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**National Association of Federally-Insured Credit Unions**

March 2, 2018

Mr. Charles Evans  
President and CEO  
Federal Reserve Bank of Chicago  
230 S. LaSalle St.  
Chicago, IL 60604

RE: Borrower-in-Custody Requirements for Electronically-Signed Loans

Dear Mr. Evans:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally-insured credit unions, I would like to share with you NAFCU's thoughts on the Federal Reserve Bank of Chicago's current Borrower-Custody-Program (BIC) guidelines. NAFCU has learned that the Chicago Federal Reserve's BIC program does not adopt a clear position with respect to the acceptance of electronic signatures on pledged collateral. The lack of clear guidance on the eligibility of such collateral directly impacts credit unions' access to liquidity in a service area that contains approximately 12 million members. Accordingly, NAFCU asks that the Chicago Federal Reserve develop guidelines to support acceptance of electronically signed loans as pledged collateral.

**General Comments**

NCUA regulations require that all federally insured credit unions have the ability (or a plan) to access contingent liquidity sources to protect the safety and soundness of the credit union system. As of 2014, NCUA rules specify that credit unions with \$250 million or more in assets must have, in addition to a written liquidity policy and contingency funding plan, access to at least one contingent federal liquidity source.<sup>1</sup> The federal liquidity source may be the Discount Window or the Central Liquidity Facility.

Access to liquidity at the Discount Window requires the credit union to establish borrowing privileges at the Federal Reserve Bank where the borrowing institution is located. In addition, all extensions of credit must be secured based on requirements prescribed by the lending Reserve

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<sup>1</sup> See 12 CFR 741.12(c).

Bank. Thus, a credit union must pledge collateral that meets specific criteria designated by the Reserve Bank.

The BIC program allows an institution to pledge a portfolio of its loans while maintaining physical control of the loans on its own premises. An institution qualifies for a BIC arrangement at the discretion of its local Reserve Bank.<sup>2</sup> In general, for commercial loan portfolios, the Reserve Bank will assess the institution's internal rating system and loan documentation practices to determine which loans are eligible to be pledged as collateral.

### **An Accessible Secondary Market for Loans with E-Signatures Exists**

NAFCU is not aware of any systemic or insurmountable barriers currently impacting the marketability of electronically signed loans in the area served by the Chicago Federal Reserve. In fact, we believe that a market premium for these loans exists based on conversations with our members. However, NAFCU understands that some Reserve Banks are only willing to accept loans with electronic signatures on a case-by-case basis out of concern for the marketability of such loans.

To ensure the marketability of pledged assets and to avoid impairments to their liquidation, BIC program guidelines indicate that a Reserve Bank will seek to perfect a security interest in the pledged collateral. NAFCU believes that perfection of a security interest in electronically signed loans would not pose a significant challenge for the Chicago Federal Reserve.

In general, perfection of a security interest in an electronically signed note is governed by the Uniform Electronic Transactions Act (UETA) and the Uniform Commercial Code (UCC). The UETA is a set of uniform rules for electronic equivalents of writing and signatures, and is the state-law counterpart to the Electronic Signatures in Global Commerce Act ("ESIGN"). The UETA has been adopted by 47 states, and among the states served by the Chicago Federal Reserve, all but Illinois have adopted it—however, Illinois has comparable law that permits electronic signatures.

The UETA provides for the transfer and negotiation of "electronic records" (which includes electronically signed notes).<sup>3</sup> Furthermore, all states within the Chicago Federal Reserve's jurisdiction have adopted provisions under UCC Article 9, which allows for the creation of paperless security interests.<sup>4</sup> Although a lender may need to demonstrate proof of control over electronic records<sup>5</sup>, credit unions have a strong incentive to meet this requirement when

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<sup>2</sup> See Federal Reserve System's Collateral Guidelines, 22 (May 30, 2017), available at <https://www.frbdiscountwindow.org/~media/Documents/FRcollguidelines.ashx?la=en>.

