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How to up FDIC coverage of a trust account

The estate-planning process provides a unique opportunity for clients to review their investment portfolios and consolidate their asset holdings.

Tony, a retired banker, refused to work with an adviser and maintained meticulous spreadsheets of more than a dozen cash accounts to maximize his Federal Deposit Insurance Corp. coverage. Tony's wife rolled her eyes and confirmed that he spent hours each month reviewing the paper statements.

In funding his living trust, I suggested he consolidate some of his cash accounts, improve his golf game, help save the environment and get increased FDIC coverage.

While many clients understand that a revocable living trust can help leverage estate tax exemptions, avoid probate and provide asset protection, they are surprised to learn that a trust account can also qualify for greater FDIC coverage. At the height of the 2008 financial crisis, the FDIC quickly enacted several interim rules to protect deposits held in trust accounts, later codified in October 2009.

Although this is not "new news," many clients and advisers have recently inquired regarding FDIC insurance for trust accounts and have been pleasantly surprised to learn that while an individual account may qualify for FDIC coverage up to $250,000, a trust account may qualify for coverage up to $1.25 million, or even more.

Revocable trusts

The FDIC recognizes two categories of revocable trust accounts: formal and informal. Formal trust accounts are typically established pursuant to written trust agreements, such as a revocable living trust, whereas informal trust accounts are payable-on-death accounts or other accounts established with language such as "in-trust-for" or "as-trustee-for."

The 2009 rules eliminate the kinship provision, which required each beneficiary to be related to the trust owner as a parent, sibling, spouse, child or grandchild in order for the trust account to be eligible for FDIC insurance coverage. Coverage is now based on the existence of any beneficiary named in the trust, as long as the beneficiary is an individual, a charity or a nonprofit organization.

The new rules for revocable trust accounts differ depending on the number of beneficiaries named in the trust.

- Five or fewer unique beneficiaries — trust deposits are insured up to $250,000 for each beneficiary regardless of the dollar amount or percentage allotted to each beneficiary. Maximum deposit insurance coverage for each trust owner is determined by multiplying $250,000 times the number of beneficiaries. For example, a trust account that names four beneficiaries (perhaps a spouse and three children) is insured for $1 million (4 x $250,000), even if the trust agreement allocates more than $250,000 to a particular beneficiary and less to other beneficiaries;
- Six or more unique beneficiaries with equal interests (each beneficiary receives the exact same amount) is calculated the same as for revocable trusts that name five or fewer beneficiaries. Maximum deposit insurance coverage for each trust owner is determined by multiplying $250,000 times the number of beneficiaries. For example, a trust account that allocates equal shares to eight beneficiaries is entitled to maximum insurance coverage of $2 million (8 x $250,000); and
- Six or more unique beneficiaries with unequal interests — each trust owner's share of the account is generally insured for the total of the beneficiaries' actual interest in the account (not to exceed $250,000 per beneficiary) or $1.5 million, whichever is greater. Where there are six or more beneficiaries, the rules have been interpreted to require specifically named beneficiaries to have ascertainable interests in order to obtain the maximum coverage. In other words, a beneficiary will be "counted" for purposes of FDIC coverage if his interest is determinable, ignoring any contingencies, such as the exercise of a testamentary limited power of appointment.

Irrevocable trusts

Irrevocable trust accounts are insured by the FDIC for up to $250,000 per beneficiary, so long as such beneficiaries' interests are noncontingent.

A noncontingent interest means a beneficiary must be entitled to receive assets from the trust regardless of whether certain conditions are satisfied.

It is important to note that the $250,000 coverage per beneficiary applies regardless of the number of beneficiaries, unlike the revocable trust rules where naming six or more beneficiaries may change the FDIC coverage of the account.

Revocable trusts become "irrevocable" upon death and present a unique opportunity to provide asset protection for beneficiaries. The biggest change to FDIC insurance coverage for irrevocable trust accounts is that where a revocable trust becomes irrevocable, such as upon the death of the grantor, the trust will continue to be treated as a revocable trust for FDIC insurance coverage purposes.

Previously, once a revocable trust became irrevocable (up to the death of the grantor), the funds in the irrevocable trust were insured under the FDIC's rules for irrevocable trusts and, as a result, insurance coverage on the account often decreased from what it had been while the trust was insured under the revocable trust rules.

Today, Tony has greater FDIC coverage, fewer paper cuts and is a scratch golfer.

Note: A special thanks to Chuhak & Tecson P.C. law clerk Kathryn Kaler for her contribution to this month's column.

THE BUZZ

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