

# Fee Panel Management



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### Introduction

Much of the post housing finance crisis guidance on the subject of appraiser selection has been in harmony. The fundamental challenge for lenders and their agents is in merging all of the many regulations and guidance around this topic to implement a single coherent and consistent policy. The objective, once the policy is in place, is setting policy into motion with a “best practices” approach.

The significance of selecting the appropriate appraiser for each assignment cannot be overstated. According to Robert L. Parson, Appraisal Policy Specialist at the Office of the Comptroller of the Currency (OCC) “appraiser selection is the single most important part of the appraisal process. Nothing trumps it”. Lenders and their agents should be giving serious consideration to how they initially select their appraiser and how they continuously monitor them. It is a two-step process.

An honest, competent appraiser produces a credible appraisal report. The purpose of engaging a fully vetted appraiser is to avoid certain risks—compliance risk, operational risk, repurchase risk, default risk, and lawsuits from investors as well as borrowers. It is also, simply put, the right thing to do.

### Best Practices Approach

The objective of this white paper is to pull all of the regulations and guidance together in a unified document and build a best practices approach. As with other areas of guidance, the regulators generally avoid a checklist approach. Our “best practices” however takes a holistic view of the topic at hand to provide a clear road map. While every effort was made to examine and analyze all the regulations, guidance and commentary specific to this subject, this document is not intended to serve as a substitute for legal advice.

## Summary of Guidance & Regulations

The relevant references in the guidance and regulations regarding fee panel management have been assembled as follows:

FIRREA, of 1989 vintage, maintains that the appraiser selected must be independent of loan production.

### Appraiser Independence

**Staff appraisers.** *If an appraisal is prepared by a staff appraiser, that appraiser must be independent of the lending, investment, and collection functions and not involved, except as an appraiser, in the federally related transaction, and have no direct or indirect interest, financial or otherwise, in the property. If the only qualified persons available to perform an appraisal are involved in the lending, investment, or collection functions of the regulated institution, the regulated institution shall take appropriate steps to ensure that the appraisers exercise independent judgment. Such steps include, but are not limited to, prohibiting an individual from performing an appraisal in connection with federally related transactions in which the appraiser is otherwise involved and prohibiting directors and officers from participating in any vote or approval involving assets on which they performed an appraisal.* (b) **Fee appraisers.** (1) *If an appraisal is prepared by a fee appraiser, the appraiser shall be engaged directly by the regulated institution or its agent, and have no direct or indirect interest, financial or otherwise, in the property or the transaction.*

### Fannie Mae Selection Criteria- April 15, 2014

*The lender is responsible for the selection of appraisers and for the qualifications and quality of work provided by the appraisers that are selected; may not use appraisals ordered or received by borrowers or other parties with an interest in the transaction, such as the property seller or real estate broker. Fannie Mae does allow lenders to use third-party vendors (for example, appraisal management companies) to manage the appraiser selection process. However, it should be noted that if a lender enters into a contract with any vendor, contractor, or third-party service provider, the lender is accountable for the quality of the work performed as if it was performed by an employee of the lender.*

*The lender (or its authorized agent) must establish policies and procedures to ensure that qualified individuals are being selected in accordance with Fannie Mae requirements, including the Appraiser Independence Requirements.*

*The lender must ensure that an appraiser has demonstrated the ability to perform high quality appraisals before using an appraiser's services. The quality of an appraiser's work is a key criterion that must be used in determining which appraiser the lender (or its authorized agent) uses for its assignments. The requirement for an appraiser to produce a high quality work product must always outweigh fee or turnaround time considerations.*

*Delegating these responsibilities to a third party does **not** relieve the lender of its responsibilities related to the appraisal or the value, condition, and marketability of the property. See B4-1.3-12, Quality Assurance, for information related to ongoing review of appraisals.*

### **Fannie Mae on Appraiser Selection**

*Fannie Mae requires a lender to use an appraiser who has the knowledge and experience that is required to perform a professional quality appraisal in a specific geographic location for the particular property type for which the lender needs an appraisal. The appraiser must also have knowledge about, and access to, the necessary and appropriate data sources for the area in which the appraisal assignment is located.*

### **Freddie Mac on Appraiser Selection**

*FHLMC states Loan officers are prohibited from " Selecting, retaining, recommending, or influencing the selection of any appraiser for a particular appraisal assignment or for inclusion on a list or panel of appraisers approved or forbidden to perform appraisals for the Seller.*

### **Excerpts from Interagency Appraisal and Evaluation Guidelines (December 2010)**

*Examiners will review steps taken by an institution to ensure that the persons who perform appraisals and evaluations are qualified, competent, and are not subject to conflicts of interest.*

- *Provide for independence of the persons ordering, performing and reviewing appraisals*
- *Establish selection criteria and procedures to evaluate and monitor the ongoing performance of appraisers*
- *Implement internal controls that promote compliance with program standards and include monitoring of third party arrangements*

### Selection of Appraisers

*An institution's collateral valuation program should establish criteria to select, evaluate, and monitor the performance of appraisers. The criteria should ensure that:*

- *The person selected possesses the requisite education, expertise, and experience to competently complete the assignment.*
- *The work is periodically reviewed.*
- *The appraiser selected is capable of rendering an unbiased opinion*
- *The appraiser is independent.*
- *The appraiser holds the appropriate State certification or license at the time of assignment.*

*The person who selects or oversees the selection must be independent of the loan production area.*

### Approved Appraiser List

*If an institution establishes an approved appraiser list for selecting an appraiser they should have appropriate procedures for the development of the list. These procedures should include a process for qualifying an appraiser for initial placement on the list as well as periodic monitoring of the appraiser's performance and credentials.*

### Engagement Letters

*An institution should **not** allow the lower cost or the speed of delivery time to inappropriately influence the ordering decision.*

*An institution is accountable for ensuring that any services performed by a third party, both affiliated and unaffiliated, comply with applicable laws. An institution should have the resources and expertise necessary for performing ongoing oversight of third party arrangements.*

*An institution also **is responsible** for ensuring that a THIRD PARTY (also known as an Appraisal Management Company) selects an appraiser who is competent and independent, has the requisite experience and training for the assignment and thorough knowledge of the subject property's market. Appraisers must be appropriately certified or licensed but this **minimum** credentialing requirement is **not sufficient** to determine that an appraiser is competent to perform an assignment for a particular property or geographic area.*

