

**Tough times compel tough question --
And a complex answer**

The recent collapse of the investment giant Bear Stearns has brought a series of calls to Norris, Perné & French LLP with a singular question. “How protected are my assets?”

Given the current economic uncertainty, and the unexpected swirl of events revolving around Bear Stearns, it’s an opportune time to both set the stage and answer the question.

Let’s provide context first. The level of bank failures to date in this calendar year isn’t enough to sound the alarms. (There have been two failures of small Missouri-based banks). Since 2000 there has been an average of 3.3 bank failures per year in the United States. The majority of those are relatively small, local banks. And there have been years when there were no failures: 2005 and 2006 had unblemished records. The year 2002 was a banner year for bank closings, with a record 12 banks closing their doors. The last time the country was hit hard with financial institutional failures was during the 1990-91 recession, when 502 banks failed over three years.

But there is preparation for the worst (much like many in the country bunkered down for the arrival of the millennium and the anticipated collapse of technology systems). Federal Deposit Insurance Corp. Chair Sheila Bair has said that smaller banks will continue to be the ones hit hardest by credit problems, and the 2009 Federal budget includes allowances for a higher rate of potential failures. She also emphasized the bigger picture: that most banks are in strong shape and the number of challenged banks is small.

However, the FDIC has added 140 workers (temporary) to its bank-failure division, for a total of 360 employees in that division. Independent analysts have suggested that 50-150 U.S. banks could fail by early 2010, predominantly the smallest banks in the country. The FDIC has placed 76 banks on its problem institutions list – about 10 expected bank failures this year.

The answer to the originally posed question is more complicated. The quick version is that the FDIC insures up to \$100,000 per depositor per insured bank, and up to \$250,000 in some retirement accounts (IRAs and Keoughs) at banks. The federally-sponsored corporation has \$52 billion set aside to cover those obligations. The same protections exist for credit unions under the National Credit Union Administration.

The above described deposit accounts are covered by the FDIC – in part because of the nature of those accounts. Deposits accounts create a debtor-credit relationship between the bank and the depositor in large part because the depositors’ accounts become the assets of the bank, for which a promise is made by the bank to repay the deposit, and in many cases interest.

What doesn't fall under the umbrella of FDIC coverage? The general rule is that deposits are FDIC guaranteed, but not investments. Bank-issued mutual and stock funds, safety-deposit box contents, annuities and life insurance policies are not insured.

But there also are assets at banks that have a higher level of protection. These are trust, fiduciary and custodial accounts at banks.

Trust and fiduciary accounts are held separately from the assets of the bank. The ownership remains with the bank customer, and those assets are not claimable by bank creditors should the bank be at risk.

Custodial accounts in bank trust departments also are segregated from the bank's assets, and treated for ownership and credit purposes essentially the same as trust and fiduciary accounts. No claims by bank creditors can be pursued against these accounts in the instance of a failure.

What about brokerages? What recourse would clients have in the event of the collapse of a brokerage house? The first response from brokerage firms is that the strength of their balance sheets provides an impenetrable defense for their clients. Given the Bear Stearns scenario, however, this doesn't provide the comfort investors want from their brokerage firms.

The more assuring safety net is the one provided by the Securities and Exchange Commission, which mandates that all U.S. brokerage firms maintain assets sufficient to repay all current obligations to customers. Broker customer assets also are segregated assets, and aren't carried on the firm's balance sheets.

Additionally, the Securities Investor Protection Corp. covers any client losses in securities up to \$500,000. Some brokerages have acquired additional insurance coverage for their clients, but typically not enough to cover the assets of high-wealth customers. *None of these protections, it should be emphasized, protect investors from declining asset prices.*

One of the best pieces of advice available in the current market is to review the provisions of your brokerage account to determine whether you have a margin account with your broker. In those instances, brokers may use the customer's securities to offset obligations. Limitation of exposure under these circumstances is a wise move in the current economic atmosphere.

The only sure bet is that the financial markets will continue to have the ability to surprise, on both the loss and gain sides. While the financial institutions have their challenges, the government also has taken unprecedented actions to address as well as prepare for those challenges. There's reassurance in those preparations, but individual investors need to ask the above questions of their various financial advisors to make sure their accounts are appropriately and adequately protected.

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