



State of Washington
DEPARTMENT OF FINANCIAL INSTITUTIONS
DIVISION OF CREDIT UNIONS

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August 9, 2010

To: Washington State-Chartered Credit Unions

From: Linda Jekel, Director of Credit Unions

Subject: Use of a CUSO to Take Assignment of a Delinquent Mortgage Loan and Foreclose, Hold and Dispose of Collateral with Environmental Risks

DCU Interpretive Letter I-10-04

Question

May a Credit Union form a Credit Union Service Organization (“CUSO”) for the purpose of transferring its loan on a gas station or convenience store with gas pumps to the CUSO and then foreclosing¹ and disposing of the mortgage loan collateral by and through the CUSO?

Summary Answer

A Credit Union may form a CUSO, either as a corporation or Limited Liability Company (“LLC”), to transfer its loan on a gas station or convenience store with gas pumps to the CUSO. The CUSO may then foreclose on the mortgage loan collateral and then hold and dispose of it as Other Real Estate Owned (“OREO”).

Consistent with this Interpretive Letter, the Credit Union and the CUSO should follow:

1. The DCU Bulletin B-10-04 (Environmental Risk on OREO Property) dated August 9, 2010, related to environmental risk assessment and the use of a CUSO to eliminate operational and legal risk to the Credit Union;
2. The National Credit Union Administration’s *Environmental Liability: Risk Management Guidance*, NCUA Letter No.: 08-CU-13, dated May 2008²

¹ Unless otherwise specifically stated, the use of the terms “foreclose,” “foreclosure” or “foreclosing” also includes the Credit Union accepting a deed in lieu of foreclosure, either in its own name or through a credit union service organization (CUSO).

² The NCUA Guidance relies substantially upon the Federal Deposit Insurance Corporation’s *Environmental Liability Updated Guidelines for an Environmental Risk Program*, FIL-98-2006 (dated November 13, 2006), and information obtained from the Environmental Protection Agency.

3. The DCU Bulletin B-09-10 (Final Rule on OREO) dated December 10, 2009.

If a Credit Union's investment in the CUSO will exceed one percent (1%) of a Credit Union's assets, a Credit Union should make written request to the Director of Credit Unions for a letter of non-objection prior to formation and use of the CUSO.³

Most OREO situations do not pose any foreseeable environmental risk or liability. So in the vast majority of situations, the formation of a CUSO to hold and dispose of OREO for environmental reasons need not be a serious consideration.⁴ However, when there is foreseeable risk based upon an environmental risk assessment, a Credit Union should follow the guidelines set forth above and strongly consider and decide whether to hold and dispose of the OREO by means of a CUSO. In any decision to form and operate a CUSO, including the holding and disposing of OREO, a Credit Union should obtain the advice of independent, knowledgeable legal counsel. In choosing legal counsel, a Credit Union should be mindful of whether its attorney is competent to give advice both as to the formation and governance of the CUSO and the limitation of liability on account of environmental risk.

Legal Authority

Washington Credit Union Act. A Credit Union may form and operate a CUSO consistent with the Washington Credit Union Act, Chapter 31.12 RCW ("WCUA").⁵ Neither the WCUA nor the Federal Credit Union Act ("FCUA") precludes the formation and operation of an LLC to act as a CUSO in lieu of using a corporation.⁶

If the CUSO is a *wholly owned* subsidiary, the investment limitation of 1% of total assets applicable to CUSOs will usually not be applicable as a matter of law.⁷ However, consistent with the broad administrative authority and discretion conferred upon the Director of Credit Unions under the Act, a Credit Union should make written request to the Director of Credit

³ See Bulletin, B-10-04, p. 4.

⁴ We caution, however, that most Credit Unions are unfamiliar with how to spot foreseeable environmental risk. Therefore, a Credit Union may be ignorant of all the potential risks that could possibly exist and when to even recognize that potential. Therefore, it is important for a Credit Union to become familiar with all of the above-referenced guidelines and to always conduct an internal, preliminary assessment of environmental risk, even if cursory and informal. See guidelines in Bulletin B-10-04.

