Understanding FDIC Insurance

It's natural to wonder exactly how a bank safeguards your money. Fortunately, the Federal Deposit Insurance Corporation (FDIC) insurance exists for this very reason: to help protect your funds once deposited. Read on to explore the purpose of FDIC insurance, how it works, and what it covers.

What Is FDIC Insurance?

The FDIC is an independent government agency that helps protect bank depositors from the loss of uninsured deposits at an FDIC-insured bank. This organization oversees FDIC deposit insurance, which provides some protection to bank customers if an FDIC-insured institution fails. In other words, FDIC insures your money at the bank up to certain limits.

A bank failure is an unlikely situation, but it does happen. When this occurs, the FDIC provides depositors with an insurance payout. That can be up to $250,000 per depositor per institution for each account ownership category. When two banks failed in Q1 2023, regulators took steps above and beyond the $250,000 limit to protect deposits.[1,2]

Remember that if your bank is an FDIC-insured institution, you don't need to apply for FDIC insurance because coverage is automatic.

The Purpose of FDIC Insurance

FDIC insurance covers traditional deposit accounts of up to $250,000 per depositor. These traditional deposit accounts include the following:

- Checking accounts
- Savings accounts
- Certificates of deposit (CDs)
- Money market bank deposit accounts

- Prepaid cards (assuming they meet all FDIC requirements)

Certificates of deposit (CD) are time deposits offered by banks, thrift institutions, and credit unions. They may offer a slightly higher return than a traditional bank savings or checking account, but they may also require a higher deposit amount. If you sell before the CD reaches maturity, you may be subject to penalties.

Bank savings accounts and CDs generally provide a fixed return, whereas the value of money market funds can fluctuate. Money market funds are investment funds that seek to preserve the value of your investment at $1.00 a share. However, it’s possible to lose money by investing in a money market fund.

In addition, the FDIC also insures retirement accounts in which plan participants have the right to direct how they invest the money, including:

- Traditional or Roth Individual Retirement Accounts (IRA) savings accounts
- 401(k)s or other self-directed defined contribution plans
- Section 457 deferred compensation plan accounts, whether self-directed or not

The FDIC may also insure an employee benefit plan that is not self-directed, such as a pension plan.

Once you reach age 73, you must take the required minimum distributions from a Traditional IRA in most circumstances. Withdrawals from Traditional IRAs are taxed as ordinary income and, if taken before age 59½, may be subject to a 10% federal income tax penalty.

Roth IRA distributions must meet a five-year holding requirement and occur after age 59½ to qualify for the tax-free and penalty-free withdrawal of earnings. One can make these withdrawals under certain other circumstances, such as the owner's death. The original Roth IRA owner is not required to take minimum annual withdrawals.

Once you reach age 73, you must take the required minimum distributions from your 401(k), 403(b), 457 plan, or other defined-contribution plans in most circumstances. Withdrawals from defined-contribution plans are taxed as ordinary income and, if taken before age 59½, may be subject to a 10% federal income tax penalty.

FDIC Insurance Limitations

Now that we understand what FDIC insurance covers let's also look at what it doesn't cover. The FDIC states that it does not cover the following:[3]

- Stocks
- Bonds
- Mutual funds
- Life insurance policies
- Annuities
- Municipal Securities
- Safety deposit boxes or their contents
- US Treasury bills, bonds, or notes

Stock prices' return and principal value will fluctuate as market conditions change. And shares, when sold, may be worth more or less than their original cost.

The market value of a bond will fluctuate with changes in interest rates. As rates rise, the value of existing bonds typically falls. If an investor sells a bond before maturity, it may be worth more or less than the initial purchase price. By holding a bond to maturity, an investor will receive the interest payments due plus your original principal, barring default by the issuer.

Mutual funds are sold only by prospectus. Please carefully consider the charges, risks, expenses, and investment objectives before investing. Your financial professional can obtain a prospectus containing this and other information about the investment company. Please read it carefully before you invest or send money.

Several factors will affect the cost and availability of life insurance, including age, health, and the type and amount of insurance purchased. Life insurance policies have expenses, including mortality and other charges. If one surrenders a policy prematurely, the policyholder also may pay surrender charges and have income tax implications. Consider whether you are insurable before implementing a life insurance strategy. Any guarantees associated with a policy are dependent on the ability of the issuing insurance company to continue making claim payments.

Annuities have contract limitations, fees, and charges, including account and administrative fees, underlying investment management fees, mortality and expense fees, and charges for optional benefits. Most annuities have surrender fees that are usually highest if you take out the money in the initial years of the annuity contract. Withdrawals and income payments are taxed as ordinary income. If, before age 59½, one makes a withdrawal, a 10% federal income tax penalty may apply (unless an exception applies). The guarantees of an annuity contract depend on the issuing company's claims-paying ability.

Municipal bonds are subject to various risks, including adjustments in interest rates, call risk, market conditions, and default risk. Certain municipal bonds may be difficult to sell. A municipal bond issuer may be unable to make interest or principal payments, leading to the issuer defaulting on the bond. If this occurs, the municipal bond may have little or no value. If one purchases a bond at a premium, it may result in realized losses. As a result, the interest on a municipal bond may be taxable after purchase.

Municipal bonds are free of federal income tax. Municipal bonds also may be free of state and local income taxes for investors who live in the area where the bond was issued. If a bondholder purchases a share of a municipal bond fund that invests in bonds issued by other states, the bondholder may have to pay income taxes.

The federal government guarantees U.S. Treasury bonds, bills, and notes on timely principal and interest payments. However, if you sell a Treasury before maturity, it may be worth more or less than the original price paid.

FDIC Insurance and You

As mentioned above, the FDIC insures up to $250,000 for a single or joint account per depositor; This means that you can have either one account or multiple accounts at the same bank, but only $250,000 may be insured.

But some strategies may enhance your coverage. Hypothetically, you could set up a revocable trust and identify one or more beneficiaries to possibly increase your coverage. Each beneficiary may receive $250,000 of coverage. For example, a revocable trust account with one owner that names three unique beneficiaries can insure themselves up to $750,000.[4]

Remember, using a trust involves complex tax rules and regulations. Before moving forward with a trust, consider working with a professional familiar with the rules and regulations.

1. FDIC.gov, March 1, 2023
2. FoxBusiness.com, March 12, 2023
3. FDIC.gov, March 1, 2023
4. FDIC.gov, March 1, 2023

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