

Developments in Deposit Insurance & Investment Protection for Municipalities



Establishment of Federal Deposit Insurance Program

- Following the stock market crash on October 29, 1929 and ensuing series of bank runs, Congress enacts **The Banking Act of 1933*** (The Glass-Steagall Act)
 - Separates commercial and investment banking
 - Prohibits banks from paying interest on commercial DDAs (Reg Q)
 - Requires bank holding companies to be examined by the Federal Reserve
 - Establishes the **Federal Deposit Insurance Corporation**
 - Independent federal agency (5-member board) whose revenues derive from interest income on reserve funds

FDIC Functions

Insurer

- Pays claims of depositors in insured institutions in receivership up to the Standard Maximum Deposit Insurance Amount (“SMDIA”)

Regulator

- The FDIC is the primary federal regulator of banks chartered by states but not members of the Federal Reserve System
- The FDIC is the back-up supervisor for the remaining insured banks and thrift institutions
 - Assess and monitors risk (“safety and soundness”)
 - Provides financial assistance or intervention (“Prompt Corrective Action”)
 - Resolves bank failures utilizing “least cost solutions”

The Deposit Insurance Fund

- The FDIC's **Deposit Insurance Fund (“DIF”)** is the reserve fund from which claims paid
 - Backed by the full faith and credit of the U.S.
 - The FDIC can draw on U.S. Treasury’s line of credit
 - Designated Reserve Ratio “Target” = 1.25% of total insured deposits
 - DIF Reserve Ratio for 3Q 2008 = 0.76%
 - Higher assessments imposed to replenish the fund



FDIC's Standard Deposit Insurance Coverage

What Everyone Knows about FDIC insurance Coverage!

- The FDIC provides insurance coverage for your **deposit accounts** with **federally-insured depository institutions** up to the **SMDIA**
 - Deposits at one FDIC-insured bank are insured separately from deposits at any other FDIC-insured bank
- **Deposit accounts** (in a nutshell)
 - Checking, savings and money market deposit accounts and certificates of deposit
- FDIC insurance does **not cover** other financial products and services that banks may offer on the holding-company level, such as stocks, bonds, mutual fund shares, life insurance policies, annuities or municipal securities

What Everyone Knows about FDIC insurance Coverage!

- Deposit insurance covers four common ownership categories:
 - **Individual accounts:** owned by and titled in the name of an individual (insured to SMDIA per owner)
 - **Joint accounts:** owned by and titled in the names of two or more individuals (insured to SMDIA per co-owner)
 - **Retirement Accounts:** IRAs, Section 457 Deferred Compensation Accounts, self-directed defined contribution plan accounts, and self-directed Keoghs (insured to SMDIA per owner)
 - **Revocable trust accounts:** Payable-on-death accounts and living trusts for estate planning (insured to SMDIA per owner per beneficiary subject to specific limitations and requirements)

Rules for “Public Unit” Depositors

Public Unit includes a **municipality** or **political subdivision** thereof

- What is a “**political subdivision**”?
 - *a improvement, sanitary, school or power district*
 - *a bridge or port authority*
 - *other special districts created by statute or interstate compact*
 - *subdivisions of municipality or any principal department thereof which is created under an express authorization delegating some functions of government and empowering the subdivision or principal department to exercise exclusive use and control of funds*
- Does not include subordinated or non-autonomous divisions, agencies, or boards within subdivisions or principal departments

Rules for “Public Unit” Depositors

- o A Public Unit is insured through its Official Custodian who must have:
 - plenary authority, including control, over funds owned by the public unit (i.e., possession, authority to open accounts and authority to perform transactions) by virtue of appointment or election
- o If the same person is an Official Custodian of the funds of more than one Public Unit, he or she is separately insured with respect to the funds held for each such Public Unit
 - But **not** by virtue of holding different offices in such Public Unit or holding such funds for different purposes

Rules for “Public Unit” Depositors

- Deposit insurance coverage **cannot be increased** by dividing funds among several putative official custodians who lack plenary authority over such funds
- Likewise, coverage **cannot be increased** by dividing funds among several accounts controlled by the same official custodian for the same public unit

Rules for “Public Unit” Depositors

Insurance coverage for public unit accounts depends primarily on two factors:

① Type of deposit

- **Time and savings deposits** (including NOW accounts, money market deposit accounts and other interest-bearing checking accounts)
- **Demand deposits**

② Location of the insured depository institution

- **In-State vs. Out-of-State** insured depository institution

Rules for “Public Unit” Depositors

If a Public Unit and Insured Depository Institution are located in the **same State**, then -

- All time and savings deposits (including NOW accounts, money market deposit accounts and other interest-bearing checking accounts) are **added together and insured separately up to SMDIA**
- All demand deposits are **added together and insured separately up to SMDIA**

An insured depository institution with a branch located in the Public Unit’s state is considered to be located in the Public Unit’s state.

