Steve Leimberg's Estate Planning Email Newsletter - Archive Message #1348

Date: 23-Sep-08
From: Steve Leimberg's Estate Planning Newsletter
Subject: **FDIC: Maximizing FDIC Insurance Coverage While Not Falling in the Ravine**

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Many clients are asking for authoritative guidance about maximizing Federal Deposit Insurance Corporation (FDIC) coverage at one or more particular banks.

A review of the various rules reveals a number of issues that can arise.

Many strategies being touted by bankers may not yield the hoped for protection, depending on how the FDIC interprets its own rules.

What could be more timely or practical than this comprehensive review of how the FDIC limits work by Ken, Alan, and Chris?

EXECUTIVE SUMMARY

FDIC insurance covers many different types of deposits at FDIC insured banks, including checking, savings, Negotiable Order of Withdrawal Deposit Accounts ("NOW"), market deposit accounts, and certificates of deposits (CDs). However, FDIC insurance only covers up to the insurance limit. Generally, the insurance limit is $100,000 per depositor per insured bank. Certain retirement accounts, such as Individual Retirement Accounts (IRAs) are insured for up to $250,000 per depositor per insured bank. While deposits at different branches of the same bank are not separately insured, deposits at separately insured banks *are* separately insured.

Applying these rules to various entities is quite complex and full of nuances and traps for the unwary. Nevertheless, there are several different types of ownership categories, as described below, and based upon these categories an individual may find that they qualify for insurance coverage exceeding $100,000, even if all the accounts are held at one insured bank.

FACTS:

INDIVIDUAL ACCOUNTS

Individual accounts are accounts owned and titled in the name of a single person. Additionally, deposits owned by a sole proprietorship are insured as the single deposits of the business owner.

The $100,000 insurance coverage limitation applies cumulatively to *all* of the individual accounts - at one bank. Individual accounts at the same bank include savings, CDs, NOW, checking, and market deposit.

However, individual accounts for the purposes of this test do *not* include retirement accounts.

In community property states, accounts titled in the name of one spouse will be classified as an individual account of the named spouse for the purposes of FDIC insurance. This is true notwithstanding the fact that under state law the bank account funds are considered to be owed jointly between the spouses.

If a parent creates a custodial account such as a UTMA account, and the account is treated as a deposit insured by the FDIC, then such custodial account will be insured up to $100,000. The custodial account is treated as an individual account in the name of the child.

If the child has *other* individual accounts at the same bank, these accounts would be added to the custodial account, and only $100,000 of assets held under these accounts would be insured for the benefit of the Child.

EXAMPLE:

Husband creates a custodial account funded with $100,000 for the benefit of Daughter.

The custodial account would be fully insured if Daughter had no other individual accounts at the bank.

If Daughter had an individual account with $25,000 of assets, only $75,000 of the assets held under the custodial account would be covered.

Husband can also create a revocable trust for the benefit of Daughter and the revocable trust account would be insured up to $100,000 in addition to the custodial account described above.

(The FDIC rules regarding insurance of revocable trusts are more fully discussed below. As further discussed below, revocable trusts or portions of revocable trusts may also be classified as an individual account if the revocable trust does not have "qualifying beneficiaries." In addition as also described below, if a Grantor retains an interest in an irrevocable trust created by the Grantor, the Grantor's interest in the irrevocable trust is also treated as a single account of the Grantor).

JOINT ACCOUNTS PROVIDE EXTRA COVERAGE

A person with a $100,000 individual account can obtain *another* $100,000 of effective coverage by setting up a $200,000 joint account with another person.

Joint Accounts are accounts that are owned by 2 (or more) people.

Qualifying joint accounts, whether owned as tenants by entirety, with rights of survivorship, or as tenants in common without survivorship as "and" or "or" accounts are insured separately from individual accounts.

Coverage for joint accounts remains the same even if the names on the account are rearranged or if the accounts alternate the usage of "and", "or", or "and/or."

