LEGAL ALERT

BANKING AND FINANCIAL INSTITUTIONS

KUTAKROCK

April 12, 2023

Services

Banking

Some Common Questions on FDIC Insurance and Maximizing Protection of Deposits Before (and After) Failure of an FDIC-Insured Bank

After the collapse of Silicon Valley Bank and Signature Bank, as well as the volatility surrounding other regional and global banking institutions, now is a good time for a refresh on the topic of FDIC insurance coverage and ways to maximize protection of your deposits in the unexpected event of bank failure. Answers to some of the key questions clients have recently asked us can be found below:

How does a depositor maximize FDIC insurance coverage?

As a review, a depositor is insured up to the FDIC insurance limit (currently, $250,000) for each deposit account held by such depositor at different eligible banks. Each of these accounts is considered a separate and distinct account for FDIC insurance purposes. For example, a depositor can have $250,000 on deposit at Bank A and $100,000 at Bank B. Because each of those accounts is separately insured, the depositor has $350,000 in total insured deposits. By contrast, deposits at different branches of the same insured institution are treated as one account and subject to the $250,000 limit.[1] To maximize FDIC insurance coverage, a depositor could utilize one or more of the following options:

a. Deposit funds in accounts at different banks, with no more than $250,000 deposited at each bank.
b. Open a deposit account with a bank that offers a deposit swapping network, such as the IntraFi Network Deposits program, through which the depositor's funds are separated into amounts below the FDIC insurance limit ($250,000 or less) and deposited at a myriad of participating insured institutions (or a cash sweep facility might be employed to periodically sweep amounts over the $250,000 limit to a multibank network).
c. Open deposit accounts with different owners:
    1. For eligible joint accounts, the FDIC insurance limit is currently $500,000;
    2. For eligible revocable trust accounts, generally, the FDIC insurance limit is currently $250,000 for each unique beneficiary[2]; and
    3. For certain eligible employee benefit plans, the FDIC insurance limit is currently $250,000 for each participant's interest, which is separate from any accounts the employer or employee may have at the same FDIC insured institution.[3]

---

[1] Generally, the FDIC insures deposits at FDIC-insured banks and savings associations up to the maximum deposit insurance amount, currently $250,000, per depositor, per FDIC-insured bank, for each account ownership category. See FDIC, Your Insured Deposits, at 3 (Jan. 2020), https://www.fdic.gov/resources/deposit-insurance/brochures/documents/your-insured-deposits-english.pdf.

[2] On April 1, 2024, the rules regarding coverage of revocable trusts are changing. See https://www.fdic.gov/resources/deposit-insurance/trust-accounts/.

[3] See FDIC, Your Insured Deposits, at 3 (Jan. 2020), https://www.fdic.gov/resources/deposit-insurance/brochures/documents/your-insured-deposits-english.pdf.

Is "pass-through" coverage available for deposit accounts maintained "for the benefit" of customers or third parties?

A person acting as an intermediary for third parties and holding funds in a fiduciary, custodial, or nominee capacity for others in a deposit account at a bank can use "pass-through" deposit coverage to increase the amount of available deposit insurance covering the account. Pass-through coverage means that the FDIC will look through the nominal depositor and recognize the interest of each beneficial owner of the funds for purposes of determining the amount of deposit insurance available.

Section 330.5 of the FDIC's regulations sets forth the deposit insurance coverage for deposits held by a depositor through a fiduciary relationship.[4] A "fiduciary" includes, but is not limited to, a trustee, agent, nominee, guardian, executor or custodian.[5] Pursuant to the regulations, if the bank's deposit account records indicate that the funds are held in a fiduciary capacity, and the fiduciary's records maintained in the ordinary course of business reflect the ownership interest of the beneficial owner of the account, the FDIC will insure the deposits of the beneficial owner to the same extent, and subject to the same limitations, as deposits held by the beneficial owner directly with the bank in the same insurable capacity.[6]

Can I get collateral to back the uninsured portion of my deposit?

Depending on applicable state or federal law, "public unit"[7] deposits may be secured by collateral or assets of the bank. In the event of the failure of the bank, the FDIC will honor the collateralization agreement if the agreement is valid and enforceable under applicable law. The FDIC does not guarantee, however, that the collateral will be sufficient to cover the amount of the uninsured funds. As such, although it does not increase the FDIC insurance coverage of the public unit deposits, collateralization provides an avenue of recovery in the event of the failure of a bank. All collateralization agreements between banks and public entities must adhere to state and federal laws, including FDIC regulations and:

a. The pledge agreement should be in writing
b. The pledged collateral should comply with the public unit's investment policy or state statute, whichever is more restrictive
c. The pledge collateral should be held at an independent third-party institution
d. Any substitutions of collateral should meet the requirements of the collateral agreement
e. Reporting should come directly from the custodian, preferably monthly

What about sweep accounts?

