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ALERT

THE IMPACT THE FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC) HAS ON ESTATE PLANNING

The recent issues with Silicon Valley Bank has many clients asking how the rules related to the Federal Deposit Insurance Corporation (*FDIC*) apply to their accounts. Unfortunately, there is no simple explanation because the rules are different depending on the "category of the account." There are eight (8) categories of accounts:

- Single Accounts
- Certain Retirement Accounts
- Joint Accounts
- Revocable Trust Accounts
- Irrevocable Trust Accounts
- Employee Benefit Plan Accounts
- Corporation/ Partnership (including LLC)/ Unincorporated Association Accounts
- Government Accounts

In this article, we will discuss the categories applicable to living trusts, irrevocable trusts, estates, and payable on death/beneficiary accounts, and their related rules. Please note that some of these rules will change in April 2024, when new FDIC rules come into effect. We will update this summary at that time. Until then, here are the FDIC coverage rules relevant to your estate plan:

Living Trusts: A living trust is a formal written trust agreement where the Settlor/Trustor of the trust controls deposits and other assets in the trust during his or her lifetime. A living trust falls under the Revocable Trust Account category.

In general, each owner of a Revocable Trust Account is insured up to $250,000 for each "unique beneficiary" so long as (1) title to the account indicates the account is held in trust and (2) the beneficiaries are identifiable. A "unique beneficiary" is (i) a living person or (ii) a charity or non-profit organization that qualifies as such under the Internal Revenue Code. The FDIC coverage for Revocable Trust Accounts is based upon the owners and beneficiaries alive at the time the financial institution fails. An alternate or contingent beneficiary does not count as a "unique beneficiary." Also, the owners of the trust (Settlors) are not counted as a "unique beneficiary."

To illustrate these rules, assume that Jon Doe establishes the Jon Doe Trust. Jon transfers title to his Bank Account to Jon, as trustee of the Jon Doe Trust. The beneficiaries of the Jon Doe Trust are Sam Doe and Tom Doe, outright. In this scenario, the Bank Account is insured up to $500,000 because there are two (2) unique beneficiaries and one (1) owner ($250,000 X 2 X 1 = $500,000).

If there are multiple owners of the living trust, each owner's insurance coverage is calculated separately. For example, if Jane and Jon Doe established the Jane and Jon Doe Trust for the benefit of Sam Doe and Tom Doe, the account would be insured up to $1,000,000 ($250,000 per beneficiary X 2 Unique Beneficiaries X 2 owners = $1,000,000).

It is common for a trust agreement to provide that beneficiaries of the trust will receive their inheritance in trust, for future distributions. For example, following the deaths of

Jane and Jon Doe, Sam Doe and Tom Doe will receive their respective shares of the trust estate in a separate share trust, with the trustee making distributions for their respective health, education, maintenance, and support. In this scenario, the future trusts are viewed as mechanisms for distributing the trust funds, and Sam and Tom Doe are each still considered "unique beneficiaries."

The abovementioned rules apply if the living trust has five (5) or fewer beneficiaries. If a living trust has more than five (5) beneficiaries, there is an additional rule that applies:

When a revocable trust owner names six or more unique beneficiaries, and all the beneficiaries have an equal interest in the trust (i.e., every beneficiary receives exactly the same amount), the insurance calculation is the same as for revocable trusts that name five or fewer beneficiaries. The trust owner receives insurance coverage up to $250,000 for each unique beneficiary. But, when a revocable trust owner names six or more unique beneficiaries and the beneficiaries do *not* receive equal shares, the owner's revocable trust deposits are insured for the greater of either (i) the sum of each beneficiary's actual interest in the revocable trust deposits up to $250,000 for each unique beneficiary, or (ii) a minimum coverage amount of $1,250,000.

Some formal living trusts provide that a beneficiary has the right to receive income from the trust or to use trust assets during the beneficiary's lifetime (known under the FDIC rules as a "life estate"), and after the life estate beneficiary dies, other beneficiaries are to share the remaining trust assets. In this case, the FDIC will recognize the life estate beneficiary as a "unique beneficiary", as well as the remainder beneficiaries in determining the insurance coverage.

One final rule to be aware of for living trusts is that a living trust generally becomes irrevocable after the death of the Settlor. In general, depositors with a revocable trust account that becomes an irrevocable trust account (*during the administration of the trust*) after the death of the owner should not deposit more than $250,000 at each financial institution. It is our recommendation that you contact the bank to discuss this issue at your earliest convenience after the death of the owner.

Payable on Death or Beneficiary Account – A "payable on death" account and a beneficiary account both fall in the Revocable Trust Accounts category because these accounts are held by the custodian with the instruction to distribute to a named beneficiary after the death of the account owner, similar to a living trust agreement. Accordingly, payable on death accounts, beneficiary accounts, and living trusts have the same rules (*discussed above*). To restate the general rule, each owner of a Revocable Trust Account is insured up to $250,000 for each "unique beneficiary."

Estate Account – An account established for or representing a deceased person's funds—commonly referred to as a decedent's estate account—falls under the Single Account category. The FDIC adds together all single accounts owned by the same person at the same banking institution and insures up to $250,000, collectively. For example, assume the Executor of the estate consolidates the decedent's three (3) accounts at the Bank into one estate account. Further assume that the value of the estate account is $300,000. The FDIC will only insure $250,000 of the $300,000—the remaining $50,000 is not insured.

Irrevocable Trusts – An irrevocable trust is a written trust agreement in which the owner (Settlor) contributes deposits or other property to the trust and gives up power to cancel or change the trust. Irrevocable trusts fall in the Irrevocable Trust Account category. The Irrevocable Trust Account rules require the following to be eligible for FDIC coverage:

- The trust must be valid under state law;
- The insured bank's deposit account records disclose the existence of the trust relationship;
- The beneficiaries and their interests in the trust are identifiable from the bank's deposit account records or from the trustee's records; and
- Each beneficiary's interest in a non-contingent interest, meaning there are no conditions that the beneficiary would need to meet before receiving their allocation of assets under the terms of the trust. A contingent interest would include distributions limited to "health, education, maintenance, and support."

In all four (4) requirements are satisfied, then the interests of a beneficiary in all deposit accounts under an irrevocable trust established by the same settlor and held at the same banking institution are added together and insured up to $250,000. For example, Jane and Jon Doe establish the Doe Irrevocable Trust. The trust provides that following the death of the surviving settlor, the trustee shall distribute the trust estate to Sam and Tom Doe, outright, in equal shares. In this example, if the financial institution failed while both settlors are alive, the FDIC coverage would be $1,000,000 ($250,000 per beneficiary X 2 beneficiaries X 2 owners = $1,000,000).

In the alternative, if a beneficiary of the irrevocable trust has a contingent interest, then the FDIC coverage is limited to $250,000, regardless of how many non-contingent beneficiaries the irrevocable trust has. For example, Jane Doe is recently deceased. The trust provides that Jane's husband, Jon Doe, shall receive distributions for Jon's health, education, maintenance, and support during his lifetime, and following his death, the balance of the trust estate shall be distributed to Sam and Tom Doe, outright, in equal shares. Because Jon Doe has a contingent interest in the irrevocable trust, the FDIC coverage limit is $250,000, despite Sam and Tom having non-contingent interests in the irrevocable trusts. Most irrevocable trusts limit distributions to the discretion of the trustee. Therefore, must irrevocable trusts are limited to $250,000 in FDIC coverage.

If you have any additional questions or comments related to FDIC coverage and your estate plan, please do not hesitate to contact our office.

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