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Banks and Banking - Insurance of Bank Deposits by the Federal Deposit Insurance Corporation

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COMMENTS

BANKS AND BANKING — INSURANCE OF BANK DEPOSITS BY THE FEDERAL DEPOSIT INSURANCE CORPORATION

The decedent provided in his will that the residuary estate should be held in trust for the designated beneficiaries during the period of administration. Under the terms of the will these beneficiaries were entitled to receive the income arising from the trust funds at semi-annual intervals. After the testator's death, his executors, in their capacity as executors and not as trustees, opened two accounts at a bank whose deposits were insured by the Federal Deposit Insurance Corporation. The executors deposited the funds which they considered to be a part of the trust corpus in the one account entitled "Estate of William F. Melosh—Capital Account," and deposited the income from the trust in the second account entitled "Estate of William F. Melosh." Subsequently the bank closed by action of its board of directors and at that time each of the above accounts contained deposits in excess of $7,000. The executors sued the Federal Deposit Insurance Corporation to recover the maximum coverage of $5,000 for each of the two accounts. *Held:* that the two bank accounts constituted but one "insured deposit" for which the executors may recover only $5,000 from the Federal Deposit Insurance Corporation. *Phair et al. v. Federal Deposit Ins. Corporation, 74 F.Supp. 693 (D.C. N.J., 1947).*

The Federal Deposit Insurance Corporation began operation on January 1, 1934, under a temporary plan for insuring bank deposits created by the Banking Act of 1933.[1] This temporary plan was replaced by the permanent plan established by the Banking Act of 1935.[2] The FDIC was created in response to agitation from bank depositors who lost more than one billion six hundred million dollars from 1920 to 1932 as a result of bank failures.[3] The chief function of the FDIC is to insure deposits of all banks entitled to insurance under the law to the extent of $5,000 for each depositor.[4] The principal case contains a judicial interpretation of the term "insured deposit" which is defined by the United States Code to mean:[5]

> "... the net amount due to any deposit or deposits in an insured bank (after deducting offsets) less any part thereof

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[1] Act of June 16, 1933, Pub.L. No. 66, Ch. 89, Sec. 12(B), 73d Cong., 1st Sess., 48 Stat. 168, 12 U.S.C.A. sec. 264 (1933).

[2] Act of August 23, 1935, Pub.L. No. 305, Ch. 614, 74th Cong., 1st Sess., 49 Stat. 684, 12 U.S.C.A. sec. 264 (1935).

[3] Rufener, Money and Banking, p. 715 (1934).

[4] Ghent v. Cliffside Park Title Guarantee & Trust Co., 16 N.J.Misc. 308, 199 Atl. 416 (1938); Zollman, Banks and Banking, Sec. 1098 (1945). Also 12 U.S.C.A. sec. 264(*l*)(1): "The maximum amount of the insured deposit of any depositor shall be $5,000."

[5] 49 Stat. 686, 12 U.S.C.A. sec. 264(c)(13) (1935).

> which is in excess of $5,000. Such net amount shall be determined according to such regulations as the board of directors may prescribe, and in determining the amount due to any depositor there shall be added together all deposits in the bank maintained in the same capacity and the same right for his benefit either in his own name or in the names of others. . . ."

The term "deposit" as used by this section of the Code has been defined by the regulations of the Federal Deposit Insurance Corporation to be sufficiently broad as to include: (1) Money or its equivalent; (2) Outstanding drafts, cashier's checks and other officer's checks (both negotiable and non-negotiable); (3) Certified checks; (4) Traveler's checks and letters of credit.[6]

The court in the principal case infers that the executors maintained the two bank accounts "in the same capacity and the same right," notwithstanding that under the express terms of the will they could have paid the accrued income segregated in the one bank account to the cestuis que trust, but could not disburse the trust corpus in the other bank account until the expiration of the period of administration. A Pennsylvania court reached a similar interpretation in *Koester v. Federal Deposit Insurance Corp.*[7] where an unincorporated library association maintained in the same insured bank several separate "memorial accounts" aggregating more than $5,000. When the bank failed the library association claimed that it merely acted as a trustee in opening the individual accounts and that in truth the individual donors were the equitable owners of these "memorial accounts." In the absence of evidence to show that the donors were actually the equitable owners, the court held that all of the accounts were maintained "in the same capacity and the same right." Here, as in the principal case, the depositor was entitled to recover a maximum of $5,000, since the several "memorial accounts" constituted but a single "insured deposit."