Rules for “Public Unit” Depositors

If a Public Unit and Insured Depository Institution are located in **different States**, then –

- All time and savings deposits (including NOW accounts, money market deposit accounts and other interest-bearing checking accounts) and all demand deposits are **added together and insured collectively up to SMDIA**

Rules for “Public Unit” Depositors

- **Public Bond Issues** – a municipality has custody of funds which by law or indenture must be set aside to discharge debt to note holders or bondholders
 - If the municipality deposits the funds with an insured financial institution, then funds deemed a deposit of trust funds by trustee
 - The note holders or bondholders are considered “beneficiaries” of the trust and **each beneficiary’s interest is insured pro rata to the SMDIA**

Rules for “Public Unit” Depositors

- **Recordkeeping requirements** for Public Bond Issues
 - The deposit account records of the insured depository institution must disclose the existence of the fiduciary relationship or the fiduciary nature of the deposit
 - The details of the fiduciary relationship and the interests of the bondholders must be ascertainable from the records of the depository institution or the records of the depositor maintained in good faith and in the regular course of business

Fiduciary or Custodial Accounts

A **fiduciary** or **custodian** is a person or corporate entity serving as an agent in establishing and maintaining a deposit account

- The FDIC will provide **pass-through deposit insurance coverage to the actual owner(s)** of a fiduciary or custodial deposit account
- The fiduciary or custodian must properly establish the deposit account and maintain proper documentation
- The FDIC will pay deposit insurance coverage to the fiduciary or custodian
 - the fiduciary or custodian will be responsible for distributing the deposit insurance payments

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

SMDIA Increased to \$250,000

- On October 3, 2008, President Bush signed the **Emergency Economic Stabilization Act of 2008***
 - Temporarily raises SMDIA from \$100,000 to \$250,000 effective as of October 3, 2008
 - Unless extended, the SMDIA will return to \$100,000 on January 1, 2010

* P.L. 110-343.

FDIC Standard Deposit Insurance for “Official Custodian” of a “Public Unit” as of October 3, 2008

Combined DDA Accounts in Same-State Insured Bank	Coverage up to \$250,000
Combined Savings Accounts in Same-State Insured Bank	Coverage up to \$250,000
Combined DDA <u>and</u> Savings Accounts in Different-State Insured Bank	Coverage up to \$250,000
Debt Service Accounts	Up to \$250,000 for each bondholder on prorated basis

More Information about FDIC Standard Deposit Insurance for Public Units

<http://www.fdic.gov/deposit/deposits/factsheet.html>



Temporary Deposit Insurance Coverage Program

Treasury Department's Initiatives to Avoid or Mitigate "Systemic Risk"

- **Secretary of the Treasury** on 10/13/08 announces a determination of "systemic risk" following the recommendation of the Federal Reserve's Board of Governors
 - Next day, FDIC unveils the Temporary Liquidity Guarantee Program consisting of two programs:
 - *Temporary Debt Guarantee Program*
 - *Temporary Transaction Account Guarantee Program*

New FDIC Transaction Account Guarantee Program (100% coverage)

- ❑ In addition to coverage afforded to transaction accounts for business entities under the standard deposit insurance program, the Temporary Transaction Account Guarantee Program (“TAGP”):
 - Covers a business depositor’s funds in **noninterest-bearing accounts** maintained at a **participating insured depository institution** and
 - provides a **100% guarantee** of those deposits irrespective of the SMDIA

Source: FDIC’s Final Rule on the Temporary Liquidity Guarantee Program, 12 CFR Part 370 (effective November 21, 2008) and TLGP Frequently Asked Questions (available on-line at <http://www.fdic.gov/regulations/resources/TLGP/faq.html>).

