Banking in the Ninth

December 2013

Community Banker and Bank Examiner: Common Cause in Keeping Both Jobs Attractive

Banking and bank examining combine two key inputs: technology and people. Ensuring that an organization keeps up to date on technology is clearly important and only grows in significance over time. But recruiting and retaining skilled individuals is even more critical to the future success of community banks and bank supervisors.

Two recent observations suggest some promise in attracting a future generation of examiners and bankers.

- CNNMoney recently listed the 100 best jobs in America. Bank examiners came in at number 18 (http://money.cnn.com/pf/best-jobs/2013/snapshots/18.html). The list noted the critical role that examiners play on behalf of the public.
- I had the privilege of spending time with faculty, students and bankers associated with Northern State University's Banking and Financial Services department in mid-November. I heard faculty and bankers talk compellingly about challenging and engaging careers at community banks. Both commercial loan officer and banking relationship manager made the CCNMoney list as well.

I readily accept the good news!

I also know that managers at banks and bank supervisors face real challenges in finding the new staff they need. Bankers routinely tell me of hurdles in recruitment. Sometimes they cite location, particularly for banks situated in rural parts of the Ninth District. Other bankers note their need for specialized, hard-to-find skills. Finally, many bankers argue that new regulations and more intense supervision make their jobs less enjoyable; a few even report some difficulty in recommending the job to newcomers.

Ron Feldman

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SAFETY and SOUNDNESS UPDATE

Overcoming the Appraiser Shortage

Ninth District bankers have expressed frustration in outreach meetings with a perceived inability to find qualified appraisers. In this article, we document some trends in appraiser availability and how bankers can address this challenge.

The number of appraisers has fallen nationally. The Federal Financial Institutions Examination Council Appraisal Subcommittee's 2012 Annual Report reports that the number of appraisers has declined nationally by approximately 15 percent since 2007.

According to industry sources, the primary source of the overall decline is the decreased demand for appraisers that occurred during the credit crisis. Specifically, the mortgage crisis resulted in a significant decline in the need for residential appraisals. As a result, many appraisers retired or left the industry. This outflow made it more challenging for firms in need of appraisals—even if they did not have loan growth—to acquire them.

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The drop in demand in many areas also has led to changes in the regional availability of appraisers. Some of the remaining appraisers have moved to parts of the country experiencing more loan growth. This shift benefits some areas of the Ninth District. For example, the number of approved appraisers has grown in western North Dakota. Of course, this shift has left other banks with few options.

The Appraisal Institute expects the number of appraisers to further decline by 25 percent to 35 percent over the next 10 years due, in part, to the high cost of entry into the appraisal field (in terms of both time and funds). Higher costs have already led to reduced entry into the position. These costs will likely continue to increase. Prospective appraisers must also meet required fieldwork experience standards to become licensed. Candidates obtain this experience through an apprenticeship or mentoring program with an existing appraiser. In 2015, changes to the formal education and mentoring requirements adopted by the Appraisal Foundation are expected to further decrease the number of new entrants into the appraisal field. Note that the Appraisal Foundation sets the minimum licensing and testing standards for all appraisers to obtain their license or certification. While individual states may add higher standards, Ninth District states have not done so in a significant way.

What can bankers do in the face of reduced appraiser availability, realizing that examiners cannot waive the appraisal requirements? Options include the following:

- Understand which transactions may not require an appraisal and use evaluations in these cases. The appraisal regulation notes three general “exceptions” in which an evaluation may be used:
  - The transaction is for less than $250M.
  - The transaction is a real estate secured business loan under $1,000M in which repayment is not dependent on the sale or cash flow of the real estate.
  - The transaction involves an existing extension of credit.
- Where appropriate, make use of the “abundance of caution” exception to appraisal requirements. Remember, though, that the credit file must document that the use of this exception is appropriate at the time the credit is extended.
- Develop or expand in-house real estate valuation expertise, potentially to include having a certified appraiser on staff if cost effective. Some banks have developed a strong internal real estate valuation policy and program that helps them meet most of their valuation needs.
- Internally discuss and document in board minutes the appraisal barriers your bank is facing and develop a plan to overcome them. Thinking about ways to address the lack of appraiser availability in advance may better prepare management to address the situation in the context of a specific loan.
- Consider whether a group of local banks may benefit from supporting a prospective appraiser through the certification process (perhaps with a commitment from the individual to practice locally for a period of time).

These suggestions will not address all cases where the shortage of appraisers delays the ability to close loans in a timely manner. There may still be situations where a bank is faced with the prospect of deciding to close a loan without first obtaining the mandated appraisal or of losing the loan prospect. Should the bank choose to make the loan prior to obtaining the appraisal, examiners will be required to cite the violation. However, their assessment of a bank’s risk management program related to collateral valuation will consider the extent to which management and the board have identified risks associated with the program and taken steps to mitigate that risk. By demonstrating that management and the board understand and have proactively taken measures to mitigate risks associated with the lack of availability of appraisers, a bank should be able to avoid examiner criticism of the risk management program.

STATISTICAL REPORTING UPDATE

Determining a Financial Institution’s Deposit Reporting Frequency

Each year, some Ninth District depository institutions find out that they must file deposit data on a new schedule or report form. It may not be clear to the institution why this change occurs. This article summarizes the Federal Reserve System’s process for identifying which institutions must change their deposit reporting schedule.

The Depository Institutions Deregulation and Monetary Control Act of 1980 authorized the Federal Reserve System to impose reserve requirements on all depository institutions and to collect data used to calculate those requirements. The Garn-St. Germain Depository Institutions Act of 1982 required that institutions with a reserve requirement of zero percent be subjected to less overall reporting than other institutions. This act also implemented the annual indexing of reporting and reserve requirement thresholds so that smaller institutions can grow their deposit base while maintaining their eligibility for reduced reporting.

