

Protecting Deposit Accounts In Financial Institutions

Finding Out If Deposits Are FDIC Insured And The
Rating Of A Financial Institution

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Disclaimer

The information provided in this briefing paper is for informational purposes only. Nothing in this paper is to be interpreted as legal or financial advice. Contact your accountant, attorney, or bank for advice on how to organize your business and how to establish your bank accounts. The Institute of Real Estate Management does not provide legal, banking, or accounting advice to its members or the public.

Introduction

This summer the third-largest bank failure in U.S. history occurred. On July 11, 2008, IndyMac Bank, F.S.B., was closed by the Office of Thrift Supervision and the Federal Deposit Insurance Corporation (FDIC) was named Conservator. IndyMac was almost entirely invested in mortgage assets. As a result of IndyMac's high exposure to subprime mortgage defaults, the bank ended up with capital well below regulatory limits. Most recently, on September 25, 2008, Washington Mutual Bank was closed by the Office of Thrift Supervision and the FDIC was named receiver. Following the closure, JPMorgan Chase acquired the assets and most of the liabilities of Washington Mutual Bank from the FDIC.

When a bank fails, the FDIC acts in two capacities. First, the FDIC, as the insurer of the bank's deposits, pays insurance to the depositors up to the insurance limit, which is explained in detail below. The FDIC estimated the cost of IndyMac's failure to the FDIC's \$53 billion insurance fund at between \$4 billion and \$8 billion. Second, the FDIC, as the receiver of the failed bank, assumes the task of selling and collecting the assets of the failed bank and settling its debts, including claims in excess of the insured limit. A depositor who has more than \$250,000¹ of eligible deposits in a failed bank will be paid through the FDIC for the insured amount of \$250,000. In regards to the funds that exceed the limit, the depositor will be given a Receiver's Certificate as proof of his claim and would receive payments as the assets of the bank are liquidated.

A total of 15 banks have been closed this year as of October 22, 2008. In comparison, three banks were closed in 2007. As of August, 2008, a total of 117 banks were on the FDIC's troubled bank list. Major bank closing and the increase in the number of banks on the troubled list has raised consumer and business concerns. Some real estate owners and managers with deposit accounts exceeding the FDIC limit have expressed concern for their deposits. The objective of this briefing paper is to inform Institute of Real Estate Management (IREM) members of how FDIC works and what real estate professionals need to know to protect their accounts and their clients' accounts.

FDIC Insurance

The FDIC is an independent agency of the United States government. The FDIC protects depositors against the loss of their insured deposits if an FDIC-insured bank or savings association fails. The Emergency Economic Stabilization Act of 2008, enacted on October 3, 2008, authorized a temporary increase in deposit coverage limits. **The basic insurance amount was raised from \$100,000 to \$250,000 per depositor, per insured bank. The increased limit**

¹ The basic FDIC deposit insurance coverage has been temporarily increased through legislative action from \$100,000 to \$250,000, from October 3, 2008, through December 31, 2009.

is effective **October 3, 2008 through December 31, 2009**. The \$250,000 amount applies to all depositors of an insured bank.

Deposits in separate branches of an insured bank are not separately insured. Deposits in one insured bank are insured separately from deposits in another insured bank.

Deposits maintained in different categories of legal ownership at the same bank can be separately insured.

How to find out if a banking institution is FDIC insured

The FDIC insures banks chartered by the U.S. government and most banks chartered by state governments. To check whether a bank or savings association is FDIC insured, call the toll-free number (877) 275-3342, or use Bank Find at www.fdic.gov/deposit/index. Insured banks must display an official FDIC sign (see below) where deposits are received, such as teller windows.



Credit unions are not insured through the FDIC

Credit unions are not insured through the FDIC. Federally insured credit union shares are insured by the National Credit Union Share Insurance Fund (NCUSIF), which was established by Congress in 1970. An individual's share insurance is similar to the deposit insurance protection offered by the FDIC. For more information on the NCUSIF, visit the following website: <http://www.ncua.gov/ShareInsurance/index.htm>.