*Loan production is prohibited from:*

*Selecting, retaining, recommending, or influencing the selection of any appraiser for a particular appraisal assignment or for inclusion on a list or panel of appraisers approved or forbidden to perform appraisals for the Seller*

Key components of Dodd Frank Title XIV:

- Mandatory Reporting
- Portability
- Customary & Reasonable Fees
- Appraiser Independence
- Copies to Borrower
- Additional powers to ASC
- AMC registration and oversight
- AVMs

AMC Minimum Requirements\*:

- Register and be subject to supervision
- Verify the credentials
- AMCs must comply with USPAP

\* Waiting on AMC Final Rules (coming soon 😊)

*If a lender chooses to engage an AMC they cannot abdicate the responsibilities of compliance such as appraiser selection to a third party.*

Note: The use of a third party increases risk, not decreases it, by definition. Unfortunately it is a commonly held belief that one can outsource risk. An institution can mitigate risks and insure against certain risks but compliance is the responsibility of the financial institution. This is why oversight is so vitally important.

Darrin Benhart, Deputy Comptroller for Supervision Risk Management of the Comptroller of the Currency, in a presentation to the Mortgage Bankers Association on September 11, 2013, made the following statement:

*We sometimes found **little oversight** of appraisal management companies (AMCs). In some cases bankers didn't understand how appraisers were selected and engaged on behalf of the bank. This is a critical function where **effective oversight was missing** especially when the function was outsourced.*

It is worth noting the date this was delivered. This was just prior to the OCC's Third Party Oversight Bulletin, which was announced on October 31, 2013. In short, lenders are

wholly responsible for the appraiser selection process even when they engage a third party.

## Fee Panel Management

Definition: The process by which a lender (or their agent) engages an independent appraiser. Implicit in this process is the initial vetting to select an appraiser as well as ongoing monitoring.

There are a number of legacy practices that are roadblocks to establishing a “best practices” approach. The misaligned incentives for third party Appraisal Management Companies (AMCs) to engage the cheapest appraiser, is one of the biggest hurdles. A best practice to ensure that a lender is complying with appraiser selection criteria would be to move to a “cost plus” model whereby the financial institution establishes the fee paid to the appraiser. The AMC would compete on their products and services and the lender would compensate them directly for their services. The practice of expecting the appraiser to pay for the services that benefit the lender is an unfair business practice. It also is virtually impossible for an AMC to maintain a viable business enterprise when the expectation is that they are to engage the best appraiser at the cheapest fee. Not only is it not sustainable, it is not compliant. There is tremendous exposure to lenders for noncompliance with the C&R provisions of Dodd Frank and class action suits as well.

Allowing loan officers to nominate appraisers to a list is yet another unacceptable practice. Some lenders believe that as long as they properly vet their lists, after loan production has nominated the appraiser, that they have maintained independence. This is not an acceptable practice according to the GSEs.

Another trend is to automate as much of the appraisal process as possible. The focus has been on the second step of the appraiser selection process, the “ongoing monitoring” half of the equation, to the detriment of the initial vetting phase. Automated scoring has its place but it is not a panacea. Scoring appraisers is an excellent method for ongoing monitoring provided quality is placed before fee and turn time. The algorithm should be transparent to all parties.

Broadcast ordering systems can support abusive practices whereby mass emails are sent trolling for the lowest bidder with zero degree of vetting. Bots have been developed that capture these orders in seconds. There are no controls in place to ensure that the party capturing the order is either qualified or will actually be the party performing the services. Appraisal quality is directly correlated to sound selection process. While it is possible that a controlled broadcast system can be established, the practice and process as detailed above is unacceptable.

There are also platforms that mortgage brokers use that are essentially phony firewalls. Brokers can select appraisers from a list of their own making. Some of these sites offer relationships with their “trusted” appraisers and an AIR compliance certificate. This is why third party oversight is a must. It is imperative that a financial institution is aware of how appraisers are being selected and the methods by which orders are being placed.

And then there are a lot of long held beliefs that a license is the only requirement for the placement of an appraiser on a panel. Evidence of a license is a minimum requirement. A license does not denote either competence or ethics. The goal here is to dispel some of these myths and establish a path for compliance.

There are several ways a lender can manage a fee panel:

- 1) Directly engage
- 2) Engage a third party (AMCs)
- 3) Incorporate a staff model
- 4) Hybrid- both direct and use of third parties or a blend with staff

Any and all of these options can be managed with a “best practices” approach. If a lender chooses to outsource any or all of its appraisal function they are increasing their risk. This will require additional oversight by the lender of their third parties. A risk/cost analysis should be carefully developed. Maintaining staff is considered by some to be the best path for achieving quality and meeting service metrics. This plan too requires a high degree of resources to manage. A financial institution cannot abdicate their responsibilities of the appraiser selection process to a third party.

A lender can ensure that they are in compliance by developing their own fee panel and defining the scope of work for the AMC to manage the order fulfillment process and quality control. Or they can audit the appraiser selection process of their third parties. AMCs must be completely transparent with their panels in order to ensure that all parties are compliant.

There are a number of panels that a lender or their third parties should manage. Implicit in the guidance is the management of both exclusionary and approved lists. Some choose to also manage a “watch” list or “probationary” list. Once you have completed the vetting of an appraiser, logic would dictate that you would move them to either an approved or “do not use” list. If they fall into a probationary list, there must be a written policy with guidance as to how and when they get moved to another list. All fee panel criteria must have written policy.

Best Practices for Fee Panel Management:

- ✓ Know your vendors
- ✓ Your vendor manager is a key employee



- ✓ Ensure you are paying C&R
- ✓ Maintain clear policy, easily accessible
- ✓ Audit your third parties. Include site visits. Constantly monitor
- ✓ Survey appraisers and ask them how you are doing
- ✓ Have a mission statement: “Engage the best and compensate them fairly”
- ✓ Create a profile and attach to each report
- ✓ Have a consumer facing solution

The list above incorporates some fundamental activities that a lender/agent should refer to as a checklist to ensure they are on the right path.

### Business Triangle



### Cost Vs. Fees

If it is generally understood you cannot achieve a cheap price, outstanding quality and quick service, why do we insist that appraising is the exception to the rule? There have been a number of business school papers written on this generally accepted principle. Even if you could defy the gravitational pull of business rules, the guidance on this issue is quite clear... you may not place service or fee before quality.

