$250,000 FDIC Insurance Per Trust Beneficiary Makes Trusts Very Attractive

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There are good reasons and bad reasons for setting up a funded revocable living trust (RLT). Here is one of the better reasons: FDIC insurance has been increased and now covers each beneficiary's interest in an RLT up to $250,000 each. The legislation authorizing the increase in deposit insurance coverage limits makes the change effective October 3, 2008 through December 31, 2009.

The FDIC regulations address two types of “revocable trusts,” informal and formal. Informal revocable trusts are sometimes called “pay-on-death" (POD), "Totten trust," or "in trust for" (ITF) accounts. Usually these are created merely by the owner signing the bank’s signature card which contains the account agreement and naming one or more beneficiaries who are to review the account upon the owner's death. These accounts are fully revocable, meaning that the owner can withdraw any amount, close the accounts, or change the beneficiaries at any time.

A formal revocable trust, sometimes called a “living trust”, “revocable trust.” or “RLT”, is created by a legal document for estate planning purposes. The owner, sometimes called the “Settlor,” Grantor” or “Trustor” is the person who creates the trust and transfers assets to it. The owner may or may not be the trustee, but the owner has full control, being able to amend or revoke the trust at any time. When the owner dies, the trust generally becomes irrevocable and contains direction for how the trust assets should be held or distributed by the trustee to or for the benefit of beneficiaries.

The owner of an informal revocable trust is insured up to $250,000 for each beneficiary if all of the following requirements are met: 1) the account title must include a commonly accepted term such as "payable-on-death", "in trust for", "as trustee for" or similar language to indicate the existence of a trust relationship; 2) the beneficiaries must be identified by name in the deposit account records of the insured bank; and 3) a beneficiary must be a person, charity or another non-profit organization.

All deposits that an owner has in both informal and formal revocable trusts are added together for insurance purposes, and the insurance limit is applied to the combined total for that owner in the same bank.

While the owner of a so-called formal trust may benefit from the trust during his or her lifetime, the owner is not considered a beneficiary for the purpose of calculating deposit insurance coverage. Beneficiaries are those identified by the owner to receive an interest in the trust assets when the owner dies. Unlike POD accounts, the beneficiaries do not have to be identified by name in the deposit account records of the bank. But the account title at the bank has to show that the account is owned by the RLT.

For example, if the RLT holds $1 million in a bank account and provides that on the grantor's death, the trust is distributed in 1/4 shares to the grantor's four children, there is $1 million of FDIC insurance on the account.

Share size does not matter until the number of beneficiaries exceeds five. Consider a trust with five beneficiaries and $3,000,000 in assets. The trust is insured for five times $250,000 or $1,250,000, regardless of individual share size. Total trust insurance is $1,250,000.

Consider the same trust with six beneficiaries with one share getting ninety percent and the others getting one-twentieth each. One-twentieth shares are insured for $150,000 each, and the ninety percent share is insured for $250,000 for a total of $1,000,000 of insurance. However, for trusts with six or more beneficiaries, the coverage is the greater of $1,250,000 or the sum of the individual insurance amounts, so it has insurance coverage of $1,250,000.

Coverage is based on the interests of beneficiaries who would become entitled to receive trust assets when the trust owner dies. Any trust beneficiary who would have an interest in the trust assets only after another living beneficiary dies, in other words, a contingent beneficiary, is not counted for this purpose.

Some living trusts give a beneficiary the right to receive income from the trust or to use trust assets during the beneficiary's lifetime, and then other beneficiaries receive the remaining trust assets after the first beneficiary dies. In this case, all of the beneficiaries are recognized for determining insurance coverage.

The regulations give this example: A husband has a living trust giving his wife a life estate interest in the trust deposits, with the remainder going to their two children equally upon his wife's death. The husband's living trust would be insured up to $750,000. In this example, the FDIC’s insurance rules recognize the wife and two children as beneficiaries. Since there is one trust owner who has three beneficiaries, the husband's trust account at an insured bank would be insured up to $750,000.

Note: Irrevocable trusts are treated differently. If the trustee may invade principal so that a beneficiary’s share can be reduced, the full coverage will not be available. Deposit insurance for an irrevocable trust account is often limited to a total of $250,000.