{{8-31-98 p.5471}}

GUIDELINES FOR AN ENVIRONMENTAL RISK PROGRAM

BACKGROUND

The potential adverse effect of environmental contamination on the value of real property and the potential for liability under various environmental laws have become important factors in evaluating real estate transactions and making loans secured by real estate. Environmental contamination, and liability associated with environmental contamination, may have a significant adverse effect on the value of real estate collateral, which may in certain circumstances cause an insured institution to abandon its right to the collateral. It is also possible for an institution to be held directly liable for the environmental cleanup of real property collateral acquired by the institution. The cost of such a cleanup may exceed by many times the amount of the loan made to the borrower. A loan also may be affected adversely by potential environmental liability even where real property is not taken as collateral. For example, a borrower's capacity to make payments on a loan may be threatened by environmental liability to the borrower for the cost of a hazardous contamination cleanup on property unrelated to the loan with the institution.

The potential for environmental liability may arise from a variety of federal and state environmental laws and from common law tort liability. The most significant environmental law establishing liability for the cost of cleaning up hazardous contamination on real property is the Comprehensive Environmental Response, Compensation and Liability Act (also known as "CERCLA" and "Superfund"). CERCLA establishes a broad legal framework that creates potential liability for the cleanup costs of hazardous contamination. Entities that may be potentially liable for these cleanup costs are the current and past owners of the contaminated property, the current and past operators of business on the property, entities that disposed of hazardous substances at the property and entities that transported hazardous substances for disposal to property selected by the transporter. CERCLA provides a secured creditor exemption from liability for banks and other lenders that do not participate in the management of the property. The United States Environmental Protection Agency has issued a rule interpreting the secured creditor exemption under CERCLA, 57 Fed. Reg. 18344 (April 29, 1992). In addition to the federal Superfund law, most states have enacted legislation that establishes similar liability under state law for hazardous contamination cleanup costs.

The other primary federal environmental law relating to hazardous contamination liability is the Resource Conservation and Recovery Act (also known as "RCRA"). RCRA establishes a comprehensive statutory and regulatory framework that governs the generation, transportation, storage, discharge and disposal of solid and hazardous wastes, and, when necessary, the cleanup of hazardous contamination. RCRA also establishes regulations governing the prevention, detection and cleanup of releases from underground storage tanks containing certain hazardous substances or petroleum. Under authorization by Congress, many states establish and administer RCRA programs as part of each state's environmental laws.

Other federal environmental laws that establish environmental liability include, among others, the Clean Water Act, the Clean Air Act and the Toxic Substance Control Act. The states, including the local jurisdictions within each state, have also enacted many other environmental laws and regulations. In addition to federal and state environmental laws, potential environmental liability may result under common law tort suits based on hazardous contamination.

Institutions need to implement an environmental risk program in order to evaluate the potential adverse effect of environmental contamination on the value of real property and the potential environmental liability associated with the real property. The failure of an institution to evaluate potential environmental risks associated with real property may contribute to an institution's inability to collect on its loans and affect the institution's financial condition.

{{8-31-98 p.5472}}

ENVIRONMENTAL RISK PROGRAM

As part of the institution's overall decision-making process, the environmental risk program should establish procedures for identifying and evaluating potential environmental concerns associated with lending practices and other actions relating to real property. The board of directors should review and approve the program and designate a senior officer knowledgeable in environmental matters responsible for program implementation. The environmental risk program should be tailored to the needs of the lending institution. That is, institutions that have a heavier concentration of loans to higher risk industries or localities of known contamination may require a more elaborate and sophisticated environmental risk program than institutions that lend more to lower risk industries or localities. For example, loans collateralized by 1-to-4 family residences normally have less exposure to environmental liability than loans to finance industrial properties. The environmental risk program should provide for staff training, set environmental policy guidelines and procedures, require an environmental review or analysis during the application process, include loan documentation standards, and establish appropriate environmental risk assessment safeguards in loan workout situations and foreclosures.