Other courts have interpreted the meaning of "deposits maintained in the same capacity and the same right" more liberally in favor of the depositor. In *Federal Deposit Ins. Corporation v. Casady*[8] it was held that deposits made by a town treasurer in the same insured bank under separate accounts distinctly designated for sinking fund, paving fund, firemen's pension fund, water meter deposit fund, and general fund were each held in a different capacity and right. Thus the depositor could recover up to the maximum amount of $5,000 upon each of the five bank accounts which aggregated more than $14,000. Again in

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[6] 12 CFR, 1946 Supp. 326.1; 12 CFR, Cum.Supp. 305.1 (1938). Also I Michie on Banks and Banking, sec. 26½ (1946); 2 Paton's Digest of Legal Opinions, p. 1766 (1942); Zollman, Banks and Banking, sec. 1099 (1945).

[7] Dist. Ct., Pennsylvania (1938) reported in 2 P-H, Federal Bank Service, PP 25,153 as cited in 2 Paton's Digest of Legal Opinions, p. 1768 (1942).

[8] 106 F.(2d) 784 (C.C.A. 10, 1939).

Billings County, N.D. v. Federal Deposit Ins. Corporation[9] a county treasurer had $4,306 of county funds on deposit in a general checking account. The county also had on deposit under five different certificates of deposit issued by the same insured bank an aggregate sum of $19,672, representing money held in a sinking fund for the purpose of retiring a bond issue. The court held that the checking account was not held "in the same capacity and the same right" as were the certificates of deposit, and therefore the general checking account represented an "insured deposit" separate and apart from that represented by the five certificates of deposit. A New Jersey court reached a similar interpretation in a case[10] where a mother owned a single certificate of deposit in the amount of $12,500. About ten days before the insured bank failed, the mother exchanged this single certificate of deposit for three of lesser amounts. One of the latter was issued in the name of a son for $5,000, a second was issued in the name of a daughter for $5,000, and the third was issued in the name of a second daughter for $2,500. The court held that each of the children was a bona fide holder of the certificate of deposit issued in his name and that therefore each child was entitled to recover up to a maximum of $5,000 from the FDIC.

It is interesting to note that the embezzlement of funds by a bank official or the failure of the insured bank to make proper bookkeeping entries to show deposits on their books will, upon failure of the bank, make the FDIC liable for the defalcations rather than the depositor.[11] In *Barton v. Johnson, Bank Com'r*[12] a father instructed the president of the insured bank to transfer $5,000 from the father's account and deposit such withdrawal to the separate account of his daughter. The cashier of the bank testified that the transfer had been made as directed. The father testified that he informed his daughter of the deposit to her account. After the bank failed the father, for the first time, learned that the withdrawal, which had been transferred to his daughter's account, had been subsequently retransferred and redeposited in his own account. There was evidence that the bank president had destroyed the records of the daughter's account and of the deposit therein without the knowledge of either the father or the daughter. The court held that under the evidence a legal deposit had been created in the daughter's name for which she may recover a maximum of $5,000 from the FDIC. In like manner *Jones v. Federal Deposit Ins. Corporation*[13] in-

[9] 71 F.Supp. 696 (D.C. N.Dak., 1947).
[10] Ghent v. Cliffside Park Title Guarantee & Trust Co., 16 N.J.Misc. 308, 199 Atl. 416 (1938).
[11] Hockenjos v. Federal Deposit Ins. Corporation, 16 N.J.Misc. 312, 199 Atl. 596, 598 (1938); Federal Deposit Ins. Corporation v. Records, 34 F.Supp. 600, 602 (D.C. Mo., 1940); Weir v. United States, 92 F.(2d) 634, 636 (C.C.A. 7, 1937).
[12] 24 F.Supp. 987 (D.C. Okla., 1938).
[13] 24 F.Supp. 985 (D.C. Okla., 1938).

volved a wife who had $10,000 on deposit in the insured bank. Six months before the bank failed, and at a time when she owed her husband $5,000 for various advances which he had made to her, the wife instructed the bank to transfer $5,000 from her account to a separate account for her husband. The court held that even though the bank had not properly handled this transfer, the evidence shows that the husband and wife are each entitled to recover a maximum of $5,000 from the FDIC.

In *Connor et al. v. Federal Deposit Ins. Corporation*[14] a brother had $8,146 on deposit in an insured bank under his individual name. Some seven months before the bank entered into receivership, he transferred $3,200 from his account to a new account made out in the names of his sister and himself, or the survivor of either. The brother informed his sister of the gift which he intended to make by this transfer, but she neglected to sign the deposit card for the joint account. The court held that the joint account constituted an "insured deposit" separate and apart from the brother's individual bank account. Therefore the brother and sister may recover up to a maximum of $5,000 from the FDIC for their joint account, and the brother in addition may recover up to a maximum of $5,000 for his individual account in the same bank. However, if the brother and sister had opened their account as tenants in common, without the right of survivorship, the brother's share as co-tenant would be held by him in the same capacity and the same right as his individual account.[15] In that event the FDIC in computing the amount of the brother's "insured deposit" would add the amount on deposit in his individual account to his share of the funds on deposit as co-tenant.

