Internal Memo

Rabobank

Select Templates | Show Form to change text in protected area

To Executive Committee

Date 22 July 2014

Copy Andre Blom

Reference

From Mark Cox / Justin Lane

Enclosures

Subject **Valuation and Collateral Inspection Functions**

Background

Following draft regulations from the ECB / DNB a Group wide policy in respect to the monitoring of collateral has been issued. Whilst neither APRA or the RBNZ are yet to adopt similar regulation, it appears possible (probable) local regulators will adopt similar measures in the future.

To comply with the regulations, the following policy setting has been established for all Rabobank entities:

"When real estate is part of the collateral base, the value should be properly assessed before granting the credit. An independent, qualified appraisal of the market value is required. Independent in this context means independent from the client and from the commercial department that maintains the relationship with the client."

Current Model

RANZG holds security over c. 30,000 properties, with 12,000 valuations conducted annually (c. 130 valuations per branch per annum).

Presently, account managers prepare valuations ('appraisals')for non-specialist rural land i.e. inspect properties, maintain a database of comparable sales, assess sales evidence compared to the subject property and write a report. These appraisals are approved by Credit as part of the application / review process. The advantage of this model is that Account Managers are well versed in land values in their regions and this expertise and knowledge is highly valued by our client base. The disadvantage is that the appraisal is not independent of the front office and it could be perceived (and is possible) that Account Managers are inflating values to assist in the provision of credit to clients. That the second line of defence lacks intimacy with the property and the local market, exacerbates the risk. To date, empirical evidence (actual sales compared to the RAGNZ appraisal) support the conservatism of our appraisals.

Risk and Country Banking have discussed various models for complying with the independence requirement and potentially reducing the risk of overvaluing collateral, whilst maintaining customer service and the Bank's value adding offering

In discussing the various models for Valuations, the key requirements were to meet the regulatory and policy requirements of being independent of the business, to retain a model that was time effective and a low imposition to borrowers (relative to the risks/complexity of assessing the collateral value) and not out of step with market practice. Ideally the model should enhance the business either from a business origination or risk perspective, or both.

Commentary

A wide ranging number of models have been discussed, which include:

Internal Memo

Rabobank

a) Full outsourcing to External Valuers;
b) Outsourcing to External Valuers over a certain value;
c) Creation of a Regionally Based Internal Valuation team;
d) Establishment of a Centrally Based Internal Valuation team that is responsible for the Valuation amount only;
e) A combination of a number of the options above and also reducing the impact by only changing the model for valuations above an agreed minimum (e.g. materiality).

Proposal

Options a) and b) have been discounted, given the Bank's market share in the Agri sector, there is insufficient capacity to outsource all valuations. There is legitimate concern about the ability of the current Rural Valuations industry to complete work in a timely manner (in many areas there is already a delay in receiving external valuations). A fully external valuation model has therefore been discounted.

Employing a regionally based internal valuation team or a smaller centralised internal valuation team that complete desktop valuations only (based on rural managers reports) has been closely considered.

The overriding requirement is to ensure 'independence" of the Front Office. A Valuations Department will sit within the Risk team and be independent of the Credit team.

The difference between the two preferred models is outlined below:

	Option c) Regionally Based Valuation Team	Option d) Centrally Based Valuation Team
Front Office retains responsibility for Client Visits / Data Collection	Yes	Yes
Complete Valuation Report	Yes	No – Value Only
No of Valuation Reports (weekly)	20	60
Ability to maintain comparables database	High	Med
Valuations Qualifications	Yes	Yes
Ability to control quality of valuations	High	Med
Compliance with 'independence' definition	Med	Low / Med
Valuations Staff Numbers (RANZG) – estimate	26	10

A regionally based internal valuation team (Option c) that has strong local market knowledge is considered most likely to deliver sufficient independence and quality valuations and is strongly preferred. An internal valuation team is a material structural change in the business, resulting in the transfer or hiring of staff into specialist (risk) roles.

Option e) may evolve further following a pilot of Option c) and an assessment of workload / practicality, but at this stage it is intended to fully pursue Option c) without exceptions.

Assessed workload would see at Regional Valuer completing between 15 – 25 valuations per week (average c. 20). The key tasks would be as follows:

- Collate information provided by Account Manager on property details (title particulars, area, improvements, geography and soil etc)
- Gather and maintain information on property sales to provide adequate comparable sales
- Apply comparable sales information to subject properties
- Complete valuation report including amount following generally accepted valuation principals
- On an ad hoc basis physically inspect the property to verify information supplied by the Relationship Manager

Internal Memo

Rabobank

The proposed model would see the transfer of one Account Manager per region into the role of a full time valuer. Subject to business requirements, and to maximise the benefit of local knowledge we anticipate the requirement of one valuer per region (there are 15 regions in Australia, and 6 in New Zealand, albeit the regions in NZ are generally 1.5x Australia in size). It is envisaged that all valuations will be completed by a Regional Valuers (i.e no minimum threshold).

Benefits

- Improved lines of defence in relation to valuation quality and creates independence to the benefit of banking regulators, external audit etc. Positions the business in the event of future local banking regulation.
- Duplication of tasks is minimised (front office will not fill out valuation report nor source or maintain comparable valuation data, Credit Approvals will not need to scrutinise valuations), this will allow the transfer of FTE without substantial further costs.
- Cost is being managed 'in house' – i.e. not paying external valuers
- Further hind sighting may not be required
- The Valuation Department will be also responsible for benchmarking appraisal information to market data and backtesting sales to appraisal information on a portfolio basis to further strengthen the framework.

Costs / Risks

- Additional resource results in double handling that increases costs
- Key person risk in that valuations are reliant on one person per region

Other

Whilst this project should be run as close to cost neutral across the business as practical (i.e. transfer of FTE's from Front Office to Risk) it is likely some additional cost will be incurred as part of this restructure. It is proposed that a pilot project be established (one in Australia and one in New Zealand) to validate our assumptions and report back further to the Executive. It should be noted that an additional Collateral Inspector has already been foreshadowed and this function should be also be incorporated into Valuations function (to be the subject of a further memo).

It is expected that the Australia and New Zealand model will operate identically.

Recommendation

1. Request approval from Global Risk Management to pursue strategy as detailed above to meet the global policy requirement; and

2. Assign or employ a contract manager to implement the model, commencing with a pilot of the internal independent valuation process, in one region in both Australia and New Zealand to be established by October 2014. The results of the pilot should be reported for full implementation by end February 2015.

Internal Memo

Rabobank

Mark Cox / Justin Lane
Head of Country Banking Credit
Country Banking Credit
SYDNEY

Draft Executive Committee Minute 28 July 2014.

Valuation and Collateral Inspection Functions

The EC noted the memorandum dated 22 July 2014 from Mark Cox and Justin Lane.

AB advised that as a result of proposed regulations by the DNB and ECB, a Group wide policy had been issued which requires valuations of real estate collateral to be undertaken by a qualified party independent of both the client and the Bank department which maintains the client relationship. After consultation between Risk and Country Banking, the recommended model to meet this requirement is to appoint a dedicated valuer in each region within AU and NZ, preferably being an existing suitably qualified Account Manager in that region. This 'Valuation Department' would sit within Risk and be independent of Credit. It is proposed that a contractor be employed to implement the model, commencing October 2014. Based on the results of the pilot, to be received by February 2015, a full implementation should be completed by end 2015. The EC approved the recommendation, subject to the involvement of one AU & one NZ Regional Manager in both the pilot and full implementation project."