The EnviroScore system meets all FDIC guidelines

Training. The environmental risk program should incorporate training sufficient to ensure that the environmental risk program is implemented and followed within the institution and the appropriate personnel have the knowledge and experience to determine and evaluate potential environmental concerns that might affect the institution. Whenever the complexity of the environmental issue is beyond the expertise of the institution's staff, the institution should consult legal counsel, environmental consultants and other qualified experts.

Policies. When appropriate, loan policies, manuals and written procedures should address environmental issues pertinent to the institution's specific lending activities. For example, the lending manual might identify the types of environmental risks associated with industries and real estate in the institution's trade area, provide guidelines for conducting an analysis of potential environmental liability and describe procedures for the resolution of potential environmental concerns. Procedures for the resolution of environmental concerns might also be developed for credit monitoring, loan workout situations and foreclosures.

Environmental Risk Analysis. Prior to making a loan, an initial environmental risk analysis needs to be conducted during the application process. An appropriate analysis may allow the institution to avoid loans that result in substantial losses or liability and provide the institution with information to minimize potential environmental liability on loans that are made. Much of the needed information may be gathered by the account officer when interviewing the loan applicant concerning his or her business activities. In addition, the loan application might be designed to request relevant environmental information, such as the present and past uses of the property and the occurrence of any contacts by federal, state or local governmental agencies about environmental matters. The loan officer or other representative of an institution might visit the site to evaluate whether there is obvious visual evidence of environmental concerns.

Structured Environmental Risk Assessment. Whenever the application, interview, or visitation indicates a possible environmental concern, a more detailed structured investigation by a qualified individual might be appropriate. This assessment might include surveying past ownership and uses of the property, inspecting the site and contiguous parcels of property and reviewing company records for past use or disposal of hazardous materials. A review of public records might include contact with federal and state environmental protection agencies to determine whether the borrower has been cited for violations concerning environmental laws and a review of federal and state lists identifying real property with significant environmental contamination.

Loan Documentation. Loan documents should include language to safeguard the institution against potential environmental losses and liabilities. Such language might require that the borrower comply with environmental laws, disclose information about the environmental status of the real property collateral and grant the institution the right to acquire additional information about potential hazardous contamination by inspecting the collateral for
{{8-31-98 p.5473}}environmental concerns. The loan documents might also provide that the institution has the right to call the loan, refuse to extend funds under a line of credit, or foreclose if the hazardous contamination is discovered in the real property collateral. The loan documents might also call for an indemnity of the institution by the borrower and guarantors for environmental liability associated with the real property collateral.

Monitoring. The environmental risk assessment should continue during the life of the loan by monitoring the borrower and the real property collateral for potential environmental concerns. The institution should be aware of changes in the business activities of the borrower that result in a significant increased risk of environmental liability associated with the real property collateral. If there is a potential for the environmental contamination to adversely affect the value of the collateral, the institution might exercise its rights under the loan to require the borrower to resolve the environmental condition and take those actions that are reasonably necessary to protect the value of the real property.

Involvement In the Borrower's Operations. Under the federal Superfund law, CERCLA, the institution may have an exemption from environmental liability as the holder of a security interest in the real property collateral. In monitoring a loan for potential environmental concerns, and resolving those environmental situations as necessary, the institution should evaluate whether its actions may constitute "participating in the management" of the business located on the real property collateral within the meaning of CERCLA. If the actions are considered to be participating in the management, the institution may lose its exemption from liability under CERCLA.

Foreclosure. A lender's exposure to environmental liability may increase significantly if it takes title to real property held as collateral. The institution should evaluate the potential environmental costs and the potential for environmental liability in conjunction with an assessment of the value of the collateral in reaching a decision to take title to the property by foreclosure or other means.

SUPERVISORY POLICY

Examiners will review an institution's environmental risk program as part of the examination of its lending and investment activities. When analyzing individual credits, examiners will review the institution's compliance with its own environmental risk program. Failure to establish or comply with an appropriate environmental program will be criticized and corrective action required.

[Source: FDIC Financial Institution Letter (FIL--14--93), dated February 25, 1993]