Qualifying as a joint account for purposes of FDIC insurance requires:

1. All co-owners must be people;

2. All co-owners must have equal withdrawal rights; and

3. All co-owners must sign the signature card for the account, unless the account is a CD or established by an agent under a durable power of attorney, a guardian, or the like.

Any joint account that does not meet the above 3 requirements is treated as being partially owned by each named individual, and the ownership interest of each individual is combined with any other individual accounts that the owner has established at the same bank for the purposes of calculating FDIC coverage.

Assuming that the joint account meets all three of the above requirements, the interests of *each* co-owner in *all* qualifying joint accounts are combined and insured up to a *cumulative total* of $100,000. The ownership interest of each co-owner in a qualifying joint account held as tenants in common is *deemed* to be equal unless a different percentage of ownership is stated in the bank's deposit account records.

EXAMPLE:

Assume a Husband and Wife have one joint account with $200,000 worth of funds.

50% of the account would be deemed to be held by the Husband and 50% would be deemed to be held by the Wife. Each would be deemed to own $100,000 of the funds. Therefore, *all* of the $200,000 would be insured. This insurance would be *in addition* to any insurance available for accounts which were held individually by either Husband or Wife.

However, if the Husband and Wife had two joint accounts and each joint account had $150,000 so that a total of $300,000 was held in joint accounts, each of the Husband and Wife would be deemed to own $150,000 in joint assets. This *exceeds* the $100,000 limitation and $50,000 of the assets deemed to be held by each of the Husband and Wife would *not* be insured. As a result, a total of $100,000 of the assets held in the above joint accounts would not be insured.

Qualifying joint accounts owned by a Husband and Wife that contain community property funds are added together and insured up to $200,000, separately from any funds that are deposited in their individual names. This provides the same level of insurance for a Husband and Wife in a community state and a non-community property state.

For the purposes of determining FDIC insurance protection, accounts owned by "joint trusts" are *not* treated as joint accounts. Instead, these accounts are classified as either revocable trust accounts or irrevocable trust accounts. The rules pertaining to these accounts are further described below.

ACCOUNTS TITLED UNDER CERTAIN REVOCABLE TRUST ACCOUNTS CAN PROTECT *ANOTHER* $100,000 PER PERSON (GRANTOR) MORE—BUT BE VERY CAREFUL

The FDIC defines revocable trust accounts as those accounts owned by one or more people with the intention that on the death of the owner(s) the deposits will belong to a third party. These accounts are revocable at the discretion of the owner. As a general rule, the assets held in a revocable trust are insured for up to $100,000 per qualifying beneficiary per grantor.

The FDIC classifies revocable trust accounts into two types: formal and informal revocable trusts.

- Informal accounts include Pay on Death ("POD") accounts, Totten Trust accounts, and In Trust For ("ITF") accounts.

- Formal revocable trust accounts are those trust accounts created for estate planning purposes, i.e. living or family trusts.

All of the formal and informal revocable trust accounts held at one bank with the same grantor are combined for insurance purposes, and the $100,000 per beneficiary coverage amount is applied cumulatively to all of the grantor's revocable trust accounts.

It is important to remember for purposes of calculating insurance coverage that the $100,000 limit per beneficiary applies to both formal and informal accounts held at the same bank by the same owner.

When a Husband and Wife establish a joint revocable trust, the FDIC provides insurance coverage for the beneficiaries entitled to receive the trust assets after the death of the surviving settlor. For the purposes of determining the insurance coverage, Husband and Wife are each deemed to be a separate grantor of the trust.

EXAMPLE:

Assume a Husband and Wife create a revocable trust which has $600,000 worth of assets that will be distributed equally to each of the couple's three children after the death of the last surviving grantor and the requirements described below are met. The entire $600,000 worth of the trust assets would be insured - in addition to any individual and joint accounts.

Based on the FDIC rules, in determining the coverage available to revocable trusts, contingencies are ignored and contingent beneficiaries can qualify for the insurance.

