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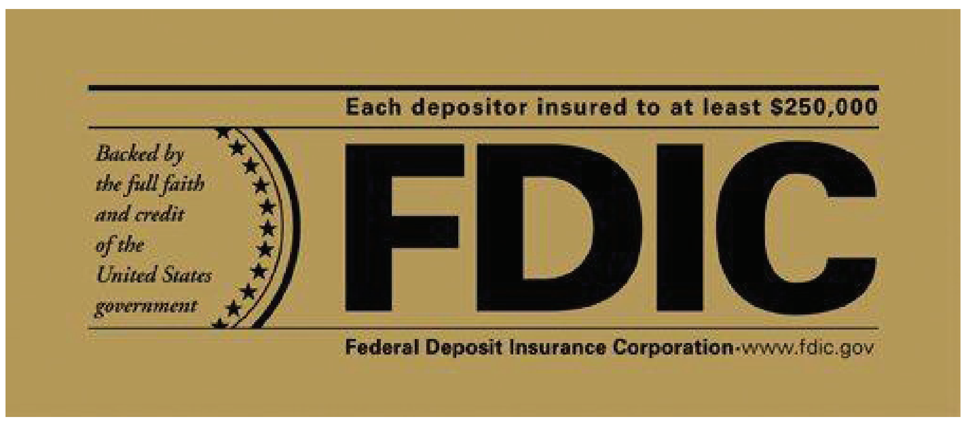
FDIC Insurance: Are Your Accounts Fully Covered?



When a client walks into a bank he or she is bombarded with signs indicating that the funds deposited in the bank are insured by the FDIC. Even if the client does not fully comprehend what that means, the signs offer the client peace of mind to know that his or her funds are safe while on deposit at the bank. However, the signs also give notice to the client that there is a limitation on the FDIC insurance to a specified dollar amount.

When a client comes into an attorney's office there are no such signs. A client who entrusts funds to an attorney to be placed in escrow, commonly known as an IOLTA account, believes those funds to be safe based merely on the fact that they are placed with the attorney. Like the client's personal account at the bank, the funds placed with the attorney are also insured by the FDIC; however, FDIC insurance coverage may be limited by considerations that are not apparent to the attorney or the client.

By Kristina L. M. Wildman

Until recently, the funds placed in IOLTA accounts received unlimited FDIC insurance. The law that allowed the unlimited protection was passed as part of the Dodd-Frank Wall Street Reform Act in 2010. Like many other laws passed in response to the financial crisis of 2008, the unlimited FDIC insurance for IOLTA accounts was valid for only two years and expired on December 31, 2012. Since there was no move by Congress to extend the unlimited coverage, the FDIC insurance coverage for IOLTA accounts is now calculated based on the amount that a client has on deposit with the financial institution as a whole, whether those funds are held in a client's personal account or on the client's behalf in the attorney's IOLTA account. This is known as pass-through coverage and it is provided to IOLTA accounts on a per-client basis.

FDIC insurance is essentially a safety net that is triggered when a bank fails. Upon the failure of an insured bank, the FDIC will repay the depositors the amount they had on deposit in the failed bank on the date of the closure up to the insured amount. The FDIC insurance applies to all types of deposit accounts, including checking accounts, savings accounts and certificates of deposit. Currently, the FDIC insures deposit accounts to $250,000 per individual depositor (not per account) at each separately chartered insured bank; however, the law allows for a single person to insure much more by holding accounts with different ownership types and at different banks.

Individual Accounts

The FDIC calculates the insurance limits based on the ownership categories of a depositor's accounts at each separately chartered insured bank. Therefore, depositors can obtain more than $250,000 of FDIC insurance by titling the accounts in different ownership categories and by using different financial institutions for their deposits. Under the FDIC rules, an individual depositor can have accounts at the same bank titled individually, jointly with one or more other individuals, and as certain types of retirement accounts. Each of these categories is considered separately for purposes of calculating the FDIC insurance amount limit.

Each of the ownership categories is afforded its own $250,000 FDIC insurance limit based on the owners of the account. The individual account, in the name of the depositor only, is insured up to $250,000. A joint account between the depositor and his spouse is insured up to $500,000 ($250,000 for each owner). Retirement accounts are calculated separately from a depositor's individual accounts and are also insured for up to $250,000.

For example, if a depositor at Bank A deposits $250,000 in an account held in his own name, $500,000 held in a joint account with his spouse, and $250,000 held in an IRA account, the depositor will not have exceeded the limits of the FDIC insurance offered for these accounts at Bank A. A depositor could then make deposits into accounts at Bank B and the calculation of FDIC insurance limits would start over as to the Bank B accounts.

