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Protect Yourself From Bank Failures

By SHELLY BANJO
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Can you bank on the safety of the money you've got stashed in banks?

Some consumers are worrying as banks report billion-dollar losses from bad loans and in the wake of the seizure of IndyMac Bank, the third-largest bank failure in U.S. history.

The good news is that you can eliminate the risk of losing money in a bank failure -- by making sure none of your accounts exceed the limits of federal deposit insurance. Many people have not been diligent about doing that, however.

Meanwhile, savers may get higher yields if they are willing to park money in insured accounts at banks facing significant financial challenges.

In the event of a failure, insured depositors usually see little interruption to their day-to-day banking services; regulatory agencies typically find another bank to acquire some or all of the failed bank's deposits. That can be critical if your entire retirement savings, trust or small-business account is held in that bank.

More Uninsured Deposits

At the time of its seizure, IndyMac Bank had about \$1 billion of potentially uninsured deposits held by approximately 10,000 depositors, according to the Federal Deposit Insurance Corp. At banks nationwide, the percentage of deposits that are uninsured has doubled since 1992, to about 37% at the end of the first quarter, according to a Wall Street Journal analysis of data reported to the FDIC.

"Regardless of the health of your bank or condition of the overall economy...returns are never high enough to justify the exposure of uninsured deposits," says Greg McBride, senior financial analyst at Bankrate.com.

The basic rule for individual accounts is that FDIC insurance covers up to a maximum \$100,000 per depositor per bank. One way to guard larger sums is to hold accounts under \$100,000 at a few separate banks, remembering that accumulating interest could push an account over the limit.

But at a single institution, you get additional coverage for most individual retirement accounts (up to \$250,000) and for deposits in different ownership categories. Joint accounts are covered to \$200,000 (\$100,000 per person). Each owner of a revocable trust account is insured up to \$100,000 per qualified beneficiary -- for example, up to \$400,000 total if a husband and wife are co-owners of an account payable on death to their two kids.

Note that the FDIC doesn't insure money invested in stocks, bonds, mutual funds, life insurance policies or annuities, even if these were bought from an insured bank.

If you have multiple accounts or certain complex trust agreements, be cautious of how the bank titles each account. Bank employees may not always know the distinctions, so verify that accounts are covered with the FDIC consumer hotline (877-275-3342) or use the deposit-insurance calculator at www.fdic.gov. A few hours of attention could be well worth it, says FDIC spokesman Andrew Gray.

High, Insured Yields

Often, struggling banks offer yields on savings accounts and certificates of deposit that are significantly higher than competitors. The week that IndyMac failed, it was offering 4.15% on a one-year CD, almost two percentage points higher than the 2.27% national average at the time, according to Bankrate.

In the months before ailing Countrywide Financial was acquired by Bank of America, it frequently showed up among the top-yielding institutions.

To be sure, high yields do not directly point to a potential bank failure. A bank could address financial challenges with, say, a capital infusion or a takeover rather than a closure.

If your deposits are under the insurance caps, you can grab higher yields and still keep your money safe, says David Root of Pittsburgh wealth-management firm D.B. Root.

Adds Mr. McBride: "As long as you're fully protected by FDIC insurance, the additional return is pure gravy."

Last week, one of the highest yielding one-year CDs was offered by Washington Mutual, which has posted huge mortgage-related losses; it was offering 4.25% online vs. a national average of 3.54%, according to Bankrate.

WaMu spokesman Derek Aney says there's "not a meaningful correlation" between deposit rates and the health of a bank. He adds that while WaMu is paying high rates on certain online deposits, that is "not true across the board," with lower rates on other maturities and at its branches.

Not everyone should reach for a high yield, however. Although you're not financially

at risk in a failure if your deposits remain under FDIC limits, seeing your bank fail can be alarming.

"At the end of the day, it comes down to personal choice and your peace of mind," Mr. Root says.

Seven banks have failed so far this year. Experts predict the suffering is not yet over, although far fewer banks are likely to fail than the 834 that went under from 1990 to 1992.

In the first quarter, there were 90 institutions on the FDIC's "problem list," up from 76 banks at the end of last year. That's just over 1% of the approximately 8,500 banks in the U.S. The names of the banks aren't released to the public to prevent panic, as regulators work behind the scenes at these banks to fix serious deficiencies in their finances and operations.



Playing It Safe

A married couple, John and Sue Smith, could hold more than \$1 million of insured deposits at a single bank by holding them in different ownership categories. For example:

- John Smith, individual account, \$100,000
- Sue Smith, individual account, \$100,000
- John Smith, individual retirement account, \$250,000
- Sue Smith, individual retirement account, \$250,000
- John and Sue Smith, joint account, \$200,000
- John and Sue Smith, revocable trust account payable on death to son and daughter, \$400,000



Wesley Bedrosian

Regulatory bodies decide to close a financial institution when its capital levels fall too low or it can't meet its obligations for the next day. No prior notice is given to customers.

Note that when a bank fails, uninsured deposits can be partially reimbursed after some time and trouble, with the money coming from sales of the failed bank's assets. In general, depositors eventually get 70% to 80% of their funds returned, Mr. Gray of the FDIC says.

In some cases, such as IndyMac's, depositors have access to part of their uninsured deposits right after the failure, but schedules vary and usually it takes up to a few years to get even the partial amount back.