



## Alerts

### Changes in Temporary FDIC Insurance Coverage for Transaction Accounts

**November 24, 2010**

*Corporate / Financial Institutions Alert*

On November 9, 2010, the Federal Deposit Insurance Corporation (FDIC) (as mandated by Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act – the “Dodd-Frank Act”) adopted rules providing for unlimited deposit insurance for noninterest-bearing transaction accounts from January 1, 2010, through December 31, 2012. These rules are effective December 31, 2010. This coverage is in addition to the \$250,000 coverage available to depositors under the FDIC’s general deposit insurance rules.

The term “noninterest-bearing transaction account” includes traditional checking accounts or demand deposit accounts on which no interest is paid. It does not include such accounts if they earn interest; nor does it include NOW accounts, money-market deposit accounts (MMDAs), and Interest on Lawyers Trust Accounts (IOLTAs).

In addition, the rules impose three notice and disclosure requirements on insured depository institutions (IDIs). Under the rules, IDIs:

- must post a prescribed notice in their main office, each branch and, if applicable, on their website;
- currently participating in the Transaction Account Guarantee Program (TAGP) must notify NOW account and IOLTA depositors that, beginning January 1, 2011, those accounts no longer will be eligible for the unlimited protection currently offered under TAGP; and
- must notify customers of any action they take that would affect the deposit insurance coverage of funds held in noninterest-bearing transaction accounts—such as changing a noninterest bearing account into an interest bearing account.

#### **Noninterest-Bearing Transaction Account**

The rules track the definition of a noninterest-bearing transaction account set forth in Section 343 of the Dodd-Frank Act; this provision defines a noninterest-bearing transaction account as:

a deposit or account maintained at an insured depository institution with respect to which interest is neither accrued nor paid; on which the depositor or account holder is permitted to make withdrawals by negotiable or transferable instrument, payment orders of withdrawal, telephone or other electronic media

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transfers, or other similar items for the purpose of making payments or transfers to third parties or others; and on which the IDI does not reserve the right to require advance notice of an intended withdrawal.

This definition covers only traditional, noninterest-bearing demand deposit or checking accounts whether held by a business, individual or other type of depositor.

**NOW Accounts and MMDAs.** Unlike the definition of noninterest-bearing transaction account in the TAGP, the Section 343 definition does not include NOW accounts (regardless of the interest rate paid on the account). Furthermore, the final rule does not cover MMDAs.

**IOLTAs.** The definition does not include IOLTAs. Thus, these accounts are not noninterest-bearing deposit accounts protected by Section 343.

However, under the general deposit insurance rules, IOLTAs may qualify for “pass-through” deposit insurance coverage so long as regulatory requirements are met. Each client for whom a law firm holds funds in an IOLTA, therefore, may be insured up to \$250,000 for his or her funds. In addition, the accrued interest to which a legal services entity or program is entitled may be separately insured for \$250,000. The FDIC has offered the following example:

If a law firm maintains an IOLTA with \$250,000 attributable to Client A, \$150,000 to Client B and \$75,000 to Client C, and the accrued interest of \$5,000 is payable to a legal services program, the account likely would be fully insured.

It should be noted, however, that if the clients or the legal services entity have other funds at the same IDI, those funds would be added to their respective ownership interest in the IOLTA for insurance coverage purposes.

**Account Agreement Governs.** Whether an account is noninterest-bearing is determined by the terms of the account agreement and not by the fact that the rate on an account may be zero percent at a particular point in time. When an account agreement provides for the payment of interest under certain circumstances, this account is treated as an interest-bearing account at all times.

As a consequence, an account with a rate of zero percent except when the balance exceeds a prescribed threshold would not qualify as a noninterest-bearing transaction account even though the balance at a point in time is less than the prescribed threshold and the interest rate is zero percent.

**Waiver of Account Fees.** An IDI may waive fees or provide fee-reducing credits for customers with checking accounts. Such account features would not prevent an account from qualifying as a noninterest-bearing transaction account as long as the account otherwise satisfies the definition of a noninterest-bearing transaction account.

**Rewards Programs.** With respect to “rewards programs” offered on noninterest-bearing checking accounts, an IDI should look to current requirements and interpretations under the FDIC’s regulations relating to interest on deposits and interpretations under the Federal Reserve’s Regulation Q to determine whether rewards provided in connection with transaction accounts will be considered interest paid on the account. If they do, the account will not be deemed a noninterest-bearing transaction account under Section 343.

**Conversion of Accounts.** An IDI may convert an interest-bearing account into noninterest-bearing checking account after December 31, 2010, and obtain the benefits of unlimited FDIC coverage. As long as, under the modified deposit agreement, the depositor may not earn interest on the account, such an account would be covered by Section 343.