⁵ See RCW 31.12.005(6) and RCW 31.12.436(8). According to RCW 31.12.436(8), a Credit Union may invest in (and, therefore, form and operate) a wholly owned subsidiary whose activities are limited to those authorized by the Act. Since a Credit Union may clearly foreclose on its mortgage loan collateral and hold and dispose of OREO, a CUSO may be formed by a Credit to operate for this purpose.

⁶ A CUSO of a federal credit union may convert from a corporation to an LLC. See *NCUA Legal Opinion Letter 02-0503* (Albin), dated June 11, 2002. The Director of Credit Unions therefore concludes that a CUSO of a federal credit union may be *chartered* as an LLC. Pursuant to RCW 31.12.404(2), the Director of Credit Unions finds generally that permitting a Credit Union to form a CUSO [*cont'd on next page*] [*cont'd from previous page*] as an LLC (1) serves the convenience and advantage of members of credit unions, (2) maintains the fairness of competition and parity between credit unions and federal or out-of-state credit unions, and (3) is therefore permissible. See, however, *Footnote 8*.

⁷ See RCW 31.12.436(8). The transfer of the loan asset to the CUSO is considered the "investment."

Unions for a *letter of non-objection* prior to formation and use of a CUSO for the purposes discussed in this Interpretive Letter. This is to ensure that each Credit Union seeking to form a CUSO for such purpose has given proper consideration to the guidance in Bulletin B-10-04 as it relates to eliminating operational and legal risk to the Credit Union.⁸

Relevant Environmental Law. Liability for environmental harm, including suits by private citizens, is governed at the federal level by the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (“CERCLA”),⁹ the Resource Conservation and Recovery Act of 1976 (“RCRA”),¹⁰ and the corresponding rules of the Environmental Protection Agency (“EPA”). Most states have their own environmental laws, which are applicable to environmental hazards within their borders that are not located on or impact federal land or enclaves (e.g., Indian or military reservations). In Washington State, the principal state law governing hazardous waste cleanup is the Model Toxic Controls Act (“MTCA”).¹¹ The Washington Department of Ecology enforces the MTCA and, like the EPA, has adopted rules implementing this state law. As with CERCLA and RCRA, private persons may also bring suit under the MTCA.

A brief summary of these laws and their impact can be found in Appendix B of Bulletin B-10-04.

General Applicability

This Interpretive Letter is generally applicable to all Washington State-chartered credit unions, similarly situated. The Director of Credit Unions may impose requirements in addition to the minimum standards set forth in this Interpretive Letter that are consistent with protecting credit union members and avoiding legal, operational, and reputational risk for a credit union.

Closing

The Division of Credit Unions does not provide legal advice. This letter is intended to provide general guidance only and is not a substitute for legal advice to the Credit Union.

⁸ The Director of Credit Unions notes that the Comptroller of the Currency has for a long time permitted a national bank to hold and dispose of OREO in a subsidiary LLC. See *OCC Interpretive Letter 735* (Williams), dated July 1996. Pursuant to RCW 31.12.516(4), the Director of Credit Unions has the power and broad administrative discretion to administer and interpret the provisions of the WCUA to facilitate the delivery of financial services to the members of a credit union. In the exercise of this power and broad administrative authority, the Director of Credit Unions also finds – consistent with the afore-mentioned grant of authority to national banks – that a Credit Union will be permitted to hold and dispose of OREO in a CUSO that takes the form of an LLC, *provided that* the Director of Credit Unions has issued a Credit Union a letter of non-objection after being provided with assurance that proper consideration has been given by the Credit Union to the guidance in Bulletin B-10-04.

⁹ 42 U.S.C. §9601, *et seq.*

¹⁰ Pub.L. No. 94-580, 90 Stat. 2795.

¹¹ Chapter 70.105D RCW.