2012 Bulletin 26
FDIC Coverage Drops to $250,000 On December 31

December 21, 2012

The *ALTA Advocacy Update* recently reported that the proposed extension of unlimited FDIC insurance failed in the Senate. So, as of December 31, 2012, the FDIC coverage on your trust account will revert back to $250,000.

Because attorneys and title agents hold funds belonging to many different customers in a single escrow account, we routinely far exceed these limits. As we continue to see bank failures in the news, this reduction in FDIC coverage is cause for concern.

While we would all hope that no court would impose liability on an escrow agent for having held its trust account in a failed bank, if the worst happens, your customers and clients will make exactly that claim – probably naming both the firm/agency and its insurer(s). We can all envision unhappy results for the escrow agent in this situation. Regardless of the ultimate ruling, this will be an expensive case to defend and harmful to an agent's ongoing business and reputation.

While the specific duties owed by an attorney or title agent in selecting a bank are far from clear – and fortunately haven't been tested in Florida courts -- this bulletin summarizes the FDIC coverage rules and suggests a four part approach to reduce an attorney's or title agent's exposure in the event of a bank failure.

<u>OUR RECOMMENDATIONS:</u>

1. Disclose to your customer which bank you use for your trust account and remind them of FDIC's $250,000 limitation. Ask them if they have any concerns. We suggest this be built into your initial "thanks for your business" letter.

2. Move your trust accounts to a "Safe" Bank – Easier said than done, right?

3. Structure your trust account to maximize the extent of your FDIC coverage. There are ways to qualify your trust account for $250,000 of coverage for <u>each of your customers</u>, instead of $250,000 for your entire trust account (sometimes referred to as "Pass-through coverage"). Even with Pass-through coverage, amounts held in your trust account will be aggregated with your customer's other accounts to limit how much is covered. So if the customer has a large CD with that bank, the CD is counted toward their total FDIC coverage.

4. Expressly limit your liability to customers in your escrow agreements. Bank failures are matters beyond your control.

As is always the case, you should consult your own legal counsel for specific guidance on this subject and your unique fact situations.

1. Disclose to your Customer.

FDIC insurance coverage limits are not per account, but per owner. So if your customer happens to already have a large CD in the bank you use, the addition of moneys to your trust account might push them outside of coverage limits unwittingly. So the best practice in this regard is to tell your customer both your choice of banks and remind them of the coverage limits – preferably in your initial written communication. Encourage them to discuss any concerns with you. This approach also bolsters the argument that they have assumed the risk of the choice of banks.

2. Move to a "Safe" Bank.

The best answer is to avoid the problem entirely by keeping your trust accounts in "safe" banks. That begs the real questions –

> "Which banks are safe?"
>
> "Which banks are *too big to fail*?"

Few of us have the expertise to meaningfully evaluate the "riskiness" of individual banks. Fortunately, there are several services that have evaluated the filings made by each bank and offer their "opinion" of the risk of holding deposits in those banks.

A wealth of financial data on individual insured institutions is available at: http://www.fdic.gov/bank/index.html, however that data requires careful evaluation. As an alternative, you can subscribe to one of the many professional rating services. One of my personal favorites – because it is easy to use -- is http://www.bankrate.com/brm/safesound/ss_home.asp.

Keep in mind that these are nothing more than the opinion of the various services. In a worst case analysis, no single "opinion" will protect you from liability Your reliance on any rating (by then proven tragically wrong) will be questioned. But if the worst happens, I would rather justify my bank selection based on expert opinion rather than a referral relationship I might have with a banker.

Our best advice is to look-up your depository bank. If they are not rated well – MOVE YOUR TRUST ACCOUNT. It's simply not worth the headache of dealing with a bank failure, even if the account is fully insured. And update your search regularly – perhaps monthly, and anytime the rumors start to fly – as things can change quickly.

One additional caveat: For smaller banks, the sudden removal of a large trust account balance may be enough to trigger the very bank failure you are hoping to avoid. Where your trust account balance constitutes in excess of 1% of the bank's total deposit assets, you may want to consider a phased reduction of the account balance, redirecting some incoming deposits into a trust account at the "safer" bank, and probably candid discussions about the process with your bank officer.

This is not a time to let loyalty to a local bank, or a good referral relationship, interfere with your objective analysis and protecting your firm or agency.

3. Maximize the Extent of FDIC Coverage.

Under some circumstances, the FDIC will provide "pass-through" coverage for each of your clients/customers up to $250,000 limit. Regardless of the rating of your chosen bank, your goal should be to make sure that each of your customers has as much FDIC insurance protection as possible.

Unfortunately, the applicable rules leave the FDIC significant discretion both in deciding which of the bank's records to consider and what language will be deemed sufficient in the bank's "Deposit Account Records." The pertinent FDIC Rules can be reviewed here

The basic rule, as set forth in 12 C.F.R. §330.5(b)(2), states

> The FDIC will recognize a claim for insurance coverage based on a fiduciary relationship only if the relationship is expressly disclosed, by way of specific references, in the "deposit account records" (as defined in § 330.1(e)) of the insured depository institution.
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> The express indication that the account is held in a fiduciary capacity will not be necessary, however, in instances where the FDIC determines, in its sole discretion, that the titling of the deposit account and the underlying deposit account records sufficiently indicate the existence of a fiduciary relationship.

(emphasis added) As one delves further into the regulation and the few opinions issued on this subject by FDIC, it quickly becomes apparent that the FDIC always retains significant discretion in their interpretation of these rules and the adequacy of the disclosure in the "deposit account records."

