DCU BULLETIN

Division of Credit Unions

Washington State Department of Financial Institutions

Phone: (360) 902-8701 ***FAX: (360) 704-6901***

October 16, 2009 No. B-09-09

Reliance on Electronic Images of Loan Documents

A number of credit unions in Washington have adopted systems for storing electronic images of loan documents. They then destroy the originals. There may be significant cost savings for credit unions implementing such a system. However, credit unions may want to keep the original note, deed, or loan agreement in order to produce the original documents in the event of litigation.

Some credit unions in Washington have relied upon the federal Electronic Signatures in Global and National Commerce Act of 2000 (E-Sign Act). This act provides that a signature, contract or other record may not be denied legal effect because it was *signed electronically*. This is not the correct law to be relying upon as a basis for preserving electronically loan documents that were *signed in ink*.

Rather, you must look to state evidence law for an answer. In Washington, RCW 5.46.010 generally permits a credit union to copy records and destroy originals in the ordinary course of business unless the original documents are assets or representative of title to assets held in a custodial or fiduciary capacity or unless preservation of the originals is required by law.

However, these laws do not resolve all legal or practical issues necessary to ensure that the records can fulfill their intended purposes and will comply with requirements other than retention. For example, the E-Sign Act does not ensure admissibility of electronic records in litigation. This is important because the practical effect of having electronic records that are not admissible into evidence in judicial proceedings may be to render the electronic record of the contract effectively unenforceable. In a number of jurisdictions around the country, judges have declined to grant foreclosure proceedings when the original loan documents could not be produced.

Nor do these laws provide specific definitions for the minimum standards of accuracy, integrity, or accessibility. Credit unions adopting electronic record retention systems should address the risks resulting from inadequate record retention practices and systems. The failure of credit unions to maintain adequate record retention systems can create significant reputation, transaction, credit, and compliance risks.

Until more specific standards are developed, credit unions should design and operate their electronic records systems so they are adequate to serve the following purposes:

- Potential use in litigation support,
- Internal and external audits and controls, and
- Compliance with regulatory requirements.

Records that the credit union may need to produce or to introduce into evidence in litigation should receive special attention. Certain courts are entertaining "produce the note" defenses and delaying foreclosures. Until that risk is eliminated, we believe that it is in the credit union's best interest to retain, in original paper format, a small number of documents – such as note, deed, and loan agreement. Under RCW 31.12.426 "each loan must be evidenced by records adequate to support enforcement or collection of the loan…" Credit union management should consider retaining the original of those records necessary to demonstrate in court the enforcement of the claim against the borrower.

Given the significance of the records maintained in most loan imaging software, the advice of an attorney in setting up such a system is also important. While it does not directly apply to credit unions, they may also find the Office of Comptroller of Currency Advisory Letter 2004-09 useful in designing such a system.

Questions about this bulletin may be directed to Mike Delimont at 360 902-8753.