EXAMPLE:

Assume a teenage beneficiary can receive trust assets only after graduating college. The interest of the beneficiary can still be insured for up to $100,000 - notwithstanding the contingency. The FDIC will assume for the purposes of providing insurance that the beneficiary *will* graduate college in the future.

However, it is important to note that contingencies are a factor in determining the *amount* of insurance available to an irrevocable trust and the beneficiaries of an irrevocable trust as described below. If an irrevocable trust contains the same provision whereby a beneficiary will only receive funds after graduating college, this contingency will prevent the beneficiary of the irrevocable trust from having an insurable interest. The rules governing the insurance that the FDIC provides for irrevocable trust accounts are more fully discussed below.

Generally, to be entitled to the insurance coverage, at the time of the bank's failure a qualifying beneficiary's interest in a revocable trust must be such that it would vest *immediately* upon the death of the grantor/owner and must *not* be contingent upon the death of any other trust beneficiary.

If the trust has more than one grantor, then the beneficiary's interest must be such that it would vest immediately upon the death of the last grantor.

Except as stated below, for the purposes of determining the total insurance protection afforded to a revocable trust, the FDIC will not provide protection for the ownership interest of any beneficiary who receives trust assets only after the death of another non-grantor beneficiary.

EXAMPLE:

Assume that Husband creates a revocable trust with $300,000 worth of assets which will be held for the benefit of Son after Husband's death. If Son does not survive Husband, the trust assets will be held for the benefit of Husband's three Grandchildren who are the children of Son. If at the time of the bank failure Son is alive, only $100,000 of the trust assets are insured. However, if Son predeceases the bank failure, at the time of the bank failure each of the three Grandchildren would be qualified beneficiaries of the trust and as a result, $300,000 worth of insurance protection would be afforded to the revocable trust.

INFORMAL REVOCABLE TRUST ACCOUNTS

Informal revocable trust accounts established for the benefit of a qualified beneficiary by a grantor are insured up to $100,000. All of the accounts established for the benefit of a qualified beneficiary by a grantor at one bank are combined for the purposes of determining the insurance coverage.

However, the account must meet the following 3 requirements:

1. The account title must include a commonly accepted term. Ex. POD, ITF, ATF (As Trustee For);
2. The bank records must identify the individual beneficiaries who take upon the death of the owner by name; and
3. Such beneficiaries must be qualifying. For purposes of this provision, "qualifying" means that the beneficiaries must be the owner's spouse, child, grandchild, parent, or sibling. Individuals described above who are either adopted or step-kin are considered qualifying beneficiaries. It is important to note that beneficiaries such as in-laws, cousins, friends, organizations and trusts are not considered "qualified." Therefore, no insurance coverage is provided for revocable trust accounts established for the benefit of these individuals.

EXAMPLE:

Suppose Husband established two POD accounts for the benefit of a Daughter, and each account had $75,000. Only $100,000 of the combined $150,000 worth of assets held in POD accounts for the benefit of Daughter would be insured (assuming that Husband had not created any other revocable trust accounts for the benefit of Daughter).

If Husband created two POD accounts, one for the benefit of Child A and one for the benefit of Child B and each POD account had $100,000 worth of assets, each account would be fully insured, assuming that Husband had not created any other revocable trust accounts for the benefit of either Child A or Child B at the same bank.

FORMAL REVOCABLE TRUST ACCOUNTS

Formal Revocable Trust Accounts, such as Living or Family Trust Accounts receive coverage for up to $100,000 per owner for each "named individual beneficiary."

To qualify for insurance, the account must meet two requirements:

- The account title must indicate that it is established as part of trust relationship; and
- Each of the beneficiaries must be qualifying as described in Item 3 of the previous section.

It is important to remember that if the requirements pertaining to living/family trust accounts or POD accounts are *not* met, then the entire amount in the account or the portion that does not qualify is added to the owner's other individual accounts, if any, at the same bank. Accordingly, if one of the beneficiaries of the account is not "qualified," then the funds corresponding to that beneficiary's interest are treated as the owner's individual funds for FDIC purposes.

