Family Office Insights

Upcoming Changes to FDIC Deposit Insurance for Accounts Owned by Trusts

The Federal Deposit Insurance Corporation (FDIC) has announced that it will be changing the way it insures deposits in accounts owned by trusts. The new rules will take effect on April 1, 2024. Here is what Family Offices need to know.

The FDIC will be simplifying how it categorizes different types of trusts. This will make it easier to determine how much deposit insurance coverage each account has, but may impact the amount of that coverage for certain depositors that are trusts. In attempting to streamline how it categorizes trusts as depositors, the FDIC has two stated goals – to make it easier for the FDIC, banks and consumers to determine how much insurance coverage a trust's account has, and to allow the FDIC to pay out deposit insurance to trusts when insured depository institutions fail. The recent collapses of Silicon Valley Bank, Silvergate Bank and Signature Bank make it more important than ever for family offices to understand how much of the money in trust accounts is protected by federal deposit insurance.

Prior to the issuance of the new rules, the FDIC has insured funds deposited by trusts differently, depending on whether the depositor was an "informal revocable trust", a "formal revocable trust" or an "irrevocable trust". The current process to calculate the coverage for each of these is different and sometimes complex, making it difficult to understand how much of the funds on deposit were covered by insurance. To end this confusion, the FDIC will be combining the three categories into one: "trust accounts".

What the new rules say:

Deposits in accounts owned by trusts with the same grantor maintained at the same insured depositary institution (IDI) will be insured up to $250,000 for each named beneficiary of the trust or trusts, up to a maximum of five named beneficiaries per trust and with each beneficiary's interests in all such trusts counted together for purposes of the US$250,000 limit. This means, for example, that there will be an effective limit to deposit insurance for "trust accounts" with the same five beneficiaries of $1,250,000. Additionally, since revocable and irrevocable trusts will be treated identically for deposit insurance purposes, they will be considered together when applying the deposit coverage limit. This means that funds on deposit by revocable and irrevocable trusts at the same financial institution will be aggregated together for the purpose of calculating the deposit insurance limit if they have the same grantor and common beneficiaries.

Another change is that the new rules will not provide coverage for trusts relating to the interests of beneficiaries who only receive an interest in the trust upon the death of one or more of the primary beneficiaries.

Consequences for Revocable Trusts

Under the FDIC's previous rules, if a revocable trust accountholder had five or fewer named beneficiaries, the account would be insured in an amount up to the total number of named beneficiaries multiplied by $250,000, without needing to consider the specific allocation of interests among the beneficiaries. If more than five beneficiaries are named, the account would be insured up to the greater of (a) $1,250,000 or (b) the total of the interests of each beneficiary (up to a maximum of $250,000 per beneficiary). As a result, under the new rules, revocable trusts with more than five named beneficiaries could lose some insurance coverage on their deposits. The new $1,250,000 cap may also result in reduced coverage for informal revocable trusts (such as POD accounts, ITF accounts and Totten trust accounts), formal revocable trusts (held under a written trust agreement) and irrevocable trusts that have the same grantor and common beneficiaries. Because trust accounts at the same IDI will be aggregated together, irrevocable trusts and revocable trusts (both formal and informal) with the same grantor at the same IDI will not have insurance on deposited funds above the amount of $250,000 per beneficiary, with no more than five beneficiaries taken into account for each such trust and with the $250,000 limit applied to the aggregate interests of a common beneficiary in all such trusts.

Consequences for Irrevocable Trusts

Under the current rules, the FDIC's deposit insurance coverage for irrevocable trusts is often limited to a total of $250,000, as coverage is dependent on whether or not beneficiaries' interests are "contingent". "Contingent" irrevocable trusts are trusts where a beneficiary's share is dependent on external factors. Examples of contingencies of this sort would include a trust in which the trustees have discretion to allocate funds among the beneficiaries, or a trust in which a beneficiary would not receive funds unless certain conditions are met, such as graduating college. By contrast, the value of non-contingent trust deposits is not influenced by extrinsic factors. Under the current FDIC regulations, non-contingent deposits are insured up to $250,000 for each non-contingent beneficiary. The value of beneficiaries' shares in contingent irrevocable trusts are aggregated, and therefore are capped for deposit insurance purposes at $250,000, regardless of the number of beneficiaries the trust has.

The new rules may reduce coverage for interests in irrevocable trusts of beneficiaries that had been considered "non-contingent", but will increase coverage for some irrevocable trust accounts with "contingent" beneficiaries. The contingency of beneficiaries' interests in irrevocable trusts will no longer be relevant, so the number of all named beneficiaries will be considered, subject to the change that disregards the interest of a beneficiary that will arise only in the event of death of a primary beneficiary. This means that contingent trusts with more than one beneficiary and an account balance above $250,000 will see an increase in coverage. However, like revocable trusts, high value irrevocable trusts with non-contingent beneficiaries may lose coverage above the $1,250,000 cut off, since under the current rule there is no limit on the number of beneficiaries that could receive coverage and revocable trusts are counted separately.

Irrevocable trusts may also lose coverage if they do not have "eligible beneficiaries", as defined in the new rules. The previous rules limited eligible beneficiaries for revocable trusts to natural persons, charitable organizations, and non-profit entities. Under the new rules, this eligibility definition will apply to irrevocable trusts as well, meaning that trusts with beneficiaries that do not fall within one of these categories may lose coverage.

Next Steps

The interplay between the deposit insurance rules and the details of trust structures can be complex, and this Insight can only provide a general summary. We recommend that family offices take this opportunity to review their trusts' deposit accounts at FDIC insured institutions to understand how these new regulations will impact deposit insurance coverage.

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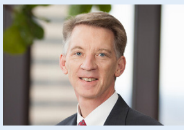

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