Revocable Trust Accounts

Unlike individual accounts, the FDIC insurance limits for revocable trust accounts are calculated based on the number of beneficiaries of the trust and not on the current owner of the account. Under the FDIC rules, revocable trust accounts include both formal revocable trusts created by a written agreement and what the FDIC considers an informal revocable trust, such as an account that names a payable on death (POD) beneficiary.

For FDIC insurance purposes there are two categories of revocable trust accounts: those with five or fewer unique beneficiaries and those with more than five unique beneficiaries. For the revocable trusts with fewer than five beneficiaries the account receives FDIC insurance in the amount of $250,000 per beneficiary. If the revocable trust has more than five beneficiaries the FDIC insurance coverage is dependent upon each beneficiary's beneficial interest in the trust. Further, if the trust has two owners, such as a joint trust, these amounts are doubled.

For example, if a depositor establishes a revocable trust for the benefit of her three children, the account would be insured for up to $750,000, based on $250,000 of FDIC insurance for each beneficiary. If a husband and wife establish a joint revocable trust for the benefit of their three children, the account would be insured for up to $1,500,000. To calculate the FDIC insurance on the joint trust the husband can calculate $750,000 of coverage, $250,000 for each child, and so can the wife.

If there are six beneficiaries of the revocable trust and they each have an equal interest in the trust, the FDIC insurance will remain at $250,000 per beneficiary. If the six beneficiaries have unequal beneficial interests in the revocable trust, then the FDIC insurance is either the sum of each beneficiary's actual interest up to $250,000 per beneficiary or $1,250,000 for the entire trust, whichever is greater.

For example, if a depositor establishes a revocable trust for her six nieces and nephews in equal shares, the account will be insured for up to $1,500,000. If the depositor instead establishes a revocable trust that leaves $1,000,000 to her three children equally and $600,000 to her three nieces equally, the FDIC insurance is calculated based on the beneficiaries' actual interest. Here, each of the children would be entitled to $250,000 of FDIC insurance coverage and the nieces would each be entitled to $200,000 of FDIC insurance coverage based on their respective interests in the trust. Therefore, $250,000 of the children's interest would remain uninsured by the FDIC and the total coverage of the account would be $1,350,000.

Irrevocable Trust Accounts

Irrevocable trusts are either created by the death of a revocable trust owner, or they are irrevocable at their inception. Under the FDIC insurance rules, an irrevocable trust that was previously revocable will continue to calculate FDIC insurance coverage pursuant to the revocable trust rules outlined above. The FDIC insurance coverage for an irrevocable trust that was irrevocable from inception will vary greatly depending on the interests of the beneficiaries and the power of the trustee(s) to invade the trust. Similar to the revocable trust rules, each beneficiary may be insured for up to $250,000, so long as their interest in the trust is not contingent. If the trustee has the power to invade the trust to distribute funds to any or all beneficiaries, then the FDIC insurance will likely be limited to $250,000 total, because the beneficial interest of the beneficiaries cannot be determined until the distributions are made.

For example, if depositor creates an irrevocable trust for the benefit of his three children, the FDIC insurance coverage will depend on the distribution language of the trust agreement. If the trust agreement provides that each child is to receive a one-third equal share of the trust assets, then the trust account will be insured for up to $750,000, or $250,000 per beneficiary. However, if the trust provides equal income payments to the three beneficiaries and then allows the trustee to invade the principal for the benefit of one or all of the beneficiaries, the beneficial interests of each child are contingent and the trust account will receive only $250,000 of FDIC insurance coverage.

IOLTA Accounts

With the recent change to pass-through coverage for IOLTA accounts, any client that deposits funds with an attorney for escrow purposes must include those funds when calculating the FDIC insurance coverage if the IOLTA account is held at the same bank the client uses.

For example, if a client has a checking account at Bank A with a balance of $500,000, the account is insured for only $250,000. If the client writes a check for $200,000 to the attorney to hold in the IOLTA account at Bank A, the client is still insured for only $250,000 on the balance of his checking account and the funds held for his benefit in the IOLTA account. If the client has a checking account at Bank B with a balance of $500,000 and writes a check for $200,000 to the attorney, the client's checking account is insured for up to $250,000 and the balance in the IOLTA account at Bank A is insured for up to $250,000 because the balances are held at separate financial institutions.

Summary

In the ten years preceding the 2008 financial collapse, only 43 banks failed. Over 470 banks have failed since January 2008. These developments have made the possibility of utilizing the FDIC insurance a very real possibility. The calculation of a client's insured balances can be completed by the client's bank and will provide the client with peace of mind. While IOLTA accounts potentially offer clients the same FDIC insurance coverage as their personal accounts, the amount that a client has on deposit in a bank and the identity of the bank(s) holding such deposits can limit the FDIC insurance coverage on both the client's personal accounts and his deposit in the IOLTA accounts. Therefore, it is important for clients to be aware of the FDIC insurance limits and the balances they have on deposit that are subject to those limits, both in personal accounts and in IOLTA accounts.