<sup>3</sup> An electronic note qualifies as a "transferable record" capable of negotiation if (1) it would meet the definition of a note under the Uniform Commercial Code (UCC) Article 3 if the electronic record were in writing, and (2) the issuer of the electronic record expressly has agreed that the e-note is a transferable record. See UETA § 16(a) (1999) ; compare with IC § 26-2-8-115 ( permitting negotiation and transfer of e-notes where "an electronic version of such record is created, stored, and transferred in a manner that allows for the existence of only one unique, identifiable, and unalterable original with the functional attributes of an equivalent physical instrument, that can be possessed by only one person, and which cannot be copied except in a form that is readily identifiable as a copy.")

<sup>4</sup> UCC Article 9 (2010) has been adopted in 52 jurisdictions, including Arkansas, Kentucky, Illinois, Indiana, Mississippi, Missouri, and Tennessee.

<sup>5</sup> See UETA § 16(d) (1999).

originating electronically signed loans, as control of a definitive document having the effect of a written original is necessary to perfect a first priority security interest.

Under the 2010 Amendments to Article 9 of the UCC, creation of an electronic security interest may be accomplished through the use of an “authenticated” security agreement.<sup>6</sup> An agreement may be authenticated through validation of a record, which includes a present intent “to attach to or logically associate with the record an electronic sound, symbol, or process.”<sup>7</sup> A “record,” in Article 9 is defined using the same language in the UETA, and encompasses information stored in an electronic medium.<sup>8</sup> Thus, credit unions are capable of creating security interests when originating paperless loans with electronic signatures.

With respect to perfection of a security interest, state law may create some variation in terms of procedure. The most common way to perfect a security interest under the UCC is to file an appropriate UCC financing statement. Many states specify that perfection of a security interest in collateral such as an automobile requires notation of the security interest to the vehicle's certificate of title.<sup>9</sup> Automotive lenders with e-lending experience tend to rely on commercial origination software that can satisfy state requirements related to transfer, negotiation, and perfection of security interests.<sup>10</sup> Credit unions are keen to comply with any rules necessary to perfect a first priority security interest for e-signed loans because doing so ensures that they can sell the loan portfolio at a premium.

Some states have also adopted rules to accommodate electronic titling of vehicle certificates. While certain choice of law rules may introduce complexities related to specific titling procedures, a Reserve Bank could always request documentation from the pledging institution that indicates whether a first priority security interest has been perfected against the pledged collateral. Once a perfected security interest is evidenced, a separate subordination agreement could be used to grant the Federal Reserve Bank a first priority interest in the collateral.

### **The Federal Reserve Bank of Chicago Should Permit E-Signatures on Loans Pledged As Collateral**

Although there is no consensus among Reserve Banks regarding requirements for electronic signatures, it is important to recognize that certain Reserve Banks do accept imaged loans with e-signatures, and many do not foreclose the possibility of accepting loans with electronic signatures.<sup>11</sup> Some Reserve Banks are willing to work with the pledging institution to assess the

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<sup>6</sup> UCC §§9-203(b), 9-102(7) (2010).

<sup>7</sup> UCC §9-102(7) (2010).

<sup>8</sup> UCC §9-102(70) (2010); UETA § 2(13) (1999).

<sup>9</sup> See UCC §9-303(b), 9-311(a)(2).