With this discussion the executives of any appraisal department need to consider the actual cost, not the fee, of an appraisal. Factors that must be considered include:

- Repurchase risk
- Revisions
- E&O Claims
- Lawsuits
- Compliance risk—MRAs (Matters Requiring Attention)

### Price

- Look to the Dodd Frank Act for guidance on how to establish a fee schedule for payment of a “Customary & Reasonable” fee.
- Ensure you are not withholding payment and violate appraisal independence.
- Pay a fair fee in a timely manner.
- Cheap is ultimately very costly. It is transference of wealth to your legal team.

### Service

- What is a reasonable turn time?
- Why not order the appraisal earlier in the process?
- Why not collect information about the collateral at the time of application?
- How do you measure professionalism?
- Do you have policy on attire?
- Do you have policy on proper communication?
- Do you survey your appraisers to find out how you are doing with service?

### Quality

- You will know it when you see it.
- Automated QC systems identify non-conforming properties.
- AVMs don’t do a great job of selecting the best comparable sales.
- It is not a great idea to suggest that appraisers respond to an AVM.
- Good appraisers produce credible appraisal reports.

It is often asserted that increasing fees paid to appraisers will not magically make them better appraisers. That is true. But you will also not be attracting the right appraisers onto your panel if your fees are unacceptable. You only can consistently achieve quality when you pay a fair fee. As a profession we will never attract the next generation of well-trained college educated appraisers if we continue efforts to compress fees.

The guidance is abundantly clear. You may not place speed of delivery and low fees over quality. Reverse logic would dictate that you should be paying a premium for quality and service. It was not an uncommon practice during the refinance wave to be paid a

premium for appraisal reports delivered within 5 working days. Needless to say it was a “carrot” that motivated appraisers to deliver that particular clients’ reports before others. It worked.

Developing a solid fee panel is a lot of work. The investment on the front end of the process will be the defining moment in setting the relationships you maintain with your panel. Appraiser selection best practices will indeed separate a successful appraisal program from one that is not sustainable. Taking advantage of vendors in periods of low demand is not a best practice or a viable long-term strategy.

In summary here is a list of “Ten Commandments” that are good rules to live by:

- 1) The single most important part of the appraisal process is appraiser selection
- 2) Fee and quality are highly correlated
- 3) Appraiser score cards are NOT all you need
- 4) Focus on the people part first, not the product
- 5) Remove misaligned incentives- do not compensate processors for engaging the cheapest appraiser
- 6) A license or certification does NOT denote either competence or ethics
- 7) Review is NOT a substitute for proper appraiser selection
- 8) The right appraiser can be your boots on the ground trusted advisor
- 9) Loan production may play NO role in appraiser selection
- 10) Appraisers are human too. Treat them well and they will respond accordingly

## Policy

Having written policy is a requirement. Bank examiners look for, not only written policy, but an assurance that policy is actually practiced. Conversely having best practices without underlying policy is also insufficient. The old adage “say what you mean, mean what you say” works well for regulatory compliance.

For the onboarding process, written policy needs to address the following:

- Selection criteria
- Application process
- Master Engagement Letters
- Background screening of professional records
- Professional conduct
- E&O insurance
- IC vs. Employee status

For the maintenance of your panel you should have written policy for:

- Committee composition
- Process for removals, additions and rebuttals
- Reports to States and other agencies
- Letters for written notification

Guidance demands both initial vetting and constant monitoring. Constant monitoring would include written policy on:

- Background checks
- Disciplinary history
- Review
- Scoring- turn times, professional conduct, quality, revisions

### **Master Engagement**

Master engagement letters have been a source of consternation for the appraisal community. While some clients have ignored them altogether and just relied upon an order form, others have chosen the completely opposite path of drafting an engagement letter of 20 plus pages. A simple order form referencing the master engagement letter keeps a concise process for each order. As for a best practices approach, keep the Master Engagement letter simple.

The purpose of a master agreement serves to memorialize terms and expectations. If there are any disputes the process is outlined in advance. Well-managed expectations make for a mutually beneficial professional relationship.

Items that should be addressed in a Master Engagement letter should include:

- Reference to policies and where to access them
- Insurance
- Application
- Background checks
- Disciplinary policy
- Professional conduct
- Reference to payment schedules
- Dispute resolution process
- Confidentiality statement

What should NOT be in a master engagement letter:

- Inappropriate indemnity agreements stating that the appraiser is responsible for things beyond their control (see State laws)
- Keep it brief. 20 plus pages of legalese is not the way to establish mutual trust
- HVCC certification or a statement that the appraiser certifies that the appraisal was ordered in an AIR compliant manner
- Statement that the fee they accept is C&R
- Insurance requirements that are too high

Items that should be included on each and every appraisal order should include:

- Identification of the subject property
- Definition of value
- Assignment conditions
- Client specific instructions
- Due date
- Fee
- Inspection notes and contact information
- Delivery instructions
- Contract of sale attached (if any)
- Plans and specs (if applicable)

Each appraiser engaged should sign a Master Engagement Agreement. Each appraiser must be individually vetted and monitored. All of these expectations should be included in the Engagement Letter.

### **Insurance and Risk**

Errors and Omissions insurance (E&O) provides for the worst-case scenario where the AMC or lender is suing the appraiser for negligence in performing an appraisal. Just the request for the appraiser to maintain E&O is, in and of itself, an excellent self-screening process. Appraisers who have an ugly claims history generally cannot obtain insurance. If a lender or AMC does not have an express insurance requirement and verification process they will have a fee panel populated by substantial numbers of bad actors. The lack of a requirement acts as a magnet to attract appraisers who are high risk.

Regulatory guidance generally requires lenders to analyze the risks posed by third party service providers and consider the appropriate types of insurance to be required (but the guidance states no specific requirement). The OCC guidance, per Bulletin 2013-29, advises that banks should require a third-party service provider to maintain adequate insurance, notify the bank of material changes to coverage, and **provide evidence** of coverage where appropriate.

The bulletin advises that banks should consider the applicability of “fidelity bond coverage, liability coverage, hazard insurance, and intellectual property insurance.” Of these types of coverage, the most relevant to a lender/AMC with respect to an appraiser is **professional liability and general liability insurance**.

