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NEW RULES ON INSURANCE COVERAGE
ON MUNICIPAL FUNDS IN FDIC INSURED BANKS

By Sidney D. Hemsley, MTAS Legal Consultant

FDIC Limits Insurance Coverage On Some Government Bank Deposits

Most cities and towns in Tennessee have money deposited in FDIC insured banks. If yours does, read on. The FDIC insures such bank deposits in any single bank up to $100,000. Some governments circumvented the $100,000 limitation on time deposit accounts by breaking up their deposits into increments of $100,000 and naming a separate custodian for each increment. However, in a recent legal opinion the FDIC declared that "multiple custodians" for public unit time deposit accounts would no longer each qualify for separate deposit insurance coverage. The shaky condition of many banks across the United States makes it important that FDIC insurance limitations on government bank deposits be clearly understood by municipal officials.

What Is a "Multiple Custodian" Public Unit Account?

The FDIC's legal opinion was generated by questions the Colorado State Treasurer raised about certain multiple custodian bank deposit practices in his state. These practices are briefly described below. They should help municipalities develop an understanding of what a "multiple custodian" public unit account is and give them a window through which to view their own banking deposit practices.

The legal opinion actually addressed two questions related to government time deposit accounts. The first question is whether the account qualifies for separate insurance coverage as a political subdivision or public unit under FDIC regulations. It was the FDIC's position that the Colorado State
Compensation Insurance Fund did not qualify as a public unit or political subdivision under FDIC regulations (12 CFR § 330.8(c)) because it was only "a subordinate or nonautonomous division of Colorado's Department of Labor and Employment," and because it "does not enjoy the exclusive use and control of money allocated to it as required by 12 CFR § 330.8(c)(3)." In other words, the practice of establishing accounts in the name of subordinate departments or funds will not necessarily qualify those departments or funds for separate deposit insurance coverage. The FDIC will consider the threshold question of whether a department or fund is actually a separate, independent political subdivision or public unit with real control of its money.

The second question is whether any accounts in any single bank are "multiple custodian" accounts as the FDIC defines them. A Colorado state statute authorized the state treasurer to invest state funds in certificates of deposit and "to appoint in writing one or more persons to act as custodians of the moneys." The same statute also limited the function of the custodian to that of a "representative of the state treasurer." While conceding that the FDIC Act (12 U.S.C. § 1813[m]) and FDIC regulations (12 CFR § 330.8) permitted "agents" as well as officers and employees to be "official custodians" of public funds, the FDIC's legal opinion zeroed in on the definition of the term "custodian." An "essential element" of custody is control, and "It is manifest that these so-called 'custodians' exercise no control over the funds and that the control remains in the state treasurer, the official custodian," according to the legal opinion. But the legal opinion went on to conclude that even the elimination of the language in the Colorado statute that restricted the role of the custodian would not help the state, because the FDIC would look to substance rather than form. If any government account is in reality a multiple custodian account over which the custodians have no control, it is not entitled to separate insurance coverage.

Municipalities and their political subdivisions with time deposits totaling over $100,000 in any single bank should look very carefully at their accounts to determine whether:

(1) The accounts qualify as public units or political subdivisions.
(2) The accounts include any multiple custodian accounts.

Any account which does not qualify as a public unit or political subdivision, or is a multiple custodian account according to FDIC regulations, does not qualify for separate deposit insurance coverage, except for the exceptions noted...
in the section titled "Phase-In Period." Such accounts will be lumped together by the FDIC with the funds of their parent department or other real custodian for the purpose of calculating the extent of deposit insurance coverage.

Separate Coverage for Time and Savings Deposits and for Demand Deposits?

Apparently time and savings deposits in any one bank, and demand deposits in the same bank, are insured separately up to $100,000. One provision of FDIC regulations governing public unit accounts (12 CFR § 330.8) provides that:

Each official custodian of funds in any State of the United States or any county, municipality, or political subdivision thereof depositing the same in time or savings deposits (emphasis the author's) in an insured bank in the same state shall be separately insured up to $100,000. (12 CFR § 330.8(a)(2)).

However, another provision of the same regulation provides that:

Each official custodian referred to in [paragraph] (a)(2) ... of this section lawfully depositing such funds in demand deposits (emphasis the author's) in an insured bank within the same state, District of Columbia, Commonwealth, possession or territory, comprising the public unit wherein the public unit is located, or in any form of deposit, whether term, savings or demand, in an insured bank outside such jurisdiction shall be separately insured up to $100,000. (12 CFR 330.8(a)(5)).

On the basis of its staff's discussions with the FDIC on this issue, Public Investor, in its May, 1985, issue, unofficially reports that the cited regulations support the conclusion that time or savings deposits and demand deposits are insured separately, but there is a possibility that that conclusion is wrong.

But do not be confused by the language of 12 CFR § 330.8(a)(2); if it is not read carefully it leads one to the conclusion that time deposits and savings deposits also are separately insured to the extent of $100,000.
However, note that under both 12 CFR § 330.8(a)(2) and 12 CFR § 330.8(a)(5) the insured party is "Each official custodian" of the governmental entities listed, not the classes of deposits. That is, under 12 CFR § 330.8(a)(2) "Each official custodian" of time or savings deposits is separately insured up to $100,000, and under 12 CFR § 330.8(a)(5) "Each official custodian" of demand deposits is separately insured up to $100,000.