<sup>10</sup> See Jane K. Winn, Electronic Chattel Paper: Invitation Accepted, 18 (September 25, 2010) (discussing market innovations supporting e-lending in the automotive space). Available at SSRN: <http://ssrn.com/abstract=1682783> or <http://dx.doi.org/10.2139/ssrn.1682783>

<sup>11</sup> See Federal Reserve Bank of Chicago, Borrower-in-Custody Guidelines, 4, (July 1, 2016), available at [https://www.frbdiscountwindow.org/~/\\_/media/Documents/07bicguidelines.ashx?la=en](https://www.frbdiscountwindow.org/~/_/media/Documents/07bicguidelines.ashx?la=en). The Chicago Federal Reserve provides that “Loans with electronic signatures are *generally* ineligible for pledge. Please contact the Reserve Bank if you wish to pledge loans with electronic signatures.” (emphasis added). See also Federal Reserve Bank of Philadelphia, Borrower-in-Custody Loan Collateral Guidelines, 4 (Nov. 29, 2016) (“If loans are issued in an

marketability of the collateral and ensure that electronic loans are adequately secured and controlled.<sup>12</sup> BIC programs that expressly reject digital signatures appear to do so out of an excess of caution. As stated previously, most states have adopted the UETA, and the single outlier within the Chicago Federal Reserve's jurisdiction has adopted equivalent language.<sup>13</sup>

Some Reserve Banks are willing to review additional lender documentation to support acceptance of electronically created collateral. For example, the Federal Reserve Bank of Minneapolis has adopted BIC guidelines designed to accommodate electronic signatures and has published an addendum for electronic collateral.<sup>14</sup> The addendum consists of a questionnaire used to assess the pledging institution's process for creating electronic records and authenticating digital signatures.

NAFCU believes that the Chicago Federal Reserve should develop definitive guidance, similar to the Minneapolis Federal Reserve's BIC addendum, which would support acceptance of electronically signed loans. While there may be complexities associated with perfection of security interests against electronically signed auto loans, there does not appear to be any rule precluding the perfection of such interests in the Chicago Federal Reserve's service area.

In addition, NAFCU understands that some states have adopted rules that afford greater flexibility with respect to filing and recording electronically signed loans. NAFCU urges the Chicago Federal Reserve to assess the extent to which states within its service area have created legal impediments to e-lending which impact the BIC eligibility of electronically signed loans. Doing so would provide credit unions and other interested stakeholders an opportunity to seek revisions to outdated rules that affect the marketability of e-signed loans and undermine the convenience associated with paperless loan origination.

## Conclusion

Credit unions are experienced lenders that know how to create legally binding and enforceable agreements utilizing electronic records and signatures. The Federal Reserve Bank of Chicago should permit acceptance of e-signed loans as pledged collateral under BIC program guidelines, provided that credit unions can demonstrate that their electronic lending platform produces adequate records. Prompt guidance in this area would resolve lingering uncertainty which arises from case-by-case eligibility determinations and would improve access to liquidity. If NAFCU

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Electronic Format or maintained in an Imaged Format with the originals destroyed, contact the FRB to discuss particulars and eligibility.").

<sup>12</sup> See Federal Reserve Bank of Cleveland, Borrower-in-Custody of Collateral Program, 5 (September 2017) ("Institutions that pledge imaged and destroyed notes or electronic notes must designate the loans as being pledged to the Federal Reserve Bank of Cleveland on its loan system or general ledger. In all cases, the loans should be adequately secured and controlled.").

<sup>13</sup> See IC § 26-2-8-115 (permitting negotiation and transfer of e-notes where "an electronic version of such record is created, stored, and transferred in a manner that allows for the existence of only one unique, identifiable, and unalterable original with the functional attributes of an equivalent physical instrument, that can be possessed by only one person, and which cannot be copied except in a form that is readily identifiable as a copy.")

<sup>14</sup> See Federal Reserve Bank of Minneapolis, Addendum to BIC Certification – Electronically Created or Imaged Notes (Jan. 2017), available at

<https://www.frbdiscountwindow.org/~media/Documents/09Addendumimaged.ashx?la=en>.

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can be a source of any additional information relevant to the proposed rule, please do not hesitate to contact me at 703-842-2266, or [amorris@nafcu.org](mailto:amorris@nafcu.org).

Sincerely,

A handwritten signature in black ink that reads "Andrew Morris". The signature is written in a cursive, slightly slanted style.

Andrew Morris

Regulatory Affairs Counsel