Professional liability is the most relevant coverage for appraisers because it covers the appraiser for negligence in the performance of an appraisal causing financial harm (e.g., the appraiser is sued for negligently high appraisal that leads the lender to make a loan at too high of an LTV that it would not have made except for the high appraisal). General liability is of lesser relevance to actual claims involving appraisers (but costs an appraiser less because of that fact) and covers the appraiser against claims for personal injuries, bodily injuries and property damage caused by the appraiser.

Insurance requirements as stated in policy should include:

- \$300,000 per claim and \$600,000 aggregate. Higher property value states- \$500,000 per claim and \$1,000,000 aggregate.
- Require proof of insurance in the form of a Certificate of Insurance (30 days notice of cancellation) to the lender/AMC.
- “Prior Acts” - date matches the time of first performance of services for the lender/AMC and that the appraiser does not make a change resulting in loss of that prior acts coverage.
- “Claims Made” - claims are not made for a long period of time after the date of an appraisal, it’s important to consider a requirement that the appraiser keep in place professional liability insurance for a certain period of time even after the agreement with the lender/AMC ends.

Peter Christensen, general counsel for Liability Insurance Administrators, suggests language for your Master Engagement letter:

### ***Professional Liability (E&O) Insurance***

*Appraiser shall at all times during the Term of this Agreement maintain professional liability insurance (“E&O Insurance”) covering damages arising from the professional appraisal services delivered by Appraiser under this Agreement. Appraiser’s E&O Insurance shall: (i) have a minimum liability limit of [\$300,000 or \$500,000] per claim and [\$600,000 or \$1,000,000] in aggregate for all claims, and (ii) be issued by an insurance carrier having a Best’s Financial Strength rating of A- or better. The E&O Insurance policy shall not contain a “regulatory agency exclusion” or any other exclusion for defense or damages relating to claims arising out of failed financial institutions or claims made by the Federal Deposit Insurance Corporation or any other state or federal regulator or insurer of banks, mortgage lenders or other financial institutions.*

*No later than the date of first performance of services under this Agreement, Appraiser shall have its E&O Insurance provider provide a certificate of insurance coverage evidencing Appraiser's current E&O Insurance and providing for 30 days advance notice of cancellation or termination of the E&O Insurance to to [AMC] or [AMC's] designated risk manager. Appraiser shall have such certificates of insurance issued to [AMC] for each annual renewal of Appraiser's E&O Insurance during the Term of this Agreement. During the Term of this Agreement, Appraiser may change its insurance carriers providing E&O Insurance, but shall not obtain coverage from a carrier or under an insurance policy which results in the loss of prior acts or retroactive date coverage covering the dates on which assignments were performed under this Agreement. Appraiser shall continue to maintain the E&O Insurance coverage required in this section, either by continuation of similar coverage with the same or a different insurance carrier or by the purchase of extended reporting period coverage or "tail coverage," for a period of three years after the date of completion of Appraiser's last assignment under this Agreement.*

### **Commercial General Liability (or CGL)**

*During the Term of this Agreement, Appraiser shall maintain commercial general liability insurance on an occurrence basis covering bodily injury, property damage liability, and personal and advertising injuries. The policy must provide coverage for [Lender/AMC] as an additional insured and waive any rights of subrogation against [Lender/AMC]. The policy must be primary to, and without contribution from, any insurance maintained by [Lender/AMC] and shall have a limit of not less than [\$500,000 or \$1,000,000] per occurrence.*

Because of the OCC's recent guidance, general liability insurance is becoming more common as a requirement from lenders for appraisers (and also for AMCs). General liability insurance is generally cheaper than E&O for appraisers because it covers less common risks for appraisers. (This means also to verify appraisers aren't sending you proof of general liability insurance in place of having E&O insurance.) Because it is cheaper, the most common liability limits for general liability for appraisers are either: \$500,000 per claim and aggregate or \$1,000,000 per claim and aggregate.

Other important risk mitigation activities should include questions posed during the application process to help weed out problem candidates. Often, but not always, an appraiser, will self-select themselves out of the process when E&O and criminal background checks are mandated.

Some lenders are requiring that the panel management process include an examination of the employment status of the appraiser. If the appraiser is engaged as a 1099 (independent contractor) by a firm, the firm is functionally an AMC, or third party, masquerading as an appraisal company. The risk this brings to the lender, if they use

AMCs, is that the AMC is engaging yet another third party. There are many risk factors when a third party engages yet another third party including but not limited to compliance with C&R.

## Appraiser Selection Criteria

The guidance is abundantly clear on this subject—appraiser qualifications must come before fee and service considerations. What is **not** explicit in the guidance is the criteria by which you should base your engagement decision. Here is a checklist of criteria to consider:

- ✓ ASC.GOV verification
- ✓ Education
- ✓ MLS or other local data sources
- ✓ Identity verification
- ✓ E&O insurance
- ✓ Foreign languages
- ✓ Minority & Women Owned Business
- ✓ Sample appraisal reports
- ✓ Competency Exams
- ✓ Scoring
- ✓ IC vs. employee (1099 or W2)
- ✓ Fee schedules
- ✓ Areas of expertise
- ✓ Geographic coverage
- ✓ Photo of Appraiser
- ✓ Signed Master Engagement Letter
- ✓ References
- ✓ Background screening-disciplinary actions and criminal checks
- ✓ Turn times

Competence might be the most difficult to assess. Best practices would indicate that requiring competency exams on each area of expertise, along with an examination of the education in a given specialty would be warranted as well. Do they have the proper credentials, for example, to accept a complex assignment? Sample appraisals are another method of ensuring competence. Samples by definition should represent an appraiser's best work. Some appraisers refuse to produce samples stating a USPAP violation. USPAP provides an FAQ on the matter. An appraiser has 3 options:

- 1) Seek permission from the client
- 2) Redact confidential information
- 3) Refuse to comply with the client request



The third option, like background screening and E&O requirements are self-selection methods that are exceedingly efficient. It is always preferable to discover these objections before engagement.

Geographic competence is a buzzword often used as of late. There have been some practices whereby the cheapest appraiser, not the best appraiser, is engaged but is not located in the local market. Please note proximity to the subject does not denote competence and conversely distance from the subject does not imply incompetence. The application of some common sense and proper due diligence will reveal the best choice. One important bit of data to seek is whether or not the appraiser has access to local MLS in the subject market or an inquiry into how many reports they have prepared in that market over the past 12 months.