New FDIC Transaction Account Guarantee Program – Q&A

- ❶ What is a “non-interest-bearing transaction account”?
 - ✓ A **transaction account** (defined under 12 CFR 204.2)
 - Intended to cover payment-processing accounts for business transactions (e.g., payroll and disbursement accounts)
 - ✓ maintained at an **insured depository institution**
 - ✓ on which **interest is neither accrued nor paid**
 - Covers DDAs, IOLTAs, NOW accounts (with interest rates of 0.5% or less) and bank-issued official checks
 - Doesn't cover NOW accounts (with interest rates above 0.5%) and MMDAs
 - Earnings Credits on DDAs not considered “interest”

Source: FDIC's Final Rule on the Temporary Liquidity Guarantee Program, 12 CFR Part 370 (effective November 21, 2008) and TLGP Frequently Asked Questions (available on-line at <http://www.fdic.gov/regulations/resources/TLGP/faq.html>).

New FDIC Transaction Account Guarantee Program – Q&A

- ② What is a participating insured depository institution?

Every FDIC-insured institution was deemed a participant in the TAGP for an initial period, then could **opt-out** of TAGP by the deadline of December 5, 2008.

Source: FDIC's Final Rule on the Temporary Liquidity Guarantee Program, 12 CFR Part 370 (effective November 21, 2008) and TLGP Frequently Asked Questions (available on-line at <http://www.fdic.gov/regulations/resources/TLGP/faq.html>).

New FDIC Transaction Account Guarantee Program – Q&A

- ③ Does the full deposit insurance coverage for non-interest bearing deposit transaction accounts cover municipal deposits?

Yes.

- ④ When does the temporary program end?

The TAGP expires on December 31, 2009.

Source: FDIC's Final Rule on the Temporary Liquidity Guarantee Program, 12 CFR Part 370 (effective November 21, 2008) and TLGP Frequently Asked Questions (available on-line at <http://www.fdic.gov/regulations/resources/TLGP/faq.html>).

New FDIC Transaction Account Guarantee Program – Q&A

- ⑤ Will funds transferred from a noninterest-bearing transaction account to an interest-bearing investment fund be insured under the Transaction Account Guarantee Program?

Funds transferred from a deposit account to an interest-bearing account or a non-transaction account would not be covered by the Transaction Account Guarantee Program.

Source: FDIC's Final Rule on the Temporary Liquidity Guarantee Program, 12 CFR Part 370 (effective November 21, 2008) and TLGP Frequently Asked Questions (available on-line at <http://www.fdic.gov/regulations/resources/TLGP/faq.html>).

New FDIC Transaction Account Guarantee Program – Q&A

- ⑥ For public fund depositors, do banks acting as “public depositories” need to collateralize only balances over \$250,000 or the entire balance?

If a participating institution is required to pledge collateral for public deposits, this requirement is imposed by state law and not by the FDIC’s regulations. The amount of collateral would depend upon the wording and meaning of state law.

Source: FDIC’s Final Rule on the Temporary Liquidity Guarantee Program, 12 CFR Part 370 (effective November 21, 2008) and TLGP Frequently Asked Questions (available on-line at <http://www.fdic.gov/regulations/resources/TLGP/faq.html>).

More Information about Transaction Account Guarantee Program

<http://www.fdic.gov/regulations/resources/TLGP/index.html>

<http://www.fdic.gov/regulations/resources/TLGP/faq.html>

Deposit Insurance for Credit Unions

- The **National Credit Union Administration** insures share accounts in federally-insured credit unions
 - The National Credit Union Share Insurance Fund “NCUSIF”) is backed by the full faith and credit of the U.S.
- “SMSIA” is \$250,000 as 10/3/08 (same as FDIC)
- On January 28, 2009, NCUA established a **temporary guarantee program** of member shares in **corporate credit unions**
 - Automatic through 2/28/09, but extended on a voluntary basis to all corporate credit unions through 12/31/09
- <http://www.ncua.gov>



Non-Deposit Investments

Money Market Mutual Funds

- “**Money Market Mutual Funds**” provide a liquid investment for individual or institutional investors - designed to achieve somewhat higher yields
 - Unlike bank deposits, **the investments are considered "shares"** and funds seek to preserve Net Asset Value of an investment at \$1.00 per share
- The S.E.C. has developed regulations governing money market funds to minimize any risk of loss for investors (principally Rule 2a-7)
 - Securities in a money market fund, for instance, must be rated by a NRSRO within certain categories
- **However, an investment in money market funds is neither insured nor guaranteed by the FDIC or any other government agency**
 - Although money market funds seek to preserve the Net Asset Value of an investment at \$1.00 per share, it is possible to lose money in these funds
 - Investors should consider carefully information contained in a prospectus, including investment objectives, risks, charges and expenses

Source: <http://www.treas.gov/offices/domestic-finance/key-initiatives/money-market-fund.shtml>.

