The Regulatory Focus

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Division of Financial Institutions

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Appraisal Review Function

For a financial institution's loan portfolio - generally the largest asset, the highest revenue generator, and the greatest source of risk, sound underwriting is the best defense to preserve the income source and minimize credit loss. The failsafe to loss is, however, adequate collateral protection which stems from accurate appraisals, and must include a sound appraisal review system.

In order for a financial institution's loan officers, senior management and board to place a high degree of confidence in an appraisal, it must accurately provide a realistic value of the collateral supporting the extension of credit. As such, a good review system provides the accountability necessary to instill such confidence.

Sound reviews ensure an appraiser complies with voluminous and complicated state and federal regulations governing real estate transactions, is properly certified for specific property types and has the competency and expertise to provide an accurate and comprehensive report. Furthermore, certain types of properties require specialized proficiency and an effective review will provide assurances that the appraiser remains within the scope of the project for which he or she is paid. It is important not to compromise quality for a lower cost or faster delivery time.

Each bank should have a system in place to not only verify appraisers are properly licensed or certified prior to hiring them, but also periodically update their credentials with changes to their eligibility. An appraiser must be licensed to perform appraisals by the state in which the property is located. Verification is available online for state and federal licenses and certifications. The Ohio Department of Commerce Division of Real Estate and Professional Licensing maintains a searchable database at https://elicense3-secure.com.ohio.gov/Lookup/LicenseLookup.aspx. A national database is also available at https://www.asc.gov/Home.aspx for verification.

An effective review function protects your institution from exposed collateral positions, the cost of having a property reappraised if it is found faulty or lacking, and complications from violations of the appraisal regulations. Reviewers should have:

- Good working knowledge of the appraisal standards and be able to identify incomplete, inaccurate, or unacceptable appraisals

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- Independence of the appraisal function (i.e., reviewers should not be performing appraisals)

- Authority to reject or act on bad appraisals (i.e., order a new appraisal, initiate a hold on loan funding, discontinue using certain appraisers report an appraiser for improper practices, etc.)

- Ability to track appraisals – looking for common problems by appraiser, loan officer, branch office, etc. to identify big picture items.

It may not be practical for every appraisal to be reviewed before the loan is funded especially smaller one-to-four family real estate loans. According to its risk appetite, the board of directors should establish – through the loan policy – the criteria for loans that must have appraisals reviewed prior to funding and those that may be reviewed after the fact, possibly by a sampling method. Appraisals may necessitate a more rigorous review process prior to funding when they are completed by new appraisers or for commercial real estate loans; whereas, less complex transactions may not require prior scrutiny. If problems are found during the review process, the appraiser should be consulted and the dispute addressed to the satisfaction of the reviewer.

Quality control over the appraisal function means added protection against loss for the bank. Identifying potential or systemic problems may require more time or expense up front, but the benefits derived can be substantial in the long run.

Additional information on the appraisal review function can be found in the Interagency Appraisal and Evaluation Guidelines at http://www.federalreserve.gov/boarddocs/srletters/2010/sr1016a1.pdf

Information Technology Risk Assessment

Safeguarding sensitive customer information is both a statutory responsibility and a prudent business practice. Risk assessment is an integral part of a financial institution's security plan, and is a requirement of Gramm-Leach-Bliley Act 501 (b). Despite the fact that the risk assessment has been a requirement since 2001, institutions continue to struggle with this process.

The basic steps needed to develop a risk assessment are as follows:

- Identify all information and information assets used by the institution. This is not limited to just information technology, as documents such as signature cards should also be included.
- Determine what type of data is held within the assets identified. (Examples include: social security numbers, account numbers, etc.)
- Based upon the information above, determine the inherent risk associated with this information asset. Inherent risk should be the driving factor for the scope of the IT audit.
- Identify the threats and vulnerabilities that may exist with this data, such as breach of data or loss of data.
- Identify controls used to mitigate the risks identified. They should be commensurate with the sensitivity of the data.
- Test the controls in an independent manner. In other words, the network administrator cannot be the individual testing the controls that they have established. An independent audit helps with this step to determine the sufficiency of the controls established.
- Based upon the effectiveness of the mitigating controls that are tested, assign a residual risk rating.
- Report the results of the risk assessment to the board of directors or to a committee designated by the board of directors to review the risk assessment. The risk assessment must be reviewed on at least an annual basis, we recommend alerting the board to changes to the risk assessment as they occur.