The guidance on appraiser selection states that it is a two-step process—initial vetting and constant monitoring. If you walk through the checklist above you will have complied with best practices for the initial vetting phase. Constant monitoring involves an examination of both the credentials of the appraiser and the ongoing quality of their work product. The trends over recent years have been the automation of scoring models. These are useful tools but often place fee and turn times before the qualifications of the appraiser.

Monitoring of the appraiser's credentials would include an option for automated updates to their criminal background as well as their disciplinary records. An appraiser could have been on your panel for a long period of time and then finds themselves in trouble with the justice system or their State appraisal agency or both. It is also considered a best practice to verify the status of the license at each and every transaction. The UCDP is verifying the credentials status at time of order. You must as well or be subject to repurchase demand if it is found that an appraiser's credentials are not valid.

## Understanding Background Screening

A **background screening** or **background investigation** is the process of looking up and compiling criminal records, commercial records, business practices and financial records of an individual or an organization. Background screening is not synonymous with criminal background checks. Background screening is often a means to objectively evaluate a person's qualifications, character and fitness. It is also the path for the initial vetting stage of appraiser selection.

There are several flavors of screening:

- Criminal- 7 to 10 years
- Skip Trace

- Professional license history/disciplinary records
- Sex Offender Registry
- Driving records
- Civil- done at the county court house level
- Employment references

### **Criminal Background Checks**

There are several reasons for performing criminal background checks. First, there is risk management. No lender wishes to subject their customers to a known criminal. The appraiser, from the consumer's perspective is representing the lender. It is imperative that they present themselves in a professional manner and have reputable credentials as well. Background checks are fairly inexpensive to run. The party ordering background checks must adhere to stringent FCRA laws. There are also State laws surrounding background checks. Some States allow for a 10 year history, others a 7 year history. To be safe and to set a standard, opt for the 7 year history.

Some criminal background checks include fingerprints. This would be a requirement that would yield no perceivable lift in information, yet would serve to create barriers for the appraiser. An appraiser who is licensed in multiple States would have to submit to fingerprints in each jurisdiction. Fingerprints take a considerable period of time to verify, approximately 2 weeks, while instantaneous criminal checks can be done against national databases.

### **Civil Background Checks**

Civil checks can be quite expensive to run in certain jurisdictions especially the northeast. To be completely thorough, one should run a civil check in every jurisdiction where the appraiser has resided and worked. This can be cost prohibitive. One needs to weigh the risks and benefits to an extensive civil probe. Civil checks would reveal civil lawsuits brought by a lender or homeowner. Often these issues do not result in a complaint to the State appraisal agency. Perhaps the most efficient method of screening for civil suits is to ask the appraiser, at time of application, if they have been subject to any lawsuits and if so to please describe. While that won't screen everyone, the mere question might self-select the appraiser off of your panel.

The FDIC has had a reasonably significant number of recent civil suits against appraisers. The FDIC does not simultaneously file a complaint with the State appraisal agency. Some insurance providers specifically exclude FDIC suits from their E&O coverage.

## Sex Offender Registry

It should go without saying that it would be prudent to screen for sex offenders. There are cases where the State appraisal agencies are aware of appraisers with criminal sex offenses and allow them to continue to practice. Allowing a sex offender inside of a customer's home would be an unconscionable failure in the due diligence process. Do not rely on your State appraisal agency to screen out criminals. While there are a few States who do run background checks, that does not ensure they will respond appropriately.

Per the Appraisal Qualifications Board, States will be required to run criminal background checks against only new applicants in 2017. Keep in mind this is just for new entries. These background checks will not be made available to lenders and AMCs. A lender or their agent should not rely on decisions made about background checks made by state appraisal agencies.

## Disciplinary Actions

A check of the [www.asc.gov](http://www.asc.gov) registry will reveal the following:

- Voluntary Surrender
- Suspensions
- Revocations

Only suspensions that are currently in effect appear in the registry. Prior suspensions do not appear in the ASC registry. The States have created their own disciplinary actions that remain under the radar and do not appear in the ASC registry. These are labeled censure, admonishment, education and so on. It would be necessary to inquire with the State agency for each and every appraiser on a periodic basis. The ASC registry will only serve to verify status of the credentials but will not necessarily reveal any underlying consent orders. A check of the ASC registry is just a small step in the overall process of due diligence. The best analogy to remember this is that you likely know someone with a driver's license who is an awful driver. Evidence of a license only means someone has met the minimum license criteria.

No client wishes to suffer a repurchase demand and discover after the fact that the appraiser has a history of disciplinary actions suggesting incompetence. While there is no explicit requirement for criminal background checks or an examination of disciplinary records a best practices approach would dictate both of these as essential when choosing the best appraiser for an assignment. Both ethical violations and competency must be determined. Constant monitoring of criminal background checks and disciplinary actions can be achieved by having your background check provider add that feature. Disciplinary actions should be monitored on a periodic basis.

Lenders have been reporting that the FFIEC regulators have been issuing MRA (Matters Requiring Attention) for not performing proper “reputation screening”. This is aligned with Bob Parson’s statement that “appraiser selection is the single most important part of the appraisal process”. Proper screening would include both criminal background checks as well as disciplinary records checks with each State appraisal agency.

Here is an example of a lawsuit illustrating the importance of background checks on independent contractors:

MURPHY, Texas– A Collin County family made a call to DirecTV for service in August 2012. They say DirecTV should be held responsible for who came into their home. A civil case is pending.

Two men responded to the call. One is named Wahren Scott Massey. Massey has been a registered sex offender in Texas since 1998. While DirecTV claims Massey was never an employee, he did go to the call as a subcontractor.

A 12 year old girl, a gymnast, was stretching and Massey was found taking photos of her on his cell phone. Massey was arrested and later convicted of attempted indecency and attempted sexual performance with a child.