EXAMPLE:

Assume Husband creates a revocable trust. Pursuant to the terms of the revocable trust $50,000 was held for the benefit of Husband's nephew. Husband's nephew is not a qualifying beneficiary. Therefore, the $50,000 held for the benefit of Husband's nephew would be deemed to be individual assets of Husband. Insurance protection would be available for these assets only if the combined value of the assets held in individual accounts owned by Husband at the same bank was less than $50,000 in addition to the assets held under the revocable trust described in this example.

It is also important to note that the $100,000 per beneficiary insurance coverage available for revocable trust accounts is a *combined* coverage that includes the assets held for such beneficiary under *all* formal and informal revocable trust accounts held at the same bank.

EXAMPLE:

Assume Husband has a POD account established for the benefit of Child A with $75,000 worth of assets and Husband also has a revocable trust in which $50,000 is held for the benefit of Child A. Only $100,000 of the combined assets held under these accounts for the benefit of Child A is insured while the $25,000 is not insured. ($75,000 + $50,000 = $125,000; $125,000 - $100,000 = $25,000). The above example assumes that Child A is a qualifying beneficiary of the POD account and the revocable trust and that all of the other requirements are met so that insurance coverage is available for each account.

For living/family trust accounts, the identity and number of trustees are irrelevant when calculating deposit coverage. If the revocable trust has multiple beneficiaries, the FDIC will assume that each of the beneficiaries' interests are equal - unless the interest of the beneficiaries is stated differently in the trust.

The general rule related to contingent beneficiaries stated above is subject to an exception. Remainder beneficiaries of a revocable living trust in which the trust assets will be held as a life estate for the primary beneficiary are considered to have an interest in the trust.

Although, the regulations disallow a contingency based on the death of another beneficiary, the regulations ignore any other conditions in the trust document that may prevent the beneficiary from acquiring their interest upon the grantor's death.

EXAMPLE:

Husband creates a revocable trust which provides that the assets on Husband's death will be held as a life estate for Wife with the remaining assets being divided equally among the couple's four children. Here, the trust would be insured for up to $500,000 because the life estate for Wife and the remainder interest of each of the four children qualify for coverage.
Planners should keep in mind that coverage can fluctuate when either the owner or a beneficiary dies. After the death of an owner, the FDIC permits a 6 month grace period in which the owner is *considered* alive for the purpose of calculating insurance coverage.

NOTE: This grace period does *not* apply to the death of a *beneficiary*. When a beneficiary dies, the insurance protection afforded to the ownership interest of the beneficiary lapses.

IRREVOCABLE TRUSTS

The FDIC defines irrevocable trust accounts as deposits held by a trust in which the grantor contributes the assets to the account but relinquishes any right to cancel or change the trust.

The interests of a beneficiary in all irrevocable trust deposit accounts established by the same grantor at the same bank are combined and insured up to the $100,000 limit.

However, the following 4 requirements must be met in order to ensure this treatment:

- The bank's deposit records must indicate the existence of the trust relationship;

- Beneficiaries and their interests must be identifiable from the bank's deposit records or the trustee's records;

- The amount of each beneficiary's interest must not be contingent. The regulations define a contingent interest as one where the trustee may exercise discretion in allocating trust assets, the trustee may invade trust assets for the health, education, maintenance or support of a beneficiary, or a beneficiary may not receive trust assets unless certain conditions are met; and

- The trust must be valid under applicable state law.

There is one very important distinction between the requirements for a revocable and an irrevocable trust. For an irrevocable trust the beneficiaries do not have to be related to the grantor for the $100,000 per beneficiary coverage to apply.

If the grantor retains an interest in the irrevocable trust, then for the purposes of determining the insurance protection provided by the FDIC, the interest retained by the grantor is considered to be a single account of the grantor.

