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Rising interest in cash that's backed (Bloomberg News)

How to max out your clients' FDIC coverage

$250K limit can easily be bumped up to $2M; CDARS, brokered CDs gaining in popularity

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U.S. investors seeking safety in cash amid the market turmoil can take advantage of several methods to insure millions above the Federal Deposit Insurance Corp.'s $250,000 limit.

A husband and wife could each have $250,000 in individual bank accounts, the maximum covered by FDIC insurance, and $250,000 each in retirement accounts such as IRAs invested in bank products rather than mutual funds or annuities. They also each can set up $250,000 trust accounts naming each other as beneficiaries and deposit another $500,000 in a joint account, where each co-owner is insured up to $250,000.

“That total comes to $2 million fully insured,” said FDIC spokesman David Barr.

Investors are holding onto cash amid concern the U.S. economy may lapse into another recession. Cash held by U.S. banks surged 8.4 percent to a record $981 billion during the week ending July 27, the Federal Reserve said in an Aug. 5 report.

“The key is to try and maximize the productivity of that cash,” as yields are approaching zero on some money-market funds and bank products, said Tom Dunn, who specializes in cash management for clients with at least $1 million to invest in federally insured programs. Dunn is senior vice president of investments for First Financial Equity Corp. in Dallas.

For those seeking insurance above the FDIC limits at one bank, the Promontory Interfinancial Network LLC will split up a large amount of cash among several banks to stay under the cap. The Arlington, Virginia-based company has been offering this service, known as a certificate of deposit account registry service, or CDARS, since 2003.

CD Network

A customer with $1 million who uses one of the participating banks may have the cash placed in CDs at five different banks, said company spokesman Phil Battey. Each CD is worth less than $250,000 to make sure any interest earnings are also insured, he said.

The network includes about 3,000 banks and savers can insure up to $50 million through CDs in multiple banks. The average holding for individuals using the service is about $925,000, said Battey. Fees for the service are embedded in the offering rates.

Similar services exist that split large deposits into money-market deposit accounts at multiple banks to stay under FDIC limits. Money-market deposit accounts may be FDIC insured while money-market mutual funds, even if sold at a bank, are not, said Barr, the FDIC spokesman.

Deposits Rise

Institutional Deposits Corp. provides an interest rate of 0.3 percent to investors and has $745 million in money-market deposit accounts through its network of 184 banks, said Bill Burdette, president of the Miami-based company.

Deposits through the Federally Insured Cash Account, which offers up to $20 million of FDIC insurance at a current rate of about 0.40 percent, increased 7 percent in the last week, said Eric Lansky. Lansky is a director at StoneCastle Partners LLC in New York, which runs the FICA program. Both FICA and IDC primarily serve businesses and nonprofits, and some high-net- worth investors.

“A lot of our customers have more than $250,000 that they want to insure,” said Robin Loftus, chief operating officer for Security Bank in Springfield, Illinois. The community bank participates in the CDARS and IDC programs because some affluent customers want CDs and others prefer money-market savings accounts for quicker access to their funds, she said.

Consumers who use the networks should make sure they don't have other accounts at banks where the money is placed that may push them over the insured limits, said Greg McBride, senior financial analyst at Bankrate.com, a unit of Bankrate Inc.

Rates May Rise

Savers who want to put their money in CDs should do so now because rates will continue to drop, said Dan Geller, executive vice president of Market Rates Insight in San Anselmo, California. “It's inevitable as long as the current economic conditions remain,” he said.

JPMorgan Chase & Co. (JPM) lowered its yield in the last week to 1.75 percent from 2 percent for a new five-year CD with a minimum deposit of $10,000, Tom Kelly, a spokesman for the New York-based bank, said in an e-mail on Aug. 10.

The national average yield as of Aug. 10 on three-year CDs is 0.91 percent and 1.54 percent on five-year CDs, according to North Palm Beach, Florida-based Bankrate.com. The top yielding online, FDIC-insured savings accounts are returning 1.1 percent, Bankrate.com data show.

The seven-day compound yield of the average taxable money- market fund was 0.02 percent as of Aug. 9, according to IMoneyNet, a research firm based in Westborough, Massachusetts, that tracks money funds.

‘Problem With Cash'

“That's the problem with cash,” said Greg Peterson, director of research at Ballentine Partners in Waltham, Massachusetts, which advises clients who typically have a net worth of at least $20 million. “It's not going to yield much because interest rates are so low.” The average rate of inflation this year through June was 2.8 percent, according to Bloomberg data.

Peterson said his firm started selling stocks and purchasing lower-risk assets in May and has recommended short- term, investment grade corporate bonds for those that need income. Investors should have a six-month reserve of cash and bonds, he said.

Banks may start charging retail customers for large deposits because they're already holding so much cash, said Geller of Market Rates Insight. That's because deposits cost banks money for FDIC insurance assessments while loan demand remains weak, Bankrate's McBride said.

Deposit Fees

Unusually high cash deposits prompted Bank of New York Mellon Corp. (BK), the world's largest custody bank, to impose fees of 0.13 percent on some institutional clients.

“Some clients during these times of market volatility have moved out of equities and are sitting on cash or in general want to keep their powder dry to get back in,” said Ram Subramaniam, head of products for TD Ameritrade Holding Corp. (AMTD)

Brokerages including TD Ameritrade and Charles Schwab Corp. (SCHW) offer FDIC-insured CDs, known as brokered CDs, from various banks. A one-year brokered CD bought through Schwab is yielding 0.5 percent, said Jeff Morley, vice president of portfolio consulting at the San Francisco-based firm.

While yields may be “slightly higher” on some brokered CDs, they're not without risk, said McBride of Bankrate. That's because it may not be as simple to get out prior to maturity by paying a penalty as with a traditional CD, McBride said. Brokered CDs are sold on the secondary market and “what you get is what an investor is willing to pay for it,” he said.

‘Kick Yourself'

Diahann Lassus said she's raised the maximum cash allocation in her clients' portfolios in the past couple of weeks “to build an extra cushion because of the volatility in the market, and so we can sleep at night.” Investors shifting some of their assets to cash should consider money-market accounts, Treasury bills, bank CDs or bank savings accounts, said Lassus, who's president of the fee-only advisory firm Lassus Wherley in New Providence, New Jersey.

“If you sell everything and go to cash you're going to kick yourself,” she said. “It's very hard to get back into a market once you've done that.”

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