**Payment of Interest in Demand Deposits.** Pursuant to Section 627 of the Dodd-Frank Act, on July 21, 2011, IDIs will be allowed to pay interest on demand deposit accounts. At that time, demand deposit accounts offered by IDIs that allow for the payment of interest will not be treated as a noninterest-bearing transaction account.

It should be noted that if an IDI begins paying interest on such accounts, it must inform depositors of any changes in the terms of an account that will affect their deposit insurance coverage.



**Official Checks.** Official checks, such as cashier's checks and money orders issued by IDIs, are "deposits" as defined under the Federal Deposit Insurance Act and, therefore, are deemed noninterest-bearing transaction accounts.

The payee of the official check is the insured party. If an official check is negotiated to a third party, that person becomes the insured party, subject to certain requirements. Because official checks meet the definition of a noninterest-bearing transaction account, the payee (or the party to whom the payee has endorsed the check) would be insured for the full amount of the official check upon the failure of the IDI that issued it.

**Bank Failure.** Under the FDIC's rules and procedures for determining account balances at a failed IDI, funds swept (or transferred) from a deposit account to another type of deposit account or a nondeposit account are treated as being in the account to which the funds were transferred prior to the time of failure. The FDIC has offered the following example:

If pursuant to an agreement between an IDI and its customer, funds are swept daily from a noninterest-bearing transaction account to an account or product (such as a repurchase agreement) that is not a noninterest-bearing transaction account, the funds in the resulting account or product would not be eligible for full insurance coverage.

Thus, sweep account products would not be treated as noninterest-bearing transaction accounts if the funds are swept into an interest bearing account as of the close of business and thereafter the IDI is seized by the FDIC.

**Reserve Sweeps.** The final rules include an exception from the treatment of swept funds in situations where funds are swept from a noninterest-bearing transaction account to a noninterest-bearing savings account, notably a MMDA. These "reserve sweeps" consist of an account which is divided into two subaccounts, a transaction account and an MMDA. The amount and frequency of sweeps are determined by an algorithm designed to minimize required reserves. The FDIC will consider such accounts noninterest-bearing transaction accounts. Other than this exception for "reserve sweeps," MMDAs and noninterest-bearing savings accounts do not qualify as noninterest-bearing transaction accounts.

## Insurance Coverage

Pursuant to Section 343, all funds held in noninterest-bearing transaction accounts are fully insured. This protection is separate from the protection afforded depositors with respect to other accounts held at an IDI. As a consequence, funds held in noninterest-bearing transaction accounts will not be counted in determining the amount of deposit insurance on deposits held in other accounts at the same IDI. The FDIC has offered the following example:

If a depositor has a \$225,000 certificate of deposit and a noninterest-bearing checking account with a balance of \$300,000, both held in a single ownership capacity, he or she would be fully insured for \$525,000 (plus interest accrued on the CD), assuming the depositor has no other single ownership funds at the same institution. Coverage of \$225,000 (plus accrued interest) would be provided for the certificate of deposit as a single ownership account up to \$250,000. Full coverage of the \$300,000 checking account would be provided separately, despite the checking account also being held as a single ownership account, because the account qualifies for unlimited separate coverage as a noninterest-bearing transaction account.

**Revocable Trusts.** Coverage for revocable trust accounts, in general, is based on the number of "eligible" beneficiaries named in the account. The question is how will the FDIC determine the number of eligible beneficiaries when calculating revocable trust account coverage for an account owner who has multiple revocable trust accounts, including one or more such accounts that would qualify as Section 343 noninterest-bearing transaction accounts? The FDIC has offered the following example:

If a depositor has an interest-bearing account with a balance of \$400,000 payable to a niece and a qualifying noninterest-bearing transaction account with a balance of \$200,000 payable to a friend, how much coverage would be available for the accounts?



The FDIC will first determine the total number of different beneficiaries that the account owner has named in all revocable trust accounts (both interest-bearing and noninterest-bearing) at the same IDI. There are two (the niece and the friend) in the above example. The FDIC will multiply that number by \$250,000 to determine the maximum coverage available on the account owner's revocable trust accounts. It would apply that amount (\$500,000) to the total balance of the account owner's interest-bearing revocable trust accounts. Because that amount is \$400,000, the revocable trust account would be fully covered. The balance of the noninterest-bearing transaction account (\$200,000) would be separately and fully covered under Section 343.

### Coverage Automatic

Under the TAGP, an IDI could decide whether to participate in the program. Because Section 343 of the Dodd-Frank Act provides Congressionally mandated deposit insurance coverage, all IDIs will automatically participate. IDIs are not required to take any action (i.e., opt in or opt out) to obtain separate coverage for noninterest-bearing transaction accounts. From December 31, 2010, through December 31, 2012, noninterest-bearing transaction accounts at all IDIs will receive this temporary deposit insurance coverage.