Funds on deposit in a partnership's name constitute an "insured deposit" separate and apart from the individual bank accounts of the several partners in the same insured bank.[16] Similarly "a deposit which is held by a person as an executor or other fiduciary is separately insured from his deposit as an individual, because the two deposits are not held in the same capacity and the same right."[17] For example if X deposits funds in a bank under the account title "X as Trustee for Y," and in the same bank X also maintains another account for his personal funds, these two accounts would be held by X in two different capacities and would therefore constitute two "insured deposits."[18] But if X is trustee of funds of which Y is the beneficiary and X deposits those funds in a bank under the account title "X as Trustee for

[14] 112 Vt. 380, 26 Atl.(2d) 105 (1942).
[15] Federal Deposit Insurance Corporation, "Is my deposit INSURED?" p. 12.
[16] Ibid., p. 12.
[17] 2 Paton's Digest of Legal Opinions, p. 1768 (1942).
[18] Supra, note 15 at p. 11.

Y," and in the same bank Y also maintains an individual account in his own name, Y being the real owner of both accounts may only recover up to a maximum of $5,000 for the two accounts upon failure of the bank.[19]

Counsel for the FDIC has expressed the opinion that where an unincorporated volunteer fire department and an incorporated fire department relief association having the same membership, each have deposits in the same insured bank, each organization's deposits would be insured up to $5,000, for each constituted a depositor separate from its members.[20] The Attorney General of Wisconsin has also expressed the opinion that the funds deposited by a public utility, which is owned by a municipality, constitute an "insured deposit" separate and apart from any deposits made by the municipality in the same insured bank, because the funds of the utility cannot be diverted to any other use of the municipality.[21]

Conclusion

From the foregoing it may be concluded that for a depositor to obtain the maximum insurance coverage on his deposits when they aggregate more than $5,000, he must do one of two basic things: (1) If the deposits are to appear solely in his individual name, he must so divide them between banks and building and loan associations which are insured by the FDIC so that the amount on deposit in any one institution does not exceed $5,000; or (2) If the funds are to be deposited in a single insured bank, he must maintain several accounts in different capacities and rights so that the amount on deposit in any one of these accounts will not exceed $5,000. To accomplish this second objective under the rule of the *Connor* case,[22] the depositor could maintain an account in his individual name, and also maintain additional *joint accounts* with his spouse, a parent, a brother or sister, and/or with each of his children.

One author, however, injects this word of warning concerning the FDIC:[23]

> "Thus far the system has worked satisfactorily; but it remains to be seen whether it could withstand a strain comparable with that of the early thirties or even of the decade of the twenties. Fortunately the elimination of some fifteen thousand weak banks since 1921 has enormously lessened the dangers inherent in a mutual insurance system."

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[19] Ibid., p. 13.
[20] 127 CCH, Bank Law Federal Service, PP 4730 as cited in 2 Paton's Digest of Legal Opinions, p. 1768 (1942).
[21] 29 Atty.Gen. 407 (1940).
[22] Supra, note 14.
[23] Moulton, Financial Organization and the Economic System, p. 360 (1938).

It is also interesting to note that during the period 1907 to 1930 eight States of the Union established bank deposit insurance plans and that each of those plans subsequently met with disastrous failure.[24]

In the light of these warnings the depositor of more than $5,000 is faced with the two-fold problem of: (1) Seeking the maximum coverage of deposit insurance by making deposits not exceeding $5,000 in several insured banks and/or in several accounts maintained in different capacities and rights under the theory that the FDIC is sufficiently strong to weather any future economic depression;[25] or (2) Disregard the insurance coverage offered by the FDIC, by depositing funds only in that bank which is financially strongest in the vicinity under the theory that the stronger a bank is financially, the less likely it will be to founder in a subsequent period of economic depression.

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[24] Butts, "State Regulation of Banking by Guaranty of Deposits," 2 Miss.L.J. 208 (1929); Butts, "Guaranty of Bank Deposits in Eight States," 3 Miss.L.J. 186 (1931).

[25] On August 30, 1948, the FDIC made its final payment on the original capital of $289,000,000 furnished by the U.S. Government in 1934, when the FDIC began operations. The FDIC, although still a government agency, is now financed entirely by the 13,500 banks whose deposits it insures. One hundred sixty billion dollars of deposits owned by ninety million persons are currently insured, and the FDIC announced that it has reserves of one billion dollars for use, if needed, in future bank aid. See The Milwaukee Journal, August 30, 1948, at page 5 of the local news section.