The basics: what types of accounts are insured

FDIC insured

The FDIC covers all types of deposits received at an insured bank, including those listed below. FDIC deposit insurance covers the balance of each depositor's account, dollar-for-dollar, up to the insurance limit, including principal and any accrued interest through the date of the insured bank's closing. The following types of deposits are FDIC insured:

- Checking deposits
- Negotiable order of withdrawal account (a checking account that earns interest) deposits
- Savings account deposits
- Money market deposit accounts
- Certificates of deposit (CDs)

NOT FDIC-insured

The FDIC does not insure money invested in the following accounts, even if the investments were bought from an insured bank:

- Stocks
- Bonds
- Mutual funds
- Life insurance policies
- Annuities
- Municipal securities

Corporation, Partnership and Unincorporated Association Accounts

Definitions

Corporation—an organization that is incorporated under the laws of the state in which it is located. This definition includes both for-profit and not-for-profit corporations, as well as Limited Liability (LLC) and professional corporations (PC).

Partnership—an association of two or more persons or entities formed to carry on, as co-owners, an unincorporated business for profit.

Unincorporated association—an association of two or more persons formed for some religious, educational, charitable, social or other non-commercial purpose.

Insurance coverage regarding corporations, partnerships, and unincorporated associations

The deposit accounts of a corporation, partnership, or unincorporated association are insured up to \$250,000² provided the entity is engaged in an independent activity, meaning the entity is operated primarily for some purpose other than to increase deposit insurance coverage.

If an entity is not engaged in an independent activity, then the FDIC will consider the entity's deposits to be owned by the person(s) who established the account. Further, accounts owned by the same entity, but designated for different purposes are not separately insured. In that case, the accounts are added together and insured up to \$250,000.

Deposits held in the name of a corporation, partnership, or unincorporated association are insured separately from the personal deposits of the owner(s) or officials of the entity.

Corporations

Separately incorporated subsidiaries engaged in an independent activity are separately insured from each other and from the parent company. If a corporation has divisions that are not separately incorporated, funds deposited by those divisions are not separately insured. Additionally, deposit accounts designated for different purposes but held by the same corporation also are not separately insured.

Insurance coverage for deposits held by a corporation is a maximum of \$250,000. The number of signatories on the account or the number of officers does not affect insurance coverage. In

² The basic FDIC deposit insurance coverage has been temporarily increased through legislative action from \$100,000 to \$250,000, from October 3, 2008, through December 31, 2009.

addition, if a corporation has multiple accounts at the same bank in the names of different divisions or offices of the corporation, the accounts would be aggregated and insured as the funds of the corporation, up to a total of \$250,000.

Homeowners Associations

The following is an example provided by the FDIC on homeowners association accounts:

A homeowners association, which has 150 members, maintains two different deposit accounts at the same bank: a checking account for its operating expenses and a reserve account for improvements to the common areas. Both of these accounts are added together and insured as the deposits of the homeowners association, up to \$250,000³. It does not matter for deposit insurance purposes that the accounts are designated for different purposes or the association has 150 members.

Account title	Deposit type	Account balance
HOA—operating expenses	Checking account	\$200,000
HOA—reserves	Savings account	\$200,000
Total deposits		\$400,000
Amount insured		\$250,000
Amount uninsured		\$150,000

Accounts Held by a Fiduciary

Deposit accounts held by an agent or other fiduciary for a corporation, partnership, or unincorporated association are insured as the funds of that entity if the requirements for fiduciary accounts are met. The deposits will be added to any other funds the entity may hold at the same bank and insured to \$250,000.

Definition of fiduciary

Fiduciary accounts are deposit accounts established by a person or entity for the benefit of one or more other parties. Fiduciary relationships include, but are not limited to, arrangements involving: a trustee, an agent, a nominee, a custodian, or a guardian. Fiduciary accounts include real estate and other escrow accounts.