### Separate Assessment

In order to participate in TAGP, an IDI must pay a separate assessment to the FDIC. Because Congress has decided that noninterest-bearing transaction accounts are fully insured deposits, the FDIC will not charge a separate assessment for the insurance of Section 343 noninterest-bearing transaction accounts. However, the FDIC will consider the cost for this additional insurance coverage in determining the amount of the deposit insurance assessment that the FDIC charges IDIs under its risk-based assessment system.

### Disclosure and Notice Requirements

The final rules include disclosure and notice requirements as part of the implementation of Section 343. Under the final rules, IDIs:

- must post a prescribed notice in their main office, each branch and, if applicable, on their website;
- currently participating in the TAGP must notify NOW account depositors (that are currently protected under the TAGP because of interest rate restrictions on those accounts) and IOLTA depositors that, beginning January 1, 2011, those accounts no longer will be eligible for the unlimited protection currently offered under TAGP; and
- must notify customers individually of any action they take to affect the deposit insurance coverage of funds held in noninterest-bearing transaction accounts—such as changing a noninterest-bearing into an interest bearing account.

**Posted Notice.** The final rule requires each IDI to prominently post a copy of the following notice in the lobby of its main office, in each domestic branch and, if it offers internet deposit services, on its website.

#### NOTICE OF CHANGES IN TEMPORARY FDIC INSURANCE COVERAGE FOR TRANSACTION ACCOUNTS

All funds in a “noninterest-bearing transaction account” are insured in full by the Federal Deposit Insurance Corporation from December 31, 2010, through December 31, 2012. This temporary unlimited coverage is in addition to, and separate from, the coverage of at least \$250,000 available to depositors under the FDIC's general deposit insurance rules.

The term “noninterest-bearing transaction account” includes a traditional checking account or demand deposit account on which the insured depository institution pays no interest. It does not include other accounts, such as traditional checking or demand deposit accounts that may earn interest, NOW accounts, money-market deposit accounts, and Interest on Lawyers Trust Accounts (“IOLTAs”).

For more information about temporary FDIC insurance coverage of transaction accounts, visit [www.fdic.gov](http://www.fdic.gov).



**Notice to Depositors Protected Under the TAGP But Not Under the Dodd-Frank Provision.** Low-interest NOW accounts and all IOLTAs are protected in full at IDIs participating in the TAGP through December 31, 2010. These accounts, however, are not eligible for the unlimited coverage afforded by Section 343 of the Dodd-Frank Act. Consequently, effective January 1, 2011, they will only be insured under the general deposit insurance rules.

The final rule requires IDIs currently participating in the TAGP to provide individual notices to depositors with NOW accounts covered by TAGP and IOLTAs that those accounts will not be insured under the new temporary insurance category for noninterest-bearing transaction accounts.

IDIs must provide such notice to depositors by mail no later than December 31, 2010. E-mail may be used for depositors who ordinarily receive account information in that manner. The notice may be in the form of a copy of the notice required to be posted in IDI main offices and branches and on websites.

As to joint accounts protected under the TAGP, an IDI need only mail the notice to the address designated on the account. If depositors have more than one affected account, one notice is sufficient if it identifies all the applicable accounts. The notice mailed to affected depositors may be in the form of the “posting” notice described above.

**Notice to Sweep Account and Other Depositors Whose Coverage on Noninterest-Bearing Transaction Accounts Is Affected by an IDI Action.** If an IDI offers an account product in which funds are automatically transferred, or “swept,” from a noninterest-bearing transaction account to another account (such as a savings account) or bank product that does not qualify as a noninterest-bearing transaction account, it must inform those customers that, upon such transfer, the funds will no longer be fully protected under the TAGP.

IDIs must notify customers of any action that affects the deposit insurance coverage of their funds held in noninterest-bearing transaction accounts. This notice requirement will apply when IDIs begin paying interest on demand deposit accounts, as will be permitted beginning July 21, 2011, under Section 627 of the Dodd-Frank Act.

Furthermore, if an IDI modifies the terms of its demand deposit account agreement so that the account may pay interest, the IDI must notify affected customers that the account no longer will be eligible for full deposit insurance coverage as a noninterest-bearing transaction account. Such notifications are mandatory; however, the FDIC has not imposed specific notice requirements. An IDI should act in a commercially reasonable manner and comply with applicable state and federal laws and regulations in informing depositors of changes to their account agreements.

For more information, please contact [Timothy M. Sullivan](#), [Michael D. Morehead](#) or your regular [Hinshaw attorney](#).

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