

Are Your Business Bank Accounts Really FDIC Insured?

Recent developments in American capital markets, and legislation responding to them, have increased the importance of confirming and maximizing FDIC insurance over business deposits in American banks. While certain bank failures have fully protected insured depository accounts, even above the \$100,000 limit then in effect, that result is hardly universal (notably, the IndyBank failure did not fully protect accounts exceeding the \$100,000 limit then in effect) and cannot remotely be guaranteed with respect to the prospects of additional bank failures that will likely occur until the credit markets stabilize and the present economic cycle changes. The recent regulatory decisions to impose the FDIC limits on the IndyMac failure (and not to prevent the Lehman Brothers bankruptcy) establish that size alone does not determine whether the "too big to fail" rule will fully protect a bank's customers. Further, in the current market environment, the limits of FDIC insurance can no longer be ignored or taken casually.

Recently, the FDIC limit on insured deposits was increased from \$100,000 to \$250,000 by the Emergency Economic Stabilization Act of 2008 as announced in FDIC Financial Institution Letter, FIL-102-2008. This important change took effect as law on October 3, 2008.

By the terms of the legislation, the increased limit will no longer apply, and the \$100,000 limit will be reinstated, in about 15 months, on December 31, 2009, unless extended or modified by Congress.

Some individual investors have focused on the FDIC limit on insured deposits, and have structured their bank deposits to maximize it (e.g., by maintaining deposits at several separate insured banks). However, many business owners maintain all of their banking accounts at a single financial institution, for reasons including business relationships and even the express requirements of loan documents. This report, therefore, focuses on business deposits concentrated at a single, FDIC insured institution (which includes savings and loans or other "thrifts") and how the new \$250,000 limit applies to them.

The FDIC provides a maximum of \$250,000 of insurance coverage for the total amount of all bank accounts of an "entity" at one bank. "Entities" includes corporations, limited liability companies, partnerships, not-for-profit organizations and unincorporated associations (which include religious, community and civic organizations and social clubs that are not incorporated). However, to qualify for the maximum coverage,

each entity must be engaged in an independent activity, meaning that the entity is operated primarily for some purpose other than to increase insurance coverage. This maximum amount of \$250,000 in insurance coverage includes the total of all amounts on deposit by the entity in its checking accounts, savings accounts, money market accounts and certificates of deposit that the entity has at a single bank. Separate accounts owned by the same entity, even if designated for different purposes, are not separately insured. Instead, such accounts are added together and insured up to \$250,000. So for example, if a corporation has an operating account, a payroll account and an accounts payable account, all are included in computing the maximum amount of insured deposits. Trust accounts, escrow accounts and retirement benefit accounts are treated separately for computing the \$250,000 maximum coverage, but must be examined individually to determine the extent of deposit insurance that applies to such accounts. If a corporation has divisions or units that are not separately incorporated, the deposit accounts of those divisions or units will be added to any other deposit accounts of the corporation for purposes of determining the limit of deposit insurance coverage.

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Funds deposited by a corporation, partnership, or unincorporated association are insured separately from the personal accounts of the stockholders, partners or members. This means that a business owner can have \$250,000 in personal accounts, and an additional \$250,000 of accounts of the separate independent entities that he owns (see below), and enjoy full FDIC coverage for both types of accounts. The number of partners, members or account signatories that a corporation, partnership, or unincorporated association has does not affect coverage. For example, deposits owned by a homeowners association are insured up to \$250,000 in total, not \$250,000 for each member of the association. However, deposits owned by a business organized as a sole proprietorship are not insured as an entity. Rather, they are insured as the single account deposits of the person who is the sole proprietor. So, funds deposited in the sole proprietorship's name are added to any other accounts of the sole proprietor and the total is insured to a maximum of \$250,000.

An important factor determining whether separate entities will receive their full \$250,000 in coverage is whether each such entity is engaged in "independent activities". If the regulators impose the FDIC insurance limit on a particular bank failure, the FDIC will review the failed institution's deposits to apply the \$250,000 limit. An entity shall be deemed to be engaged in an independent activity for purposes of this limitation "if the entity is operated primarily for some purpose other than to increase deposit insurance." 12 C.F.R. § 330.9(d). The fact that each entity is separately

chartered and/or has its own tax ID number is not dispositive as to whether each entity is engaged in independent activity, and therefore entitled to its own separate \$250,000 in FDIC insurance coverage. FDIC-Advisory Opinion-95-14 August 23, 1995. The fact that entities are solely owned by the same individual does not preclude each from entitlement to its own separate \$250,000 insurance coverage, as long as each entity is separately chartered and is engaged in a separate independent activity. Nor does the fact that the entities are not now engaged in the original activities for which they were established preclude an entity from continuing to have an entitlement to its own separate \$250,000 insurance coverage, so long as it has not altered its business purpose to be operated primarily for the purpose by engaging in other disqualifying activities.

There are other related deposit insurance issues which we will briefly mention. The most common one is the use of "payable on death", revocable trust accounts and similar accounts with multiple beneficiaries to increase deposit insurance coverage. These methods are available, but these methods must be employed with caution and unfortunately some bank employees are not as accurate in their understanding of the FDIC limitations as they should be. The second issue is the use of "consolidators" who offer services to act as a fiduciary or agent to "scatter" a person's deposits into a number of separate banks so that no one deposit is in excess of the insured limits. The deposits are often kept in the name of the company for the benefit of the fund's true owners. Some of these services are very

reliable, but depositors must exercise caution in using such a service, and verify that the services are correctly set up, properly establish and account for such deposits and comply with the recordkeeping requirements of 12 C.F.R. § 330.4 in order for the deposits not to be consolidated by the FDIC in the event of a bank failure.

Business owners should review their account structure and holdings, to determine whether, and the extent, of their exposure to financial losses from uninsured deposits, and act appropriately to mitigate any such exposure. Attorneys in our firm are available to assist you with questions about your deposits and the utilization of various methods to insure you have the maximum deposit insurance protection, or if you are unfortunate enough to have deposits in a failed deposit institution, we can assist you with any problems you have in obtaining the full amounts of your deposits.

For additional information, you may utilize the information and programs available on the FDIC's web site which can be accessed at <http://www.fdic.gov>. A program called "Edie the Estimator" is available for simple computations, but you must be careful that you fully understand all of the terms used for the various categories or types of deposits to avoid an erroneous conclusion. ■

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