FDIC insurance of fiduciary accounts

Funds deposited by a fiduciary on behalf of one or more principals are insured as the funds of the principal (the actual owner) to the same extent as if the funds were deposited directly by the principal, provided *all* of the following requirements are met:

- The fiduciary nature of the account must be disclosed in the account title.
- The identities and the interests of the principals for whom the fiduciary is acting must be ascertainable from either the deposit account records of the bank, or records maintained

³ The basic FDIC deposit insurance coverage has been temporarily increased through legislative action from \$100,000 to \$250,000, from October 3, 2008, through December 31, 2009.

in good faith and in the regular course of business by the depositor or by some person or entity that had undertaken to maintain such records for the depositor.

If the client has deposits in a bank in the same ownership capacity that funds are being placed by the agent, all deposits would be added together and the total only insured up to the insurance limit of \$250,000⁴ for that ownership category. Thus, it is important to ask the client if he or she has any individual or joint accounts at a bank that your company is, or is planning to, deposit funds at on behalf of that client.

For example, Expert Management Company serves as an agent holding funds in trust for its client Jacob Winston, a property owner. Jacob Winston has \$150,000 of funds held by Expert Management Company at USA Bank and Jacob Winston also has a CD for \$150,000 in his name alone at the same bank. Both amounts would be added together and Jacob Winston would only be insured for \$250,000 with \$50,000 uninsured. This example is in chart form below.

In the following example all accounts held at USA Bank

Funds deposited in the name of:	Funds belong to:	Deposit type	Account balance
Expert Management Company	Jacob Winston	Savings	\$150,000
Jacob Winston	Jacob Winston	CD	\$150,000
Total deposits			\$300,000
Amount insured			\$250,000
Amount uninsured			\$50,000

If security deposits are held an account where it is clear that the owner/manager is acting in a representative capacity, pass-through insurance should be available. It is also important to note that security deposits of tenants that are deposited into an account set up in the name of an owner or manager are not insured per tenant. In other words, if an account balance exceeds \$250,000, the owner or manager's account is FDIC insured for \$250,000. The FDIC would not cover \$250,000 per tenant whose funds were in that account.

FDIC Insurance of Personal Joint Accounts

A joint account is a deposit owned by two or more people. If all of the following requirements are met, each co-owner's share of every account that is jointly held at the same insured bank is added together with the co-owner's other shares, and the total is insured up to \$250,000. To qualify for insurance for joint accounts, all of the following requirements must be met:

1. All co-owners must be people. Legal entities such as corporations, trusts, estates, or partnerships are not eligible for joint account coverage.

⁴ The basic FDIC deposit insurance coverage has been temporarily increased through legislative action from \$100,000 to \$250,000, from October 3, 2008, through December 31, 2009.



2. All co-owners must have equal rights to withdraw deposits from the account. For example, if one co-owner can withdraw deposits on his signature alone, but the other co-owner can withdraw deposits only with the signature of both co-owners, the co-owners do not have equal withdrawal rights.
3. All co-owners must sign the deposit account signature card unless the account is a CD or is established by an agent, nominee, guardian, custodian, executor or conservator.

The FDIC assumes that all co-owners' shares are equal unless the deposit account records state otherwise. For example, a husband and wife could have up to \$500,000 in one or more joint accounts at the same insured bank and the deposits would be fully insured. The husband's ownership share is insured up to \$250,000 and the wife's ownership share is insured up to \$250,000.

Insurance coverage of joint accounts is not increased by rearranging the owners' names or by changing the styling of their names. Alternating the use of "or," "and" or "and/or" to separate the names of co-owners in a joint account title also does not affect the amount of insurance coverage provided. In addition, using different Social Security numbers on multiple accounts held by the same co-owners will not increase insurance coverage.

