibility of Risk Management Units.

Internal Valuation professionals' retribution and promotion should not be linked to mortgage business commercial objectives.

The existence and compliance of these internal rules and internal reporting lines should be monitored by the Supervision authorities.

### **Conclusion-**

Quality Valuations are of paramount importance for a sound mortgage lending activity and, as a result, for MBS and Covered Bond Investors confidence.

Ensuring an independent performance by the valuer is a must to achieve a quality valuation.

Independent valuers can be either internal or external to the lenders.

It is the responsibility of the lenders to have adequate mechanisms to ensure that valuers are kept well protected from undue influence from lending commercial units and transaction participants. Supervision authorities must ensure that lenders do have those adequate mechanisms.

Jose Ramon Ormazabal  
September 2007