



## FDIC COVERAGE FOR OPERATING & RESERVE ACCOUNTS

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Since the fall of 2007, the Federal Deposit Insurance Corporation (FDIC) has seized banks and thrifts of all sizes with cumulative losses to the FDIC's insurance program for the 38 failed institutions estimated at \$15.6 billion. The seizures or emergency mergers extended from small community banks, such as Sherman County Bank of Nebraska, to several of the largest banks and thrifts in the U.S. including IndyMac, Washington Mutual and Wachovia. With continued contraction in global economic activity, rising unemployment, declining asset values and persistent illiquidity in credit markets, bank failures are projected to accelerate. As a result, it is very likely that state and federal banking regulators will continue to seize insolvent banks leaving customers to seek recovery for amounts on deposit under the FDIC's programs if the failed institution's deposits are not immediately acquired by a healthy institution through a FDIC brokered purchase and assumption transaction.

The U.S. government created the FDIC insurance program in response to the bank failures of the Great Depression. However, like all insurance programs, the FDIC has limits as to covered losses. Until the passage of the Emergency Economic Stabilization Act (the "Act") by the US Congress in October 2008, the FDIC only guaranteed bank deposits up to \$100,000. The Act temporarily raises FDIC insurance coverage for interest bearing deposit accounts to \$250,000 and provides unlimited protection for personal and business checking deposit accounts that do not bear interest through December 31, 2009 unless the measures are extended or made permanent. Deposits at different branches of the same bank are still only guaranteed up to \$250,000. You can visit the following site to quickly determine the extent of coverage for your personal and business deposit accounts: [www.myfdicinsurance.gov](http://www.myfdicinsurance.gov).

While FDIC insurance limits are now high enough to protect the majority of personal deposit accounts, the operating and reserve accounts of many commercial real estate investors may still be at risk. Interest bearing operating and reserve accounts, while now covered up to \$250,000, can frequently exceed the coverage provided as property rents and other revenues are deposited to make periodic debt service payments or accrue for future CAPEX, leasing, tax or other expenses. For example, if a property's operating account routinely collects over \$250,000 in rent but you do not simultaneously make debt service and other payments when the account balance exceeds \$250,000, this coverage is not insured and may potentially be unavailable for payments to creditors if the deposit institution becomes insolvent. Similarly, if a property's replacement or tax reserve account accumulates over \$250,000 in deposits during the course of the year the excess will not be insured and could create a shortfall in funds available for taxes and planned or emergency CAPEX if the institution fails.

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Estimates as to the number of institutions that will fail as a result of the current credit crisis and recession vary widely with some suggesting many more failures particularly among community and regional banks - 13 banks have already failed since the beginning of 2009. There are several resources available to assess the health of your bank. A simple, user-friendly resource can be found at [www.thestreet.com/screener/index.html](http://www.thestreet.com/screener/index.html) where, after clicking on the “Banks and Thrifts” tab, you simply enter your institution’s name and a rating of financial strength is provided. You can also search for healthy banks by state and rating level prior to opening a new account. For a more substantive report of an institution’s financial condition, quarterly Call Reports are provided at the Federal Financial Institutions Examination Council web site <https://cdr.ffiec.gov/public/>.

To mitigate risks to funds on deposit, there are several ways to maximize coverage under the FDIC’s programs. One method is to use several accounts with different banks as FDIC insurance is limited at \$250,000 in coverage per institution for accounts held under a common name (e.g. the name of the single purpose entity holding title to the property). For example, have all property rents and revenues deposited with Bank A, sweep a daily or weekly amount to Bank B to be held for monthly debt service payments and fund a replacement reserve account at Bank C. While this approach does mitigate the risk of loss upon a bank failure, it requires the property owner or manager to monitor accounts with several banks which can increase the administrative burden especially if significant revenue is realized on a monthly basis and/or substantial reserve funds are on deposit for renovation, construction, taxes or other expenses. Where property related deposits are in amounts that make it impractical to setup and administer multiple accounts sufficient to provide full FDIC coverage an alternative solution is to setup an account with a Certificate of Deposit Account Registry Service (a CDARS account) where insurance for deposits can reach \$50 million. A CDARS account takes large deposits and divides these deposits into separately insured CDs through a network of FDIC insured banks while providing a single point of contact and aggregated monthly statements across all accounts.<sup>1</sup>

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<sup>1</sup> <http://www.cdars.com/how-cdars-works.php>