Another example of why it is a best practice to check each State for disciplinary records. This is an excerpt from a Commonwealth of Virginia consent order:

*John Doe explained to Ramsey about his function there and the amount of time required. Ramsey advised Doe that he had things to do and some private telephone calls to make. Ramsey also advised Doe that he (Ramsey) would be in the garage if there were any questions. Ramsey then decided to see how Doe was progressing and went inside. As Ramsey approached he heard a drawer shut.*

*Once inside the room, Ramsey saw Doe putting clothing back into his (Ramsey's) wife's lingerie dresser drawer and at the same time his genitals were out of his unzipped pants. When Ramsey asked what was going on, Doe replied "Oh no, oh no, oh no, I'm sorry."*

*Ramsey then asked Doe to leave the house. Ramsey then contacted the York County Sheriff's Office and the Grafton Fidelity Bank.*

*On May 7, 1997, in the York County General District Court, Criminal Division, Doe plead guilty to "Intentionally make or procure another to make an obscene display of the accused's person or private parts in a public place or in a place where others were present," in violation of Virginia Code § 18.2-387, a Class 1 Misdemeanor.*

*John Doe failed to inform the Board in writing within 30 days of pleading guilty in the York County General District Court, Criminal Division. HF's failure to inform the Board in writing within 30 days of pleading guilty to a misdemeanor involving moral turpitude may be in violation of the Board's 1995 Regulation § 4.3(10)(c).*

*Doe agrees to a monetary penalty of \$500.00 for violation of 1995 Regulation § 4.3(10) (a).*

*Additionally, Doe agrees to continue therapy with Suzanne Tignor, LCSW, or another licensed qualified therapist in the event Ms. Tignor is not available. Doe will make six month written submissions to the Board confirming that the licensed therapist is seeing Doe on occasion and informs the Board that he has no further sexual problems and is not a threat to the citizens of the Commonwealth of Virginia.*

*Doe agrees to a three year probationary period. As to Count I, 1995 Regulation § 4.3(10) (c), this aspect of the file is closed with a finding of no violation. This charge was dismissed on May 6, 1998 by the Court and John Doe has no criminal conviction.*

No disciplinary record appears in the ASC registry for John Doe. He is eligible to do business with you. His license is in "good standing". He may in fact be on your fee panel.

In summary, it would not be considered a best practice, and possibly not compliant, to allow a third party background check company to make a pass/fail decision for you. It would potentially also expose you to additional liability when allowing third parties screening companies to make these crucial decisions. There has been a trend since background screening has become more commonplace to seek an industry standard. There are no data standards or legal standards from State to State. Resist the urge for the "easy button". Each institution's policies are unique to them.

Appraiser selection based upon sensitive personal and professional screening should not be offloaded to a third party background check provider. It could also possibly not be compliant with FCRA (Fair Credit Reporting Act). There are a growing number of FCRA related lawsuits each year.

As noted previously the appraiser selection process is a two-step process--1) initial vetting and 2) constant monitoring. It would be a best practice to search the ASC registry as well as State records for disciplinary records during the onboarding process as well as on a go forward basis.

## Managing Lists

There is nothing explicit in the guidance, which suggests that you must maintain a panel. But common sense and adherence to a best practices approach would dictate that you

must. Once an appraiser is properly vetted they should be placed upon an “Approved” list otherwise you will have to perform a lengthy process for each and every order. Conversely, if an appraiser has performed poorly, caused losses due to over-valuation, committed fraud, or triggered repurchase requests as a result of errors or omissions, it would be prudent to place them on an “Exclusionary” list. Some lenders and AMCs also manage a “Watch” list. This list can be for new panel members or for those who are having challenges meeting service levels.

Unfortunately “blacklisting” has negative connotations and inspires fear among appraisers. The practice of removing appraisers from a panel, for all the wrong reasons, has been horribly abused. A best practice would be to abandon any lists from the pre-HVCC era if the provenance of that list has not been documented.

The practice of disseminating lender “black lists” by black market methods is not compliant. Unfortunately no AMC can practically process an order without comparing their panel against large lenders’ “black lists”. Often these lists are not directly communicated from the lender as these orders come from correspondent channels. The AMCs are forced to perpetuate this practice. Any lender who has these legacy lists, without proper documentation, should abandon them and begin anew.

Dodd Frank mandates that lenders and AMCs must file a complaint for substantive USPAP violations. It would stand to reason when a complaint is filed that the appraiser would automatically be placed on a DNU (Do Not Use) list. The practice of managing exclusionary lists, in a responsible manner, is a must.

Many lenders and AMCs manage their fee panels by committee. A committee format would be comprised of staff appraisers, with an understanding of USPAP, and relieve any single individual from making a potentially career ending decision about a fee appraiser. Management by committee, with a solid rebuttal process, ensures that all parties engage in a transparent, fair process.

Here is what FHA says about blacklisting:

*Allowing the removal of an appraiser from a list of qualified appraisers or the addition of an appraiser to an exclusionary list of qualified appraisers, used by any entity, without prompt written notice to such appraiser, which notice shall include written evidence of the appraiser’s illegal conduct, a violation of the Uniform Standards of Professional Appraisal Practice (USPAP) or state licensing standards, improper or unprofessional behavior or other substantive reason for removal.*

While there is no federal law that mandates that an appraiser be notified of removal from a panel, there are some State laws that do require notification. It would be a best

practice to have this policy clearly available and accessible to appraisers with a rebuttal process.

Fannie Mae and Freddie Mac also maintain exclusionary and watch lists, of sorts. These lists also cannot be obtained directly by AMCs. Lenders need to maintain a process to inform their third parties, in real time, of changes to these lists. Both policy and process are critical with respect to managing lists. At all costs, appraiser independence must be at the core of fair and equitable fee panel management.

## Customary & Reasonable Fees

This is by far one of the most challenging components of fee panel management. Let's first examine what are immutable facts... fee cannot be the determining factor in appraiser selection. Payment of a "Customary & Reasonable" fee is a matter of federal law. Dodd Frank outlines the process of determining C&R as follows:

*Lenders and their agents shall compensate fee appraisers at a rate that is customary and reasonable for appraisal services performed in the market area of the property being appraised. Evidence for such fees may be established by objective third-party information, such as government agency fee schedules, academic studies, and independent private sector surveys. **Fee studies shall exclude assignments ordered by known appraisal management companies.***

The Interim Final Rule introduces two "Presumptions of Compliance" that directly contradict the law. While there is nothing to prohibit anyone from adopting either presumption it would be considered a best practice to adhere to the language in the law. To do so otherwise would put the lender and their agents at risk. Litigation is costly. And taking an adversarial position against the appraisal community would not be a sustainable long-term strategy. It is simply the compliant thing to do and the right thing to do to engage the best appraiser and pay them a fair fee.