Many commercial banking customers participate in sweep programs that enable the customer to have excess cash in its main deposit accounts (e.g., checking accounts) "swept" to other accounts and used

---

[4] 12 CFR 330.5.

[5] 12 CFR 330.5(b)(1).

[6] 12 CFR 330.5(b)(1) and (b)(2). So, in certain cases, a deposit account that is established by a third party for the benefit of several owners may benefit from "pass-through" coverage such that each owner's funds are insured up to the $250,000 coverage limit.

[7] Typically, this collateralized deposit option is only available to "public units" and "state monies". For deposit insurance purposes, the term "public unit" includes a state, county, municipality or "political subdivision" thereof, which would include school districts and village districts. The term "political subdivision" includes drainage, irrigation, navigation, improvement, levee, sanitary, school or power districts, and bridge or port authorities and other special districts created by state statute or compacts between the states. It also includes any subdivision of a public unit or any principal department of such public unit: (1) The creation of which subdivision or department has been expressly authorized by the law of such public unit; (2) To which some functions of government have been delegated by such law; and (3) Which is empowered to exercise exclusive control over funds for its exclusive use. 12 CFR 330.15.

Banking and Financial Institutions Practice Group Contacts

Bryan G. Handlos
402.231.8784
bryan.handlos@kutakrock.com

Jeffrey S. Makovicka
402.231.8751
jeffrey.makovicka@kutakrock.com

to purchase shares in money market mutual funds (MMMFs) and other similar investment securities. The nature of sweep programs vary. Regardless of the specifics of the sweep program, swept funds can generally be divided into two buckets.

First, swept funds are used by the bank to purchase, on behalf of the customer, external assets such as shares in a MMMF. Holdings of assets, such as MMMFs purchased through external investment fund management, should not constitute deposits and therefore are not expected to be subject to the resolution of funds on deposit in the failed bank. Rather, for funds that are not deposits, the bank must disclose to the customer pursuant to 12 CFR 360.8(e), in the applicable program agreement, the status such assets would have if the bank failed. In general, such assets should belong to the bank's customer, even if the bank made the share purchases as agent of the customer and held such shares in the bank's name and on behalf of its customers.

Second, some swept funds are held by the bank in accounts (such as omnibus accounts) that may earn interest or other returns paid by the bank. These funds are generally not holdings of shares in an external asset such as an MMMF that belong to the customer. This "cash" remains in a deposit account and should likely constitute a deposit subject to the resolution of deposits in the failed bank.

In the event of a bank failure, determining whether "swept" funds remain with the failed bank or in investment vehicles outside of the failed bank, involves analyzing the failed bank's normal cut-off time for the sweep option and also the cut-off point established by the FDIC, as appointed receiver, among other factors. Customers that participate in a sweep program should be able to see information through their online banking portal, if it is available, regarding their holdings of assets such as MMMFs purchased through external investment fund management as well as their cash funds that remain deposits with the bank.

If I have a loan at the failed bank, can I offset that loan with any insured or uninsured deposits at the failed bank?

A depositor may be able to use uninsured deposits at a failed bank to offset amounts outstanding under its loan. Per FDIC guidance on bank failures, the FDIC has said:

In the case of a delinquent loan, the FDIC will "set off" the loan against the borrower's deposits (if any) before paying deposit insurance. In the case of a non-delinquent loan, the depositor might elect to "set off" the loan against his/her deposits in order to receive full value for any uninsured funds (i.e., funds in excess of the $250,000 insurance limit). In either case, no "offset" is possible unless the obligations are "mutual" – meaning that the borrower and the depositor must be the same person or legal entity acting in the same legal capacity.[8]

For questions on FDIC insurance, please contact Bryan Handlos or Jeff Makovicka, listed on the left. You may also visit us at **www.KutakRock.com.**

---

[8] FDIC: When a Bank Fails - Facts for Depositors, Creditors, and Borrowers at https://www.fdic.gov/consumers/banking/facts/borrowers.html#:~:text=In%20the%20case%20of%20a,any)%20before%20paying%20deposit%20insurance.