Money Market Mutual Funds

- GFOA Recommended Practices

<http://www.gfoa.org/downloads/CCIUseofVariousTypesofMutualFunds.pdf>

U.S. Treasury's Temporary Guarantee for Money Market Mutual Funds

- **The U.S. Treasury's Temporary Guarantee for Money Market Mutual Funds**
 - Treasury will guarantee the share price of any publicly-offered eligible money market mutual fund registered with the SEC that applies for and pays a fee to participate in the program (**expires April 30, 2009**)
- The coverage applies only to investments held in participating money market funds **as of the close of business on September 19, 2008**, which will represent the maximum amount of assets eligible for reimbursement under the program.
 - Any increase in the number of shares held in an account after the close of business on September 19, 2008 is not guaranteed.
 - If the number of shares held in the account fluctuates over the period, investors will be covered for either the number of shares held as of the close of business on September 19, 2008, or the current amount, whichever is less.

Source: <http://www.treas.gov/offices/domestic-finance/key-initiatives/money-market-fund.shtml>.

More Information about the Temporary Guarantee of Money Market Mutual Funds

<http://www.treas.gov/offices/domestic-finance/key-initiatives/money-market-fund.shtml>

Investment Securities

Securities Investors Protection Corporation

- Under the Securities Investor Protection Act (1970), SIPC replaces securities **registered** in the name of customers but **missing** from broker-dealer accounts
 - SIPC helps individuals whose money, stocks and other securities are stolen or put “at risk” by a broker
 - **SIPC DOES NOT PROVIDE INVESTMENT INSURANCE**
- SIPC is neither a government agency nor a regulatory authority
 - It is a nonprofit, membership corporation, funded by its member securities broker-dealers

Source: <http://www.sipc.org/who/notfdic.cfm>

SIPC vs. FDIC

“It is important to understand that SIPC is not the securities world equivalent of FDIC – the Federal Deposit Insurance Corporation. Congress specifically considered creating a Federal Broker-Dealer Insurance Corporation, but lawmakers wisely concluded that such a designation would be both misleading and out of step in the risk-based investment marketplace that is so different from the world of banking.”

Source: <http://www.sipc.org/who/notfdic.cfm>

SIPC Requirements

- SIPC protection is available only if the failed brokerage firm is a **member of SIPC**
 - SIPC Membership Department @ (202) 371-8300
- Exclusions
 - Commodity futures contracts, fixed annuity contracts, currency and investment contracts not registered with SEC

Source: <http://www.sipc.org/who/notfdic.cfm>

SIPC's Role in Recovering Securities

- The SIPC **returns** actual stock and other securities to customers in whose names the securities are registered
 - SIPC does not protect investors against **fraud** or **market losses**
- SIPC's reserve funds will be used (about \$1.5B), if necessary, to **purchase replacement securities** in the open market

Source: <http://www.sipc.org/who/notfdic.cfm>

SIPC Coverage Limits

- The SIPC coverage is up to a ceiling of **\$500,000 per customer**
 - Maximum of **\$100,000** for **cash claims**
- Additional funds may be available to satisfy the remainder of customer claims

Source: <http://www.sipc.org/who/notfdic.cfm>

More Information about SIPC

<http://www.sipc.org>

http://www.sipc.org/pdf/SIPC_English_2008.pdf

Take-aways?

- Review State law and local Charter
- Review accounts and recordkeeping
- Review Recommended Practices of GFOA at http://www.gfoa.org/index.php?option=com_content&task=view&id=118
- Stay informed about new or revised legislation, programs and rules and regulations (not just the chatter)

Important Notice

The content of this presentation is provided in a non-technical manner for educational purposes only. It is not designed or intended to provide a legal interpretation of the FDIC's laws and regulations on insurance coverage, or authoritative financial, accounting, investment or other professional opinion or advice which may be relied on by anyone. Expert assistance in any of these areas is strongly recommended, for which the services of a registered, certified or otherwise-qualified professional should be sought.

For greater detail concerning the technical aspects of insurance coverage, depositors or their counsel may wish to consult the Federal Deposit Insurance Act (12 U.S.C.1811 et seq.) and the FDIC's regulations relating to insurance coverage (12 C.F.R. Part 330).

Federal law expressly limits the amount of insurance the FDIC can pay to depositors, and no representation that is made by any person can increase that coverage.