Once a financial institution has established their policies around C&R, it is a matter of determining a fee schedule. The lender should be establishing a fee schedule by which their third parties should engage appraisers. To adhere to a best practices approach the lender should negotiate fees for service based upon scope of work with their third parties. Some lenders may choose an AMC to simply engage and place orders while others may want a thorough documented QC process. There is an entire spectrum of services that third party AMCs can offer. Like any other business, the fee and the scope need to be aligned for a mutually beneficial relationship.

The development of a national fee schedule is fairly straightforward. It really isn't complicated. Create a spreadsheet with each county and each product in the US. Dodd Frank states that you may use the following methods—independent fee survey,



academic studies or a government fee schedule. A solid plan might be to examine all three methods. Fee surveys can be sent to your current panel as well as to the entire population fairly inexpensively. Several States now have academic studies available. When in doubt you can always default to the VA fee schedule.

## Mandatory Reporting

Reporting an appraiser to their State appraisal agency for violations of USPAP has always been a requirement. Dodd Frank merely reinforced the practice with the full weight of a federal law. The GSEs also require that a lender file a complaint when it is discovered that the appraiser violated State laws or behaved unethically.

Dodd Frank Mandatory Reporting:

### Examples of material failures to comply

- *Materially mischaracterizing the value of the consumer's principal dwelling, in violation of § 226.42(c)(2),*
- *Performing an appraisal in a grossly negligent manner, in violation of a USPAP rule*
- *Accepting an appraisal assignment on the condition that the appraiser will assign a value equal to or greater than the purchase price to the consumer's principal dwelling, in violation of a USPAP rule.*

Interagency Guidelines:

- *An institution should file a complaint with the appropriate state appraiser regulatory officials when it suspects that a state certified or licensed appraiser failed to comply with USPAP, applicable state laws, or engaged in other unethical or unprofessional conduct.*
- *An institution must file a complaint with the appropriate state appraiser certifying and licensing agency under certain circumstances. An institution also must file a suspicious activity report (SAR) with the Financial Crimes Enforcement Network of the Department of the Treasury (FinCEN) when suspecting fraud or identifying other transactions meeting the SAR filing criteria.*

GSEs:

- Freddie Mac



*In accordance with the Appraisal Independence Requirements, when there is a reasonable basis to believe an appraiser or Appraisal Management Company is violating applicable laws, or is otherwise engaging in unethical conduct, the matter must be promptly referred to the applicable State appraiser certifying and licensing agency or other relevant regulatory bodies.*

- Fannie Mae  
*Any Seller that has a reasonable basis to believe an appraiser or Appraisal Management Company is violating applicable laws, or is otherwise engaging in unethical conduct, shall promptly refer the matter to the applicable State appraiser certifying and licensing agency or other relevant regulatory bodies.*

FHA/HUD:

- *Allowing the removal of an appraiser from a list of qualified appraisers or the addition of an appraiser to an exclusionary list of qualified appraisers, used by any entity, without prompt written notice to such appraiser, which notice shall include written evidence of the appraiser's illegal conduct, a violation of the Uniform Standards of Professional Appraisal Practice (USPAP) or State licensing standards, improper or unprofessional behavior or other substantive reason for removal.*

## Audits of Fee Panels

The OCC bulletin of October 30, 2013 on Third Party Oversight has placed greater emphasis upon a review of AMC (a third party) practices, policies and procedures. The focus of this paper is fee panel management. The lender, as well as their third parties, are responsible for appraiser selection. A lender can develop their own panel or they can delegate that task to their AMCs.

If they choose the latter they should reasonably audit their panel for the following:

- ✓ ASC.GOV verification
- ✓ Education
- ✓ Local data sources
- ✓ Identity verification
- ✓ E&O insurance
- ✓ Copy of driver's license
- ✓ Foreign languages
- ✓ Minority & Women Owned Business
- ✓ Sample appraisal reports
- ✓ Competency Exams
- ✓ Scoring

- ✓ IC vs. employee (1099 or W2)
- ✓ Fee schedules
- ✓ Areas of expertise
- ✓ Geographic coverage
- ✓ Photo of Appraiser
- ✓ Signed Master Engagement Letter
- ✓ References
- ✓ Background screening-Disciplinary Actions and criminal checks
- ✓ Turn times

The audit should also include a review of the policies and procedures for the selection process. Additionally the scoring methodology and constant monitoring processes should be assessed. Random samples of appraiser profiles should be reviewed.

A process audit should be performed to ensure that broadcast ordering systems are not deployed to select the cheapest appraiser. Exclusionary lists should be examined to ensure that the AMC is compliant with appraisal independence and appraisers are not being excluded for not reaching targeted numbers. An examination of the Reconsideration of Value (ROV) process will reveal compliance, or lack thereof, with the appraisal independence.

Unacceptable practices:

- Placing fast and cheap over quality
- Concentration of orders with one appraiser raises a red flag
- Engagement of known bad actors
- Exclusionary lists with no documentation

## Summary

The benefit of adopting a best practices approach for fee panel management is that compliance will actually yield a reward of savings, promote mutually beneficial relationships with appraisers, keep your bank examiners happy, and assist with risk avoidance.

## Frequently Asked Questions

Q. Can a lender provide a list to an AMC?

A. Yes, but the AMC should be assured through their Service Level Agreements (SLAs) that the lender's processes were compliant with Appraisal Independence Requirements.

Q. Can a loan officer nominate an appraiser to a panel provided the appraiser is properly vetted?

A. No.

Q. Is a check of the ASC Registry sufficient due diligence?

A. No for a number of reasons. First, 60% of the disciplinary actions do not appear in the ASC Registry. Second, evidence of a license does not denote either competence or ethics. I am sure many know someone with a driver's license who is an incompetent driver. The point being that an appraisal license or certification means that they have met the minimum criteria to obtain a credential.

Q. Is a round robin process a best practice?

A. Not really. The best appraiser for each assignment should be selected.

Q. Can a lender abdicate their risk and responsibilities of appraiser selection to a third party AMC?

A. No. Interagency Guidelines

that risk increases once a third party is engaged. The lender remains ultimately responsible.