EXAMPLE:

Assume the grantor created an irrevocable trust and retained an interest in the irrevocable trust worth $60,000. This $60,000 would be insured so long as all of the single accounts of the grantor at the same bank had assets totaling less than $40,000.

Often, irrevocable trusts contain provisions which prevent the beneficiaries from meeting the requirements stated above. For instance, if the trust provides that a trustee may invade the principal of the trust and as a result the remainder interest of the other beneficiaries may be reduced or eliminated, the remainder beneficiaries of the trust will not qualify for protection.

In addition, the beneficiaries of the trust will not qualify for protection if the trust agreement states that a beneficiary needs to meet certain conditions to receive assets or if the trust agreement provides that the trustee may allocate the assets among the beneficiaries in unequal shares. In such cases, the insurance provided for an irrevocable trust account is normally limited to $100,000.

EXAMPLE:

Assume that Husband creates an irrevocable trust with $500,000 worth of assets which will be held for the lifetime benefit of Wife and on Wife's death the trust assets will be split equally among the four children of Husband and Wife. Further assume that the trustee has the authority to invade the principal of the trust for Wife's benefit and that the value of Wife's interest in the trust as calculated pursuant to the FDIC regulations is equal to $30,000. Wife's $30,000 interest in the trust would be insured. The remainder interest of each of the children would not qualify for insurance coverage because the trustee has the authority to invade the principal for the benefit of Wife. The irrevocable trust as an entity would qualify for $100,000 worth of insurance coverage. Therefore, the total amount of assets held under the irrevocable trust which would qualify for insurance coverage would be equal to $130,000. ($30,000 (Wife's interest) + $100,000 (irrevocable trust) = $130,000 (total coverage)).

This is an important distinction between a revocable and an irrevocable trust. As stated above, no insurance protection is provided to a revocable trust as an entity. If a revocable trust does not have qualifying beneficiaries, up to $100,000 worth of protection is provided to the assets held under the revocable trust but only because the assets under the trust are considered to be single assets of the grantor and not because the revocable trust is afforded any insurance protection as an entity.

EXAMPLE:

Husband creates an irrevocable trust with $100,000 worth of assets and the beneficiaries of the irrevocable trust do not qualify for insurance protection. The irrevocable trust normally will still receive $100,000 worth of protection. However, if Husband funds a revocable trust account with $100,000 and none of the beneficiaries are qualified beneficiaries, and Husband also has $50,000 in assets held in individual accounts, only $50,000 of the assets held under the revocable trust will be protected because the combined total of the accounts deemed to be owned individually by Husband cannot exceed $100,000.

COMMENT:

Planners should keep in mind that different ownership categories operate in different spheres. Insurance coverage can extend beyond just $100,000 for any given person at the same bank provided that the individual satisfies each of the requirements for the various ownership categories.

It is important to understand the qualifications for each category because, as shown above, the assets may be *deemed* to be owned by the grantor/owner individually, which limits the total amount of coverage available to these assets.

Depending upon the amount of money in individual accounts and non-qualifying accounts the grantor/owner may only have part of his or her assets insured. The ultimate goal of any planning is to ensure that *all* (or as much as possible) of the client's money is fully insured, but the path to that goal can be winding and narrow.

For applications of these rules to a particular client's situation, the planner can visit http://www.fdic.gov/edie. This site contains a calculator where a planner may insert information, including deposit accounts held at FDIC insured banks, current balances, and names of each owner and beneficiary, to calculate a client's particular FDIC coverage.

In addition, individuals or practitioners may contact the FDIC at 1-877-275-3342 to obtain more information regarding the coverage provided for living trust accounts.

EDITOR'S COMMENT:

Ken and Alan and Chris have prepared some really great diagrams of how this all works. You'll find it waiting for you as **LISI** **Estate Planning Newsletter # 1347**.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Ken Crotty Alan Gassman Chris Denicolo

CITE AS:

CITES:

12 U.S.C. 1811 et seq. (2006)

12 C.F.R. Part 330
http://www.fdic.gov/

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