CHAPMAN AND CUTLER LLP

To the Point!

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Foreign Branch Deposits: FDIC Insurance and Depositor Preference

The FDIC approved a final rule that amends the deposit insurance regulations regarding deposits payable outside the United States. The rule clarifies that deposits in foreign branches of U.S. banks are not eligible for FDIC insurance even if the deposit is payable at both the foreign branch and one of the bank's U.S. branches (*"dually payable"*).

The rule also affirms a 1994 FDIC General Counsel Advisory Opinion which provides that if the foreign branch deposits are not dually payable, the foreign bank depositors will be treated as general creditors for the purposes of the FDIC's deposit preference regime. Only a dually payable foreign branch deposit will be treated in the same manner as a domestic uninsured deposit.

In its notice, the FDIC discussed a number of issues related to the rule which banks with foreign branch deposit programs should consider in analyzing potential changes. If a bank chooses to make its foreign branch deposits dually payable to obtain more favorable treatment under the deposit preference rules, such dually payable deposits will be subject to the reserve requirements of the Federal Reserve's Regulation D. However, such dually payable deposits will not increase a bank's deposit insurance assessment since the deposit insurance assessment base currently includes all bank liabilities including foreign branch deposits.

The new rule will be effective thirty days from its publication in the Federal Register.

Business Lending: Compliance with the Spousal Guaranty Provisions of the Equal Credit Opportunity Act (*"ECOA"*)

A recent federal district court case found that a violation of the spousal guaranty provisions of the ECOA could be used as an affirmative defense against the enforcement of the guaranty even after expiration of the ECOA's two-year statute of limitations. This decision reinforces the importance of loan policies that correspond to the ECOA requirements and training of bank employees in how to apply the policies when considering applications for business loans.

The ECOA prohibits a creditor from requiring the guaranty of a married applicant's spouse if the applicant requests individual credit or individually meets the creditor's standards of creditworthiness. The intention to be a joint applicant must be evidenced at the time of the application. Since business credit applications are not required to be in writing, it may be difficult to establish the intention of the applicant(s). The creditor cannot assume that a financial statement that lists jointly held property of the husband and wife and is signed by both spouses verifying the accuracy of the information represents an intention to apply for credit jointly, and joint signatures on a note may not be used to evidence an intent to jointly apply for credit.

Although a business may be determined to be creditworthy, a creditor may require the guarantees of the partners, the directors, the officers or shareholders of the business. A creditor may also require the guaranty of another person if the business application does not meet its standards of creditworthiness, but it may not require the guaranty of the spouse of a married partner, director, officer or shareholder of the business.

Banks should ensure that their policies and procedures require lenders to obtain sufficient evidence at the time of application to establish whether a joint or individual application is intended. Banks should consider including a statement signed at the time of application affirming the intention to file an individual or joint application. Loan files should clearly indicate the bank's determination on the creditworthiness of the applicant. If an applicant on an individual application is not creditworthy and the bank requires a guaranty, the bank's policies must state that the bank will not require a guaranty from the married applicant's spouse.

Payroll Cards

The bank payroll card business is growing rapidly. In 2012, employers placed nearly $34 million on 4.6 million payroll cards. Even so, there are a number of concerns regarding the issuance and use of such payroll cards that should be taken into consideration by banks before offering such products.

State employment law may restrict how payroll cards may be issued and the terms that apply to the cards. Some states require that employees have access to their wages without a fee. Other states specifically mandate that free withdrawals be provided if wages are placed on payroll cards. Specific disclosures to be provided to employees are required by some states and employers may be prohibited from requiring that an employee receive wages on a payroll card. These state law restrictions mean that payroll card programs must be customized by state or follow the most restrictive requirements of all states to ensure compliance with state laws generally. For example, an Illinois employer may pay wages by cash, check or direct deposit, provided the employee designates the account to which the direct deposit is to be made. Accordingly, a payroll card program must be optional for Illinois employees because the employer cannot require that a particular financial institution be the place for deposit to hold employees' wages.

Payroll card products are under scrutiny by various legislators and regulators. Members of Congress recently sent a letter to the Consumer Financial Protection Bureau (*"CFPB"*) expressing concern that payroll cards may take advantage of vulnerable, low-income workers and requesting that the CFPB determine whether additional regulation is appropriate. The CFPB included payroll cards on its July 2013 semiannual regulatory update as a topic for further investigation this year. In addition, the New York Attorney General has contacted 20 employers including Costco, Walmart, Walgreens and Home Depot related to their use of payroll cards to pay New York employees. Finally, class action litigation was filed on July 13, 2013 against McDonald's in Pennsylvania alleging that employees, contrary to Pennsylvania law, were not given the option to be paid other than with a payroll card.

While state laws apply to the employer, and the New York Attorney General investigation and the Pennsylvania litigation have targeted employers, banks that offer the product must be concerned that failure to offer business customers a payroll card program that is compliant with state law could result in reputational damage and carries undesired legal risk.

Fannie and Freddie Exempt from Chicago Ordinance

On August 23, 2013, a judge for the U.S. District Court for the Northern District of Illinois ruled that Fannie Mae and Freddie Mac are not subject to the City of Chicago's (the *"City"*) ordinance effective November 2011 that requires mortgage creditors to upkeep their vacant properties (the *"Ordinance"*). The Federal Housing Finance Agency (the *"FHFA"*), conservator of Fannie Mae and Freddie Mac, brought suit against the City in 2011 challenging the Ordinance on the basis that the City did not have the authority to impose such burdens on federal agencies. The Ordinance imposes daily fines up to $1,000 if mortgage creditors do not mow lawns and provide basic maintenance on vacant buildings.

The Ordinance also requires mortgage creditors to pay $500 to register vacant properties. The court reasoned that the Ordinance imposes an “impermissible tax on the federal government” because the revenue from the registration fee did not pay for any service provided by the City and that the Housing and Economic Recovery Act of 2008 preempted the Ordinance. While this ruling was a win for Fannie Mae and Freddie Mac, the Ordinance continues to apply to financial institutions with property in the City, holding them responsible for maintaining their properties with significant financial penalties for non-compliance.

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