To carry out its responsibilities under these acts, the Federal Reserve System conducts an

annual two-phase review in which staff compare available deposit data to the annually indexed reporting thresholds to determine each institution's filing requirement (weekly, quarterly, annually or nonreporter).[1]

The first phase of the review occurs in March through June. Staff use total deposit data from the previous December's Call Report to identify which current nonreporters should file the annual report as of June 30 and which institutions that filed the annual report in the previous year should become nonreporters.[2]

The second phase of the review occurs in July and encompasses weekly, quarterly and annually filed deposit data to determine the reporting status for each institution that would begin in September. An institution's reporting assignment is based on the maximum observed levels of net transaction accounts and total transaction accounts, savings deposits and small time deposits during the first half of the current year.[3]

As a result of the annual two-phase review, some institutions must begin filing deposit data more frequently and others are eligible for reduced reporting. The Reserve Banks notify affected institutions of the change in their reporting status when such a change occurs. An institution required to report on an increased frequency will begin the new regimen in September. An institution eligible for reduced reporting may elect to continue reporting at the higher frequency at its discretion. However, that institution must continue that level of reporting for a full year (i.e., September to September).

Please contact a Statistical and Structure Reporting analyst with any questions at mpls.statistics@mpls.frb.org, (612) 204-6445 or (888) 887-0926 if calling from outside the Minneapolis/St. Paul metropolitan area.

[1] Banking Edge/Agreement corporations and U.S. branches and agencies of foreign banks that provide weekly deposit data are not eligible for reduced reporting and are therefore excluded from this review. Bankers' banks and corporate credit unions are not eligible for reduced reporting. At any time of the year, a depository institution that is experiencing above normal growth could be required to begin reporting more frequently.
[2] Data are adjusted for any merger activity that may have occurred since the previous December.
[3] For weekly deposit reporters, it is the maximum of the 13 weekly averages from weeks ending in early April through late June; for quarterly deposit reporters, it is the maximum of the two weekly averages in the March and June reporting periods; and for annual reporters, it is the values reported for June 30.

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Supervisors have a series of recruitment and retention challenges as well. Travel is a perennial difficulty for examiners. Private sector demand for examiners is currently high. Public criticism of bank supervision increased during the financial crisis and after as well.

Certainly banks and bank supervisors face some distinct staffing challenges. Some of the challenges and potential solutions, however, strike me as having common ground, and I conclude with a discussion of three.

First, both supervisors and banks in the Ninth District need a steady flow of qualified staff. Bankers and supervisors have common cause in ensuring that adequate training, both school-based and on-the-job, exists. We also have an interest in ensuring that training programs turn out candidates who want to remain in all parts of the Ninth District. Where such education does not exist at the level needed, we should work together to help appropriately support it.

Second, we both need to explain what our professions have to offer. Community bank examiners often highlight the variety of tasks they face and the opportunity to have a positive influence when explaining what they like about their jobs. Certainly both community bankers and supervisors make major contributions to society. We should feature these aspects of the job prominently.

Finally, both supervisors and bankers have a shared interest in having an appropriate regulatory and supervisory regime. Such a framework protects the interests of the public while ensuring that the benefits associated with protecting the public outweigh the costs. Maintaining an appropriate balance in this regard will continue to attract staff to both community banks and supervisory agencies. Comments by bankers on regulatory proposals, for example, are critical to achieving that balance; the revisions made to Basel III in response to banker feedback demonstrate the value of banker feedback.

–Ron Feldman
Executive Vice President, SRC

The Real Estate Settlement Procedures Act (RESPA) outlines specific computation and disclosure rules for escrow accounts associated with federally related mortgage loans. Federal Reserve examiners have found cases where lenders improperly modified the escrow account analysis when borrowers pay property taxes at loan closing in order to prevent a large escrow payment increase the following year. In this article, we discuss the nature of the concern and how lenders can address these situations while still complying with RESPA.

When a borrower or seller pays a property tax payment at loan closing, the borrower then has only one remaining property tax payment due during the 12-month escrow account computation period. The bank can include only this remaining property tax payment in its escrow account computation analysis. The escrow account may then have a shortage, which could lead to a substantial increase in the borrower's monthly escrow payment in the second year. To avoid this, we have seen lenders include two property tax payments in the escrow account analysis, which can lead to an inaccurate initial deposit, monthly escrow account payment, or cushion. Lenders must use a 12-month computation period. Including two property tax payments in the escrow analysis results in a 13-month computation period.

Under RESPA, a lender has two options for preventing a significant shortage during the loan's second year. First, the lender can explain the situation to the borrower at loan closing and provide the Consumer Disclosure for Voluntary Escrow Account Payments. HUD recommends using this disclosure when the lender believes that escrow account disbursements will increase substantially in the second year of the loan. Under this option, the borrower can pay additional funds into the account during the loan's first year to prevent an increased payment the following year. Even if the borrower chooses not to make these additional payments, he or she will learn about the shortage that will occur in the loan's second year. HUD provides model language for this disclosure, which is located at the following link:
http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/rmra/res/respagui.

Second, at any time, the bank can provide a short-year statement, which ends the current escrow computation year and begins a new escrow computation year. Under this option, the borrower's payment will still increase during the second year, but the increase may not be as substantial, depending on when the bank completes the short-year statement. HUD provides examples of short-year statements as Public Guidance Documents, which lenders can access through the link above.