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Estate Planning & Elder Law

Taking Advantage of FDIC Insurance Loopholes Could Impede Your Estate Plan

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After the banking crisis of 2008, many depositors became alarmed and more aware than they ever had been before regarding where they were depositing their money and how much of it was insured. The reality is that through the Federal Deposit Insurance Corporation ("FDIC"), which was established under the Banking Act of 1933, a single depositor is granted only $250,000 of principal and income insurance at each FDIC-nsured bank. However, this rule applies only to single depositor accounts and thus allows for several exceptions, so long as certain stipulations established by the FDIC are met. For example, revocable trusts are allocated $250,000 of insurance protection at each FDIC-insured bank, per named beneficiary, regardless of the number of grantors; each depositor is granted $250,000 of insurance coverage for their qualified retirement accounts held at each FDIC-insured bank (which is considered a separate allocation from the $250,000 total coverage otherwise offered to single depositors) and joint account holders are given $250,000 of insurance coverage, per joint owner, per FDIC-insured bank. Unfortunately, while some bankers might view these exceptions as solutions to the short-term problem of FDIC insurance, these exceptions could drastically alter an individual's estate plan, partially or in full, if exercised outside the guidance of an estate planning attorney.

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Imagine Mary Jones, a New Jersey resident and widow, who has two children, a son and a daughter. She has among her various assets three certificates of deposit ("CD") at an FDIC-insured bank, and each CD is valued at $100,000. As indicated above, since she is a single depositor with accounts solely in her name, she has $300,000 worth of CDs insured for only $250,000, thus leaving $50,000 of one of her CD's unsecured. However, as indicated, Mrs. Jones could alleviate this problem if she held one of her accounts in joint name with another individual, such as her daughter, since each joint owner is allocated $250,000 of insurance coverage at each FDIC-insured bank.

To illustrate an unintended negative side effect of adding her daughter's name to one account, imagine Mrs. Jones suddenly passes away. Just as with any jointly held account, the CD held jointly with her daughter will pass to her daughter outside of probate, despite Mrs. Jones' actual intent, which was contained in her will, and which was to treat both of her children equally. She has now unintentionally transferred a 100 percent interest in this single $100,000 CD to her daughter, which she held jointly solely for the purpose of obtaining increased FDIC insurance. As a result, her daughter is under no legal obligation to share the CD with her brother, and furthermore, could face potential gift taxing implications of her own if she did try to fulfill her mother's intentions and share it with her brother. To make a bad situation worse, even though the federal estate tax was repealed for only 2010, many states have maintained an estate tax, such as in New Jersey, where the exemption amount remains at $675,000. Assuming Mrs. Jones has an estate worth more than $675,000, there will be New Jersey estate tax owed, and if her will stipulates that the estate will bear the burden of all the estate tax due, including that due for assets passing outside of probate, the siblings will ultimately split the estate tax on the joint account passing in its entirety to the daughter. Now Mrs. Jones is not only unintentionally leaving less to her son by allowing this CD to pass outside of probate to her daughter, but her son is also forced to share the burden of the estate tax due on this account.

Alternatives

The financial institution that recommended Mrs. Jones hold an account in joint name with her daughter might anticipate this scenario in advance, and as an alternative, they might advise Mrs. Jones to hold one of the $100,000 CDs jointly with her daughter and one of them with her son. However, if Mrs. Jones takes this advice, her problems will almost certainly snowball, as the possibilities for disaster under this scenario are many. For example, if Mrs. Jones took this advice, she would need to remain conscious at all times never to cash in one of these CDs before the other, or to avoid allowing one to grow at a higher rate than the other. As another problematic example, if Mrs. Jones were ever incapacitated and had an attorney-in-fact managing her financial affairs, the attorney-in-fact might have no knowledge of this arrangement, or forget about the arrangement, and consequently begin making financial decisions that ultimately destroy the arrangement. At the end of the day, if either of these accounts alter in value while Mrs. Jones is still alive, and the alteration is not corrected before she passes away, she will find herself in a similar predicament as when she held only one CD jointly with her daughter.

To avoid the problems that will almost certainly result from holding accounts jointly for the purpose of obtaining increased FDIC insurance, Mrs. Jones can simply spread her money amongst multiple financial institutions. Since each depositor is insured for up to $250,000 at each institution, Mrs. Jones can take $250,000 to Bank A and $50,000 to Bank B, and successfully insure her entire $300,000 without having to hold accounts jointly with anybody.

However, if Mrs. Jones doesn't have the time or resources available to travel to more than one bank, or prefers to do business exclusively with Bank A, the Certificate of Deposit Account Registry Service ("CDARS") might offer Mrs. Jones the insurance protection she requires, without having to transfer her investments into joint name. With CDARS, so long as the financial institution with which an individual is investing is a CDARS participant, an individual can insure as much as $50,000,000 (yes, million) in CDs at any one bank. To illustrate how this program works, let's consider Mrs. Jones' $300,000 and assume she takes it all to Bank A and informs the banker she wants to invest exclusively in CDs. The first $250,000 can be invested in CDs at Bank A, with no concern of lacking insurance. However, as previously explained, the remaining $50,000 is left uninsured. Through CDARS, the Promontory Interfinancial Network, which acts as a middle man, selects another CDARS participating institution in which to invest Mrs. Jones' $50,000 CD. Mrs. Jones only does business with Bank A, which is how it appears on paper, but in reality, $50,000 of her CDs are invested (and insured) at Bank B. Furthermore, there are no service fees for CDARS, however, depositors often pay the price for this service in the form of receiving a lower interest rate on the portion being invested by CDARS, since CDARS is a private for-profit organization.

To avoid the inconvenience of investing with multiple banks, and the lower interest rates that accompany CDARS, another possible solution is for Mrs. Jones to contact her estate planning attorney and amend her estate plan. A codicil to her will stating that any accounts held in joint name are titled jointly for convenience only may alleviate these problems upon her passing. Under this scenario, Mrs. Jones could add her daughter's name to one of her CDs as a joint account holder to ensure the expanded FDIC insurance coverage of her deposits at Bank A, while the codicil to her will should ensure that upon her passing, any of the assets held jointly with her daughter will still pass to her daughter as an operation of law, but can be offset against other assets in the estate. Of course, if it turns out that the daughter has ill will towards her brother, or is just plain greedy, she can still attempt to assert her unfettered right to these assets. Hence, different solutions might be appropriate for different families, and Mrs. Jones would be in the best position to pick the most appropriate solution to her FDIC insurance quandary after discussing all possibilities with her estate planning attorney.

Regardless of whether Mrs. Jones chooses to pursue implementing a codicil, or is instead tempted to take the advice provided by her banker, only her estate planning attorney can assure her that her decision is sound based upon the factors that comprise her particular scenario. Since the law often gets in the way of a decedent's actual intent, conferring with her estate planning attorney before making any alterations to the titles in which her accounts are held is the best way Mrs. Jones can prevent her children from facing unexpected frustration, taxes and legal fees upon her passing, and most importantly, is the only way to ensure her estate plan is executed as she intended it to be. ■