The Wealth Counselor

A monthly newsletter for wealth planning professionals

New FDIC Insurance Rules and Limits: Are Your Clients Fully Protected?

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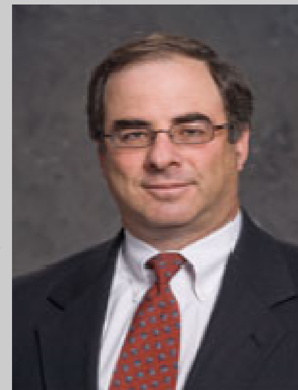

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With the rash of bank failures, your clients are likely wondering whether - and to what extent - the FDIC (Federal Deposit Insurance Corporation) insures their bank accounts. A new law increases some coverages, and new rules from the FDIC clarify how depositors can ensure maximum FDIC insurance coverage, but your clients may need to modify their planning slightly to take full advantage of these new rules.

FDIC

The FDIC is an independent federal agency that ensures the availability of deposited funds after a participating bank's failure. Created in 1933 after a run on banks left many account owners penniless, the FDIC promotes public confidence and stability in the nation's banking system by insuring deposits at participating institutions. Some institutions do not participate and may offer higher interest rates on deposits because they do not have to pay the FDIC insurance premiums.

Planning Tip: When created, the FDIC was just for U.S. banks. Since 1989, it has also insured participating savings associations located in the United States.

Before October 3, 2008, the FDIC insured up to $100,000 for each account beneficiary. ***However, part of the Emergency Economic Stabilization Act of 2008 signed that day temporarily increased the FDIC insurance coverage to $250,000 per beneficiary. The temporary increase lasts until the end of 2009, except in the case of certain retirement accounts, including IRAs, for which the increase is permanent.***

Planning Tip: FDIC insurance covers checking accounts, savings accounts, money market deposit accounts (but not money market *mutual funds*), certificates of deposit, and

certain retirement accounts at participating institutions.

Planning Tip: FDIC insurance does not cover investments in stocks, bonds, mutual funds, life insurance policies, annuities, or municipal securities, even if bought from an FDIC-insured institution. The FDIC also does not insure U.S. Treasury bills, bonds, or notes. The U.S. government itself backs those investments.

New Coverage for Money Market Mutual Funds
FDIC insurance does not cover money market mutual funds. However, the United States Treasury Department has created an optional temporary guarantee program for both taxable and tax-exempt money market mutual funds. For participating money market mutual funds, it is is effective from September 19, 2008, through September 18, 2009.

New Rules for Non-Interest-Bearing Accounts
Beginning October 14, 2008, FDIC insurance temporarily covers all non-interest-bearing deposit accounts ***for the entire amount of the account***. These are mainly payment-processing accounts, such as payroll accounts used by businesses, but is not limited to them, and includes all personal and business deposit accounts that do not earn interest. This temporary increase is optional for each bank. ***The increased coverage ends November 13, 2008, for accounts at those banks that opt out and December 31, 2009, for banks that do not.***

New Interim Rules for Revocable Trusts
On September 26, 2008, the FDIC issued an interim regulation (effective until November 29, 2008) that simplifies the rules for determining the insurance coverage available on revocable trust accounts. Under the new rules, clients can protect up to $250,000 for each revocable trust "beneficiary" under certain circumstances. A "beneficiary" is a non-owner that is a natural person or a charity or other non-profit organization.

Planning Tip: Although further changes can be made, the FDIC is anticipating that the new rules will become permanent. What is presented here makes the same assumption and adjusts all coverage calculations for the increase of the Standard Maximum Deposit Insurance Amount ("SMDIA") from $100,000 to $250,000 in the October 3, 2008, Emergency Economic Stabilization Act. The SMDIA is subject to inflation adjustment.

Planning Tip: The FDIC treats payable-on-death (POD), "Totten trust," or "in trust for" (ITF) accounts as "informal" revocable trust accounts. "Formal" revocable trusts are revocable living trusts created for estate planning purposes. The FDIC will aggregate all of the clients' revocable trust accounts, formal and informal, at the same institution for purposes of FDIC insurance coverage.

Under the revised rules, the insurance limit will be the greater of (a) $1,250,000; or (b) the sum of all the named beneficiaries' proportional interest in the trusts, limited to $250,000 per different beneficiary. The "qualified beneficiary" determination requirements adopted in 2004 are no longer applicable.

