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Article for *Minnesota Counties*

New FDIC Rules Affect County Deposits and Investments

By Rebecca Otto, State Auditor

In response to this fall's financial crisis, Congress temporarily increased the amount of Federal Deposit Insurance Corporation (FDIC) protection for bank deposits. In addition, the FDIC is temporarily guaranteeing certain bank bonds. The Office of the State Auditor has received a number of inquiries from counties regarding the impact of these changes on county deposits and investments. The unique and temporary nature of these new rules, combined with the uncertainty in the financial markets, present a series of challenging issues for counties.

The new limit is $250,000 per bank depositor, which includes government entities. All of the other FDIC rules regarding public depositors will still apply. The new coverage limit has a "sunset provision," however, and will be in effect only through December 31, 2009.

Certificates of Deposit

If your county purchases Certificates of Deposit (CDs), you will now be able to purchase them in amounts insured up to $250,000. The FDIC will cover the value of the CD and any interest that has accrued up to $250,000.

Keeping this in mind, if you were to purchase a CD, make sure that it is an amount that will allow the FDIC coverage to insure the principal and any accrued interest. For instance, your county buys a CD in the amount of $250,000 at 5% interest paid quarterly, but the issuing bank fails the day before interest is posted (or credited) to the CD. In such a case the FDIC will only cover $250,000, the value of the CD, and the county will not collect the interest that had accrued over three months -- at 5%, over $3,000. If, however, the county had purchased a CD in the amount of $246,000 and the issuing bank failed the day before interest was posted, the FDIC would cover your CD and the accrued interest up to $250,000.

Protecting CDs That Mature After December 31, 2009

A CD with a value over $100,000 that matures after December 31, 2009 -- the sunset date for the higher protection limits -- presents a different set of challenges in the face of a bank failure. In this case, the amount of the CD over $100,000 would be uninsured, unbonded and uncollateralized. Caution should be used in purchasing any CD with a value in excess of $100,000 that would be due to mature after December 31, 2009.

Options for protecting your CD depend on the type of CD. There are two types of CDs: negotiable and deposit. A negotiable CD, frequently purchased from an out-of-state bank, is transferable, and the issuing bank has no record as to who holds the CDs it has issued. A deposit CD is frequently purchased from a local bank, which identifies your county as the account holder. There is, however, usually a penalty for early withdrawal of this type of CD.

If your county holds a negotiable CD in excess of the FDIC limit from a bank outside the state of Minnesota, your only option will probably be to sell the CD. Its value at the time of sale will be a function of its interest rate and maturity date -- and you may lose money on the CD. The fact that the CD is now partially uninsured may also affect its salability. The CD could be worth less at the time than the principal owed, in which case the county may have a loss.

If, on the other hand, your county holds a deposit CD in excess of the FDIC limit, in addition to the option of selling, you may be able to obtain pledged collateral. If the depository that issues the CD declines to pledge collateral, the county will have to cash in the CD -- and incur any penalty for early withdrawal. To avoid this situation, your county can either try to negotiate with the depository bank to take the early withdrawal provision out of the CD or provide a waiver in writing. Alternatively, it may be possible for the depository bank to agree in writing to collateralize the CD should it ever become partially uninsured.

Care should also be taken with CDs that are pledged as collateral for the protection of the county deposits. If CDs are pledged as collateral and they are no longer completely insured by the FDIC on January 1, 2010, other collateral will have to be obtained by the county to protect its bank deposits.

Transaction Accounts with Unlimited FDIC Coverage

One of the programs being offered by the FDIC is unlimited FDIC coverage for non-interest-bearing transaction accounts. Transaction accounts include those types of accounts that can affect a transaction electronically such as ATM withdrawals or automatic payments. “NOW” and “IOLTA” accounts can pay up to one-half percent interest and still be considered “non-interest bearing.”

The program is optional and a number of banks have opted out. A list of banks opting out can be found at the FDIC website at: http://www.fdic.gov/regulations/resources/TLGP/optout.html. When our audit crews calculate required collateral, they may verify participation in the program through this website.

The benefit of these types of accounts to the bank is obvious. If a county is keeping a large amount of county funds in a non-interest bearing account, there should be some financial benefit to the county.

FDIC-Guaranteed Bank Bonds

The FDIC has adopted a Temporary Liquidity Guarantee Program to help banks increase their liquidity. Under this program, the FDIC backs certain qualified bonds issued by banks with the full faith and credit of the United States. However, to be eligible to be collateral or public investments in Minnesota, federal securities must meet the requirements set forth in Minn. Stat. ch. 118A which basically requires that such securities be issued by a federal entity, not just guaranteed by the federal government. For a more detailed look at the statutes involved please see our Statement of Position entitled "Status of FDIC-Guaranteed Bonds under Minnesota Law" at:

http://www.auditor.state.mn.us/**.**

Coverage Is Temporary

According to the FDIC, only eleven banks failed in the United States between October 1, 2000 and December 31, 2007: since January 1, 2008, thirty-five banks have failed. Although the increased FDIC coverage does provide increased protection to bank depositors, it is only temporary. Given the current condition of our financial markets, additional caution with regard to these new rules is warranted.