Q. Is there anything to prohibit a mortgage broker from owning an AMC?

A. Not at the present time. (Note: at the time of this publication the AMC Final Rules have not been released.)

Q. Should a lender engage an AMC that is broker owned?

A. No. A broker who owns an AMC would be violating Appraisal Independence. There is an obvious conflict of interest. This would be revealed during a thorough due diligence process.

Q. Is the use of broadcast systems compliant?

A. It could be but generally not very likely. The best appraiser should be selected for each assignment.

Q. How do I establish a customary and reasonable fee?

A. An analysis of academic studies, independent private sector fee surveys, and the VA fee schedule.

Q. Is it a violation of USPAP for an appraiser to submit sample appraisal reports?

A. No. They can seek permission from the client or they can redact private information.

Q. Can background checks be shared?

A. Yes. A client should only accept a background check through a secure system.

Q. Should a background check company issue a pass/fail on an appraiser?

A. No. According to the OCC it would not be compliant for a third party to make that decision. The danger is that the third party would be creating a national "Do Not Use" list.

Q. Why do some clients require a letter of good standing from the State appraisal agency?

A. They would be fairly useless. Appraisers can have disciplinary actions that are serious but still maintain an active status.

Q. Can I pay my support staff a bonus based upon how cheaply they can engage the appraiser?

A. No. That would not be compliant. The lender or AMC are to engage the best appraiser, not the fastest and not the cheapest.

Q. If an appraiser accepts a fee then it must be C&R, correct?

A. No, it may be neither. Acceptance of a fee by an appraiser in no way is assurance that the fee is compliant with Dodd Frank.

Q. If that State ran a background check on the appraiser why should I run one?

A. At present most States do not run one and those that do generally do so only initially. There are a few exceptions. Again it is not the State's role to perform your due diligence. Your standards would more than likely differ from the State's. There are quite a few appraisers with a criminal background who maintain valid credentials.



## The Clearbox® Solution

*"An ounce of prevention is worth a pound of cure."*

- Benjamin Franklin

Clearbox was designed as a vendor management tool to assist lenders and Appraisal Management Companies. Clearbox maintains profiles on every licensed and certified appraiser in the US. Since "appraiser selection is the single most important part of the appraisal process," you need to have access to the most comprehensive credentials database available today.

Let's face it... there is nothing fun about regulatory compliance. But in the case of vendor management there is no denying the business case that you must know your vendors! Really know them. Clearbox is the single source that provides all of the information you need to select the best appraiser for each assignment. Let us take the pain out of the process.

Here is a quick summary of our products and how they help you remain in compliance.

**SELECT™** is a credentials hub that is available by subscription. The appraisers' profiles include photos, fee schedules, disciplinary records, a criminal background check (optional), geographic coverage, education and full contact information.

- Add, remove, monitor fee panels in "real time"
- Share lists with correspondent lenders, internally and with other third parties
  - Exclusionary
  - Approved
  - Unlimited user defined fields
- Fannie Mae and Freddie Mac Do Not Use lists
- Complete history of state Disciplinary Actions
- Background checks with constant monitoring
- Recruit appraisers with a click of a mouse
- Access to the most comprehensive credentials database in the US
- Fraud avoidance

Compliance with:

- ✓ Appraiser Selection Criteria
- ✓ Geographic competence

### XFILES™

There are only three ways to check disciplinary records:

- 1) Search the state site or contact the state regulatory agency directly and ask for each disciplinary record.
- 2) Subscribe to Clearbox and have instant access to over 14,000 disciplinary records (X-Files)
- 3) Order a Clearbox ClearOne report for \$15.00 and receive the appraiser's profile (if registered), background check and disciplinary records.

The need to check disciplinary records is driven by risk management decisions at financial institutions. Some banks have been issued a MRA (Matter Requiring Attention) for not performing proper background screening. Proper background screening requires both a criminal background check and review of all disciplinary records.

Clearbox is the only source that has aggregated all the data necessary to perform proper due diligence.

### CBOX™

CBOX is our groundbreaking solution, which makes compliance with Mandatory Reporting much easier. We have simplified the complaint process by matching the alleged offense with a matrix of USPAP violations. All complaints are then filed electronically. When you are audited, you can show your log of complaints filed through Clearbox. All complaints are kept private and not shared with anyone else.

### AREA56™

Without a doubt, tracking State legislation is an unwieldy task. Not only do we monitor the States for activity, we also have created a concise summary of all legislation.

We also have the only searchable database of AMCs today.

### Qscore™

For very practical reasons, clients need to assess an appraiser's skill set before, not after they engage them. Clearbox Qscore exams help evaluate an appraiser's knowledge. All exams are voluntary and are a great way for appraisers to determine their own skillset.

## Fee Survey

Within Fee Survey, we have created a productivity tool for establishing your fee schedules that is the most comprehensive product available today. It is updated in real time as each appraiser creates a new profile or updates their existing profile.

We have also created a grid displaying the mean, median and mode fee averages. VA fee schedules are overlaid as well. The population of each county is shown along with the appraiser population for the county. A ratio of general population to appraiser population helps illustrate the availability of local appraisers.

You can also create a fee schedule for every county in the US with the click of a button and export your fee schedule to Excel or a PDF.

## API (Application Programming Interface)

The API is simply a data feed of information from Clearbox that you can add to your transaction platforms. This information can be used to:

- \*Verify the active status of a credential at each transaction
- \*Vet your appraiser prior to engagement
- \*Constant monitoring
- \*Create consumer facing appraisal solutions
- \*Develop risk scores of the appraiser

Clearbox is merely the data provider. You can benefit by using our data to design new tools for your internal processes or create products for your clients.

## The Business Case

For appraisers, Clearbox offers the ease of maintaining their “approval package” in one place. Registered appraisers can utilize the “share profile” option to send their profile to anyone with an email address.

Clearbox provides a great opportunity for appraisers to increase their online visibility, highlight their experience and earn new business.

In today’s difficult regulatory environment, the first order of business is to ensure compliance with appraiser selection. Lenders also need to ensure that they engage the best appraiser. The Government Sponsored Enterprises are putting tremendous scrutiny on appraisal quality. Quality begins with selecting an appraiser with the right credentials.

Clearbox gives AMCs the competitive advantage. Only AMCs who can ensure their clients that they are compliant and allow transparency into their fee panels will continue to prosper and thrive.

In summary, Clearbox is a simple yet powerful tool for managing the “people part” of the appraisal process.

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