The Wealth Advisor

New FDIC Rules: Are You Protected?

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With the rash of bank failures, you may wonder whether - and to what extent - the FDIC (Federal Deposit Insurance Corporation) will protect your bank accounts. Fortunately, new rules from the FDIC clarify how you can ensure maximum FDIC insurance coverage. You may need to modify your planning slightly to take advantage of these new rules.

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FDIC

The FDIC is an independent federal agency that ensures the availability of deposited funds after a bank 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 your deposits at any FDIC-insured institution.

Planning Tip: FDIC-insured institutions include most banks and savings associations located in the United States. It does not include brokerage firms.

Until very recently, the FDIC insured up to $100,000 for each account beneficiary. Beginning October 3, 2008, the FDIC temporarily increased coverage to $250,000 per beneficiary.

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.

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

Planning Tip: FDIC insurance also does not cover money market mutual funds. However, the United States Treasury Department recently created a temporary guarantee program for money market mutual funds that is effective for one year beginning September 19, 2008.

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. This includes personal and business checking accounts that do not earn interest.

New Rules for Revocable Trusts
The FDIC recently issued rules that clarify the insurance limits when the account is in the name of a revocable trust. This clarification confirms that you can protect up to $250,000 for each revocable trust beneficiary under certain circumstances.

As you may know, a revocable living trust (also known as a living trust or inter vivos trust) is a trust that you create during your lifetime to control your property during any disability and at death. As a result, revocable living trusts typically name as beneficiaries the maker of the trust, plus a spouse, children and grandchildren, if any. Revocable trusts also often name siblings, parents, and other relatives and friends as beneficiaries, as well as charities.

Under the new FDIC rules, a trust account owner with up to five different beneficiaries named in all of his or her revocable trust accounts at one FDIC-insured institution will have FDIC insurance up to $250,000 per beneficiary. In other words, if your revocable trust(s) names five beneficiaries, the FDIC will insure up to $1,250,000 at any one FDIC-insured bank.

What Beneficiaries Count for Revocable Trust Coverage?
If you create your own individual revocable trust (other than a joint revocable trust), the FDIC rules tell us that you are not a beneficiary of this trust for FDIC purposes. What if your trust names a primary beneficiary (one who takes before the contingent or alternative trust beneficiaries)? The FDIC rules also tell us that the contingent beneficiaries generally do not have an interest in a revocable trust for FDIC purposes while the primary beneficiary is living.

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

Example:
Husband has a 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 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 5 Beneficiaries
What if your 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 revocable living trust names eight beneficiaries equally. If your FDIC-insured bank fails when you have $2,500,000 in this trust

account, the FDIC will insure $2,000,000. What if instead you had $1,500,000 in your 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 - three beneficiaries insured at $250,000 each, plus one at $25,000.

Joint Revocable Living Trusts
If you have an account for a joint revocable trust, you and your spouse both have $250,000 FDIC insurance per qualifying beneficiary. In other words, a joint trust with three named beneficiaries will have $1,500,000 of FDIC coverage (both spouses have $750,000 of FDIC insurance--$250,000 each for three beneficiaries).

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, you 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, self-directed 401(k)s, and self-directed Keogh plan accounts (or H.R. 10 plan accounts) designed for self-employed individuals.

Planning Tip: The FDIC adds 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. These are deposits owned by two or more people (businesses and other legal entities do not count for this purpose).

Planning Tip: With joint accounts, the FDIC will add together each of the co-owner's share of every account that is jointly held at the same insured bank with the co-owner's other shares, and insure up to $250,000.

Irrevocable Trust Accounts. The interests of a beneficiary in all irrevocable trust accounts established by you and held at the same insured bank are added together and insured up to $250,000.

Alternatively, if you as the trust maker retain any interest in the trust, the FDIC will add the amount of your retained interest to any single accounts you own 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 account.

Corporation/Partnership/Unincorporated Association Accounts. The FDIC insures accounts owned by a corporation, partnership, or unincorporated association up to $250,000 at a single bank. This includes for-profit and not-for-profit organizations under the same ownership category. This FDIC insurance is separate from your personal accounts if you are one of the entity's stockholders, partners, or members.

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: Since the FDIC insures deposits with each FDIC-insured bank separately from deposits at a different insured bank, consider holding different accounts at separate FDIC-insured institutions to ensure the availability of FDIC insurance for all of your bank accounts.

Conclusion
If your 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 your situation with your planning team, you can ensure that you have maximum coverage for all your accounts, including your revocable trust account, in the event any of your banks fail.

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