FDIC Joint Account Example

Account title	Deposit type	Account balance
Liz and Mike Smith	Checking	\$75,000
Liz or Mike Smith	Savings	\$250,000
Liz or Mike or Al Smith	CD	\$300,000
Total deposits		\$625,000

Insurance coverage for each owner is calculated as follows:

Depositors	Ownership Share	Amount Insured	Amount Uninsured
Liz	\$ 262,500	\$ 250,000	\$12,500
Mike	\$ 262,500	\$ 250,000	\$12,500
Al	\$ 100,000	\$ 100,000	\$0
Total	\$ 625,000	\$ 600,000	\$ 25,000

Explanation why it is not insured for the entire \$625,000:

- Liz's ownership share in all joint accounts equals 50% of the checking account (\$37,500), 50% of the savings account (\$125,000), and 33.33% of the CD (\$100,000), for a total of \$262,500. Since her coverage in the joint ownership category is limited to \$250,000, \$12,500 is uninsured.
- Mike's ownership share in all joint accounts is the same as Mary's, so \$12,500 is uninsured.

- Al's ownership share in all joint accounts is 33.33% of the CD, or \$100,000, so his share is fully insured.

Reviewing a financial institution's rating

The FDIC publishes financial information reported by lenders at www.fdic.gov under "Bank Find." Similar data on credit unions is available through the NCUA website at www.ncua.gov. The information provided by the FDIC may not be easy to understand by individuals without a background in banking. A bank analyst can explain what the numbers mean. Some research companies post their ratings of banks and credit unions online at no charge. For instance, Bankrate and BauerFinancial have rating systems.

Bankrate offers a Safe & Sound® service that is a proprietary system designed to provide information on the relative financial strength and stability of U.S. commercial banks, savings institutions, and credit unions. It rates banks using a five star rating system (see chart below).

Safe & Sound CAEL rating system		
Safe & Sound CAEL rating	Definition	Star rating
1	Superior	★★★★★
2	Sound	★★★★
3	Performing	★★★
4	Below peer group	★★
5	Lowest rated	*
No Report	Complete data not available	Not Rated "NR"
Closed	Institution is closed	Closed
G	Designates high growth	--

Bankrate provides its Safe & Sound CAEL ratings information for businesses and consumers to use as only one factor in connection with their banking decisions. Businesses and consumers are advised to independently evaluate all financial institutions, consider other information, including the strength of the financial institution's management, and to individually contact financial institutions to seek answers to their questions. Bankrate's rating information should not exclusively be relied upon in making banking decisions.

In addition to issuing its rating system, Bankrate also prepares a written report for each rated financial institution that has at least four quarters of historical financial data on file with the applicable federal regulatory agencies.

The Bankrate website address is www.bankrate.com. To look up a bank in Bankrate's Safe & Sound system, visit http://www.bankrate.com/brm/safesound/ss_home.asp.

BauerFinancial offers a similar service. It also uses a five-star rating system. Two stars or less indicate the bank is facing some challenges. For more information, visit www.bauerfinancial.com.

If your bank receives a low rating from a rating service, do not panic. Contact your bank and inquire into why it has that rating. A bank may have a good explanation. For instance, new banks without a track record of earnings tend to receive low ratings. Another explanation may be that a bank has had some losses, but it still has plenty of capital.

On a related note, you may want to discuss with your bank how your account's deposit insurance can be enhanced.

Resources

FDIC Information

FDIC

<http://www.fdic.gov/>

Failed bank list

<http://www.fdic.gov/bank/individual/failed/banklist.html>

Your Insured Deposits by FDIC

Link to page: <http://www.fdic.gov/deposit/deposits/insured/index.html>

Direct link to PDF document: <http://www.fdic.gov/deposit/deposits/insured/yid.pdf>

When A Bank Fails by FDIC

<http://www.fdic.gov/consumers/banking/facts/index.html>

FDIC's Bank Find

http://www4.fdic.gov/IDASP/main_bankfind.asp

Resources for reviewing a financial institution's rating

Bankrate

www.bankrate.com

Bankrate's Safe & Sound system

http://www.bankrate.com/brm/safesound/ss_home.asp

BauerFinancial

www.bauerfinancial.com

FDIC Bank data and statistics

<http://www.fdic.gov/bank/statistical/index.html>