Here are some other wrinkles:

- In determining coverage for living trust accounts, a life estate interest is valued at $250,000.
- Irrevocable trusts that spring from a revocable trust upon the death of the revocable trust owner will continue to be insured under the revocable trust rules.
- If an account is made POD to a revocable trust, the FDIC will consider the trust beneficiaries to be beneficiaries of the POD account.
- For joint revocable trust accounts, the numbers are doubled because the calculations are per owner per beneficiary.

What Beneficiaries Count for Revocable Trust Coverage?
What if a trust names both primary and contingent or alternative beneficiaries? The new FDIC rules also tell us that the contingent beneficiaries generally do not have an interest in a revocable trust for FDIC-insurance purposes while the primary named beneficiary is living.

However, there is an exception to this general rule if the primary beneficiary has a "life estate," which the FDIC regulations define as the right to receive income, or some or all of the trust principal, during the primary beneficiary's lifetime. With this type of trust, the FDIC counts both primary and contingent beneficiaries for purposes of determining FDIC coverage.

Planning Tip: If the trust's primary beneficiary (typically a surviving spouse) has a life estate, the FDIC will count both the primary beneficiary and the subsequent beneficiaries for purposes of the $250,000 per beneficiary insurance. The FDIC defines a life estate as the right to receive trust income or principal during the beneficiary's lifetime.

Example:
Husband has an individual living trust that gives wife a life estate interest in the trust, with the remainder going to their two children equally upon wife's death. In this example, the FDIC's insurance rules recognize the wife and the two children as beneficiaries. Since there is one trust owner who has three beneficiaries, husband's revocable trust account at an FDIC-insured bank is protected up to $750,000.

Revocable Trusts with More than $1.25 Million or Five Beneficiaries
What if the client's individual revocable trust account has more than $1,250,000 or more than five different beneficiaries? Under these circumstances, the FDIC will insure the ***greater*** of either: $1,250,000 or the aggregate amount of all the beneficiaries' interests in the trust(s), limited to $250,000 per beneficiary. For example, suppose your client's revocable living trust names eight beneficiaries equally. If your client's FDIC-insured bank fails when the client has $2,500,000 in this trust account, the FDIC will insure $2,000,000 (1 x 8 x $250,000). What if instead your client had $1,000,000 in a revocable

trust account and three named beneficiaries in equal shares, plus one beneficiary in the amount of $25,000? In this instance, the FDIC will insure only $775,000 [$25,000 + (1 x 3 x $250,000)].

Joint Revocable Trusts
For married clients who have a deposit account in the name of a joint revocable trust, both spouses have $250,000 FDIC insurance per qualifying beneficiary. Here's an example:

Couple's joint living trust gives the survivor a life estate interest in the trust, with the remainder going to their two children equally upon the survivor's death. In this example, the FDIC's insurance rules recognize the survivor and the two children as beneficiaries. Since there are two trust owners, each of whom has three beneficiaries, the joint revocable trust account(s) at an FDIC-insured bank are protected up to $1,500,000 (2 owners x 3 beneficiaries per owner x $250,000 per beneficiary).

Planning Tip: If the owners of a joint revocable trust account are themselves the sole beneficiaries of the trust, both spouses are eligible for up to $250,000 of FDIC insurance. The FDIC treats this arrangement as a joint account (discussed below).

Multiple Account Types at One FDIC-Insured Institution
In addition to the FDIC-coverage for revocable trusts outlined above, clients may also be eligible for up to $250,000 of deposit insurance coverage for each of the following types of accounts at any one FDIC-insured institution:

Single accounts. This includes accounts in an individual's name alone and accounts in the name of a sole proprietor business (for example, "DBA accounts").

Certain retirement accounts. This includes:

- All types of IRAs (traditional, Roth, SEP IRAs and SIMPLE IRAs);
- All Section 457 deferred compensation plan accounts;
- Self-directed defined contribution plan accounts (such as self-directed 401(k)s, self-directed SIMPLE 401(k)s, self-directed defined contribution money purchase plans, and self-directed defined contribution profit-sharing plans) and;
- For joint revocable trust accounts, the numbers are doubled because the calculations are per owner per beneficiary.
- Self-directed Keogh plan accounts (or H.R. 10 plan accounts) designed for self-employed individuals.