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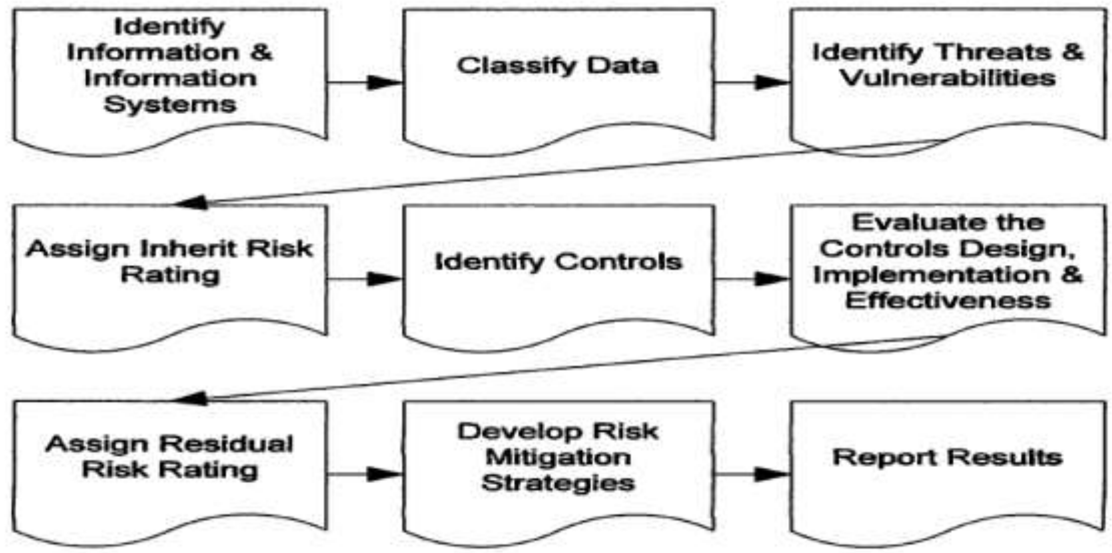
Information Technology Risk Assessment Continued...

A flowchart of the risk assessment process has been copied from the FFIEC IT booklets (illustrated below).



As indicated in the basic steps, the risk assessment plays a critical role in determining the audit process. Management should determine the scope of their IT audits using the risk assessment as a tool that identifies their highest inherent risks. If management chooses to outsource the development of the risk assessment to a vendor or consultant, they should ensure that the same consultant or vendor does not develop the risk assessment and review it as a part of their audit.

Division Monthly Report

Have you ever wondered what happened to a particular financial institution, whether it was a bank, savings institution, or credit union? Well, our Monthly Report may contain the answer to your question. By tracking depository corporate activities, the Monthly Report serves several purposes: it helps to identify current trends in corporate activities for Ohio chartered depository institutions and it verifies corporate application statuses in process at the Division of Financial Institutions. Within the Monthly Report you will also find sections devoted to new and converted state-chartered institutions, reorganizations, mergers, change in control, branch openings, closings, consolidations, as well as relocations, name changes, liquidations, enforcement actions, and other activities. The "Other Activities" section was recently added to address situations where an application is not processed for approval by the Division, but still affects a state-chartered institution. The Monthly Report also keeps consumers informed by providing detailed information directly from your state regulatory agency.

The Division of Financial Institutions Monthly Report is available for viewing on the Division's Webpage, www.com.ohio.gov/fiin/default.aspx, under the News & Reports Section.

Post Examination Survey

Earlier this year the Division implemented a Post Examination Survey designed to provide Ohio bankers the opportunity to provide direct feedback regarding how to improve the examination process. Completion of the survey will be requested after all examinations of Ohio-chartered banks and savings institutions. The Superintendent will e-mail the survey to the CEO, President or managing officer of the institution. It can be returned to the Division via e-mail or direct mail. Thank you in advance for taking the time to contribute to improving the examination process by completing the survey.