Phase-In Period

The FDIC has provided for a phase-in period for the new rule governing multiple custodian deposits by public units. Any such deposit made under state or local law similar to the Colorado statute, and in effect on or before April 5, 1985, will be separately insured. However, deposits made after that date will be insured under the new rule which eliminated separate insurance coverage. But note that the phase-in period appears to cover only cases in which the multiple custodian deposits were made under the authority of a state or local law. Any municipality which has a multiple custodian account established under questionable authority should assume the new rule applies to the account.

What Should the City Or Town Do?

Any city or town which has multiple custodian accounts falling under the new rule should determine the value it places on the protection FDIC insurance provides for municipal funds. If it is dissatisfied with its present protection, there are two immediate alternatives available to it. First, it can restrict its total time deposits and its total demand deposits each to $100,000 in any single bank. If it is not comfortable with the possibility that time deposits and demand deposit are not separately insured up to $100,000, it can restrict its total deposits in any single bank to $100,000.

1Tennessee does not have a similar statute. However, some cities and towns may have either similar local ordinances authorizing the appointment of multiple custodian accounts, or informal, unauthorized practices which accomplish the same thing.
Second, it can require that any depository for municipal funds furnish security for deposits in excess of $100,000. Expert long range investment advice tailored to its particular account and deposit arrangement is also worthy of consideration.

Questions?

If you have any questions or desire additional information on this subject, contact an MTAS Management, Finance, or Legal Consultant. As an interpretative aid, a selected provision of 12 U.S.C. § 1813(m)(1) and the full text of 12 CFR § 330.8 are included with this bulletin.

References

FDIC News Release, PR-40-55 (4-4-85).

FDIC Legal Opinion, March 19, 1985 issued to Honorable Roy Romer, State Treasurer, 140 State Capitol, Denver, Colorado 80203.

Public Investor, May 6, 1985, pp. 5-6.


12 CFR § 330.8-Public Unit Accounts.

Under Tennessee Code Annotated, section 9-5-101 et seq., the depositories for only state government funds are required to provide certain collateral to secure state deposits. Some municipal charters have similar requirements with respect to municipal deposits. But Tennessee Code Annotated, section 45-2-806, provides that no bank receiving state or municipal deposits may be required to furnish security for those deposits to the extent those deposits are insured under the FDIC Act.
12 U.S.C. § 1813(m)(1)

Each officer, employee or agent of ... any municipality, or of any political subdivision thereof, herein called "public unit," having official custody of public funds and lawfully depositing the same in its insured bank shall, for the purpose of determining the amounts of insured deposits, be deemed a depositor in such custodial capacity, separate and distinct from any other officer, employee or agent of the same or any public unit having official custody of public funds and lawfully depositing the same in the same insured bank in custodial capacity.

12 CFR § 330.8 Public Unit Accounts

(a)(1) Each official custodian of funds of the United States depositing the same in time or savings deposits in an insured bank shall be separately insured up to $100,000 as to such deposits. Each such official custodian depositing such funds in a demand deposit shall be separately insured up to $100,000.

(2) Each official custodian of funds of any State of the United States or any county, municipality, or political subdivision thereof depositing the same in time or savings deposits in an insured bank in the same State shall be separately insured up to $100,000.

(3) Each official custodian of funds of the District of Columbia lawfully depositing the same in time or savings deposits in an insured bank in the District of Columbia shall be separately insured up to $100,000.

(4) Each official custodian of funds of the Commonwealth of Puerto Rico, the Virgin Islands, American Samoa, or Guam, or of county, municipality, or political subdivision thereof lawfully depositing the same in time or savings deposits in an insured bank in Puerto Rico, the Virgin Islands, American Samoa, or Guam, respectively, shall be separately insured up to $100,000.

(5) Each official custodian referred to in paragraphs (a)(2), (3) and (4) of this section lawfully depositing such funds in demand deposits in an insured bank within the same state, District of Columbia, Commonwealth, possession or territory comprising the public unit or wherein the public unit is located, or in any form of deposit, whether time, savings or demand, in an insured bank outside such jurisdiction, shall be separately insured up to $100,000.

(6) For purposes of this paragraph (a), if the same person is an official custodian of more than one public unit, he shall be separately insured with respect to the public funds held by him for each such unit, but shall not be separately insured by virtue of holding different offices in such unit or, except as provided in paragraph (b) of this section, holding such funds for different purposes.
(b) Public bond issues. Where an officer, agent or employee of a public unit has custody of certain funds which by law or under the bond indenture are required to be paid to the holders of bonds issued by the public unit, any deposit of such funds in an insured bank shall be deemed to be a deposit by a trustee of trust funds of which the bondholders are pro rata beneficiaries, and each such beneficial interest shall be separately insured up to $100,000.

(c) Political subdivision. The term "political subdivision" includes any subdivision of a public unit, as defined in section 3 (m) of the Federal Deposit Insurance Act, or any principal department of such public unit, (1) The creation of which subdivision or department has been expressly authorized by State statute, (2) to which some functions of government have been delegated by State statute, and (3) to which funds have been allocated by statute or ordinance for its exclusive use and control. It also 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. Excluded from the term are subordinate or nonautonomous divisions, agencies, or boards, within principal departments.