Planning Tip: The FDIC aggregates all qualifying retirement accounts owned by the same person in the same FDIC-insured bank and insures the total up to $250,000.

Joint accounts, or deposits owned by two or more people. To qualify, the joint account

owner must satisfy all three of the following conditions:

1. All co-owners must be people. Legal entities such as corporations, trusts, estates, or partnerships are not eligible for joint account coverage;
2. All co-owners must have equal rights to withdraw deposits from the account. For example, if one co-owner can withdraw deposits on his or her signature alone but the other co-owner can withdraw deposits only with the signature of both co-owners, the co-owners do not have equal withdrawal rights; and
3. All co-owners must sign the deposit account signature card unless the account is a CD or is established by an agent, nominee, guardian, custodian, executor or conservator.

Planning Tip: With joint accounts, the FDIC aggregates each co-owner's share of every account that is jointly held at the same insured bank by that co-owner and insure each co-owner for up to a total of $250,000.

Irrevocable Trust Accounts. The interests of a beneficiary in all deposit accounts established by the same trust maker and held at the same insured bank under an irrevocable trust are added together and insured up to $250,000, but only if the beneficiary meets all of the following conditions:

1. The insured bank's deposit account records must disclose the existence of the trust relationship.
2. The beneficiaries and their interests in the trust must be identifiable from the bank's deposit account records or from the trustee's records.
3. The amount of each beneficiary's interest must not be contingent as defined by FDIC regulations.
4. The trust must be valid under state law.

Alternatively, if the trust maker retains an interest in the trust, the FDIC will add the amount of the trust maker's retained interest to any single accounts owned by him or her at the same bank and insure the total up to $250,000.

Planning Tip: The rules for revocable trusts apply to trusts that were revocable but that have become irrevocable because of the death of the trust maker.

Employee benefit plan accounts. The FDIC insures up to $250,000 for each participant's non-contingent interest in an employee benefit plan.

Corporation/Partnership/Unincorporated Association Accounts. The FDIC includes for-profit and not-for-profit organizations under the same ownership category and will insure deposits owned by a corporation, partnership, or unincorporated association up to $250,000 at a single bank. The FDIC insures these separately from the personal accounts of the entity's stockholders, partners, or members.

New Rules for Certain Unsecured Bank Debt

Beginning October 14, 2008, FDIC insurance covers certain newly issued senior unsecured debt issued by a member bank on or before June 30, 2009, in the event the issuing bank subsequently fails or its holding company files for bankruptcy. This includes promissory notes, commercial paper, inter-bank funding, and any unsecured portion of secured debt. Coverage would be limited to June 30, 2012, even if the maturity exceeds that date.

Worst-Case Scenario

Bank failures at a rate similar to the Great Depression is unlikely. However, if there are significant bank failures, the FDIC may not have the liquidity to immediately pay out all FDIC-insured claims. According to the FDIC website (at fdic.gov), the FDIC directly supervises about 5,250 banks and thrifts, more than half of the institutions in the U.S. banking system. The FDIC insurance fund totals approximately $49 billion, which insures more than $3 trillion of deposits in insured U.S. banks and thrifts.

Planning Tip: The FDIC insures deposits with each FDIC-insured bank separately from deposits at a different FDIC-insured bank. Therefore, clients should consider holding different accounts at separate FDIC-insured institutions to ensure the availability of FDIC insurance for all of their accounts. Inter-bank programs are available to assist depositors in spreading their assets to achieve complete coverage by FDIC insurance.

Conclusion

If clients' FDIC-insured bank accounts have significant value they may be covered up to $250,000 per beneficiary, per account type, at each FDIC-insured institution. By discussing these limits and rules with clients, the planning team can help allay client concerns while helping to ensure that clients have maximum coverage for all their accounts, including revocable trust accounts, in the event of a bank failure.

To comply with the U.S. Treasury regulations, we must inform you that (i) any U.S. federal tax advice contained in this newsletter was not intended or written to be used, and cannot be used, by any person for the purpose of avoiding U.S. federal tax penalties that may be imposed on such person and (ii) each taxpayer should seek advice from their tax advisor based on the taxpayer's particular circumstances.

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