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A Way to Beat the FDIC Limit

Savers can have extra security with a program that allows \$1.5 million in insured deposits.

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Eugene Ludwig, once the nation's top bank regulator, was running a financial industry consulting firm when stock prices started tanking in 2000 and investors began to scurry to find safer places to put their money.

But Ludwig knew that many well-heeled investors —especially senior citizens, who had decades of savings to secure —faced a serious problem when depositing money in banks: Federal deposit insurance limits were stuck in the 1980s.

"When I was comptroller of the currency [from 1993 to 1998], I consistently heard complaints from banks that they could not satisfy their customers' need for more deposit insurance," said Ludwig, now chief executive of Promontory Interfinancial Network in Washington. Federal Deposit Insurance Corp. coverage "has not kept pace with inflation."

In the meantime, bank savings and CD deposits have rocketed, particularly since 1999. The total in those accounts is \$4.8 trillion now, up from \$3.45 trillion at the end of 1999, according to Federal Reserve data.

To be sure, bank failures have been relatively rare in the last few years. But when banks do fail, customers can lose money if their deposits exceed the \$100,000 FDIC insurance limit, government officials acknowledge. Even if the risk of loss is tiny, for many savers the point of keeping money in the bank is to be 100% safe.

In the last three years, uninsured deposits in U.S. bank failures topped \$227 million, though some of that potential loss was recovered after regulators sold bank assets and returned the proceeds to depositors, said FDIC spokeswoman Elizabeth Ford in Washington.

"You see depositors getting burned in bank failures," said Mark Jacobsen,

president and chief operating officer of Promontory and former chief of staff at the FDIC. "It's not the sophisticated customers. It's the unsophisticated customers like the school boards, the community groups and the retirees."

Depositors who want to keep more than \$100,000 in bank savings consequently face a challenge: They must either deposit money in a number of banks, staying below the insurance limit at each; divide their money at one bank using separate trust accounts to get \$100,000 coverage per account; or leave a portion of their deposits at risk.

Ludwig, Jacobsen and other former regulators who now run Promontory figured savers aren't happy with any of those options. So they recently came up with one of their own: a bank deposit swapping service called CDARS, for Certificate of Deposit Account Registry Service.

What CDARS does is secure deposit insurance for up to \$1.5 million per depositor through a single bank. It does this by linking hundreds of participating community banks through a computer network. The banks effectively trade deposits online so that a customer can deal with one bank, but gets deposit insurance coverage through perhaps dozens.

Here's an example of how it works: Mrs. Jones has \$500,000 in retirement savings, and being highly risk averse, she wants it all in the bank. If her bank is a member of the CDARS network, it would divide her savings into six blocks of less than \$100,000 each and go online to trade those blocks for like-size deposits from customers at other banks in the system.

Mrs. Jones would get one interest rate on her entire deposit, and she would get one regular statement on the account. But her money would be fully insured among the six banks.

Meanwhile, her bank likes the arrangement because it's effectively keeping the full amount of her deposit to lend.

Mrs. Jones would get a list of all the banks that have her money so she could avoid depositing more cash in those institutions and going above the insurance limit.

"The whole point here was whether we could solve somebody's paperwork and running-around-town hassle," said Sean Gannon, senior vice president at Community Bank in Pasadena. "I am a big supporter of the program."

So is Rhonda Swanson, senior vice president and chief financial officer of Palm Desert National Bank. The bulk of the bank's customers are small businesses, community associations and charities, she said. They often need to deposit more than \$100,000, sometimes just for short periods until bills roll in for a major event, for example. But because of restrictive bylaws and organization rules, they must have deposit insurance for every dollar.

Palm Desert National Bank had previously purchased private insurance for customers who needed coverage above the \$100,000 limit, or purchased Treasury securities for them, Swanson said. But neither customers nor the bank found those options appealing, she said. CDARS is a win for both the customer and the bank, she said.

The CDARS system, now 6 months old, is growing rapidly, Ludwig said. Promontory has about 600 banks in 48 states enrolled in the system. Ludwig expects to have 1,000 banks in the network before year's end.

Savers who are interested in the system can get more information, including names of banks that are members, on the Internet at www.cdars.com

For the specifics on FDIC insurance, go to: www.fdic.gov

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