So as an attorney or title agent, your basic goal is to build a paper trail that fully and clearly discloses the fiduciary nature of the account in the "safe" bank's "deposit account records."[1] It isn't enough that your checks and deposit slips both say "Escrow Account" or "Trust Account."

Florida Statute §626.8473 leaves no ambiguity that all "funds received by a title insurance agent … shall be trust funds received in a fiduciary capacity by the title insurance agent and shall be the property of the person or persons entitled thereto." (2) and are not "subject to any debts of the title insurance agent." However, given the degree of discretion maintained by FDIC under the C.F.R., there is no clear – absolutely certain – way to assure that your disclosure will be legally sufficient after a bank has failed.

My recommendation would be:

a. Make certain that the deposit opening documents are updated to reflect the name of the account as "[Law Firm Name] Trust Account" or "[XYZ] Title Agency, Escrow Account"

b. Ask that the updated account opening documents – and which piece of paper this appears on may be critical under the FDIC rules -- clearly recite that

> "This is a [title agency/law firm] escrow account under [Fla. Stat. 627.8473/Chapter 5 of the Rules Regulating the Florida Bar] containing

[1] "Deposit account records" are defined term in 12 C.F.R. 330.1(e)

> (e) Deposit account records means account ledgers, signature cards, certificates of deposit, passbooks, corporate resolutions authorizing accounts in the possession of the insured depository institution and other books and records of the insured depository institution, including records maintained by computer, which relate to the insured depository institution's deposit taking function, but does not mean account statements, deposit slips, items deposited or cancelled checks.

funds belonging to others received by the [title agent/law firm] in a fiduciary capacity."

c. 12 C.F.R. 330.5(b)(2) requires that the details of the relationship and the interests of other parties "must be ascertainable either from the deposit account records of the insured depository institution or from records [of the law firm/title agent]". So you've got to keep good trust account records. No surprise there.

d. While it is arguably unnecessary under the language of the rule, given the scope of the FDIC's discretion, we recommend you formally supplement the bank records by hand-delivering to your bank officer (and getting them to acknowledge receipt) a document entitled "Supplement to Deposit Account Record" and again recite that

> "[Name of Account] [account number]
>
> This is a [title agency/law firm] escrow account under [Fla. Stat. 627.8473/Chapter 5 of the Rules Regulating the Florida Bar] containing funds belonging to others received by the title agent/law firm in a fiduciary capacity. The relationship and the interests of other parties in this account are ascertainable from records maintained, in good faith and in the regular course of business, by the [title agency/law firm]"

Taking these steps to assure coverage of each customer's interest in a trust account is not a panacea. Since the entire purchase price for each transaction is usually in a trust account at the moment of closing, many customer sub-accounts will exceed the $250,000 insurance level at some point during the transaction. So at best, maximizing the FDIC coverage is a supplement to picking a "Safe" bank.

4. Limit your Liability with a Well Written Escrow Agreement.

We started this bulletin with the hope that no court would impose liability on an escrow agent for bank failures and other matters clearly beyond their control. But that result is by no means certain. An escrow relationship may be modified or limited by contract, at least where not contrary to statute or notions of unconscionability.

"Best Practices" have long dictated that no funds should be held without an express written escrow agreement. Today, we will go a step further and suggest that those escrow agreements should expressly disclaim liability for:

a. The financial status or insolvency of any other party, or any misrepresentation made by any other party.

b. The legal effect, insufficiency, or undesirability of any instrument deposited with or delivered by or to Escrow Agent or exchanged by the parties hereunder, whether or not Escrow Agent prepared such instrument.

c. The default, error, action or omission of any other party to the escrow.

d. Any loss or impairment of Funds that have been deposited in escrow while those Funds are in the course of collection or while those Funds are on deposit in a financial institution if such loss or impairment results from the failure, insolvency or suspension of a financial institution, or any loss or impairment of Funds due to the invalidity of any draft, check, document or other negotiable instrument delivered to the Escrow Agent.

e. The expiration of any time limit or other consequence of delay, unless a properly executed settlement instruction accepted by Escrow Agent has instructed the Escrow Agent to comply with said time limit.

f. Escrow Agent's compliance with any legal process, subpoena, writ, order, judgment or decree of any court, whether issued with or without jurisdiction and whether or not subsequently vacated, modified, set aside or reversed.

g. Any shortfall in the sufficiency of the amount held in escrow to accomplish the purpose of the Escrow.

h. Any obligation to collect additional funds, unless such obligation is in writing and signed by the Escrow Agent.

In the title arena, this can be problematic because the FAR/Bar and other "standard" real estate contracts do not include this level of protective language. Since the attorney/title agent is not usually a party to the initial contract, and not obligated to accept an escrow simply because a contract has been signed; the limitation on liability needs to be agreed by way of a supplemental letter "accepting" the escrow subject to the various terms and conditions.

Conclusion:

These are certainly the "interesting times" of the Chinese curse. With regard to FDIC insurance, we are operating in largely (and fortunately) untested legal waters – either as to the FDIC interpretations in a particular case or as to our liability as escrow agent for bank failures and other matters beyond our control. Absolute safety is not possible.

However, by keeping your trust accounts in "safe" banks, building a paper trail to support maximum FDIC coverage and contractually limiting your liability, you can reduce your exposure to this "Interesting" issue.

Happy Holidays from the
Florida Land Title Association!

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