December 17, 2003

Donna Howard, Branch Services Supervisor
Deer Valley Credit Union
16215 North 28th Avenue
Phoenix, AZ 85053-3040

Re: Insurance Coverage for Revocable Trust Account.

Dear Ms. Howard:

Regional Director Jane Walters has asked us to respond to your letter concerning insurance coverage for a particular, revocable trust account established by one of your members in connection with a living trust. Although we usually do not address insurance coverage of particular accounts in writing, your inquiry raises questions that may be of interest to other credit unions and we think this guidance may be helpful to them as well. Our view is that the burden is on members who establish living trusts, not credit unions, to consult with their own private counsel regarding the legal and regulatory sufficiency of a trust so that it will qualify for insurance.

You have asked about the extent of insurance coverage for funds held in connection with living trusts, which are insured under the revocable trust provisions in our share insurance regulation. 12 C.F.R. §745.4(e). We conclude that the trust in this case has a defeating contingency affecting the interest of two of the beneficiaries and, therefore, the interests of those beneficiaries do not qualify for separate insurance. Shares in the account attributable to those interests are added together with any shares in any individual accounts owned by the Settlor and insured up to $100,000.

Your member, to whom we will refer as the Settlor, has established an account under the terms of a living trust. The trust document specifies that the Settlor, who is also the initial trustee, retains control over the entire balance in the account during his lifetime, with funds going to identified beneficiaries on his death. The trust is revocable during the lifetime of the Settlor. The trust provides that, when the Settlor dies, his son and his brother are each to receive $1,000 if they survive the Settlor. The balance is then paid 10% to the Settlor's daughter, if she survives the Settlor, and the remaining 90% is held in trust for the Settlor's wife until her death, at which time the balance is paid to the daughter. The condition that a beneficiary must survive the Settlor is not a defeating contingency. This trust, however, also provides that "[n]otwithstanding anything contained herein to the contrary," if the wife dies before or at the same time as the Settlor, the "entire" trust will be distributed to the daughter. There is a parallel provision stating that, if the daughter dies before or at the same time as the Settlor, the wife will receive the "entire" trust.

Insurance coverage for living trusts is in the section of our insurance rule governing revocable trusts, which include other types of trust accounts that evidence an intent that any balance remaining in the account on the death of the owner be distributed to identified beneficiaries. 12 C.F.R. §745.4. Because there is a separate, living trust document, a two-step analysis is required to determine the extent of insurance coverage. The first issue concerns the relationship between the Settlor and the designated beneficiaries. As with any revocable trust account, the beneficiary must be the spouse, child, grandchild, parent or sibling of the settlor to qualify for separate insurance coverage. 12 C.F.R. §745.4(e). All of the beneficiaries meet this first test. Second, the regulation requires that, to qualify for insurance, the terms of the living trust must not subject the beneficiary's interest to a "defeating contingency." Id. The rule defines a defeating contingency as "a condition that would prevent the beneficiary from acquiring a vested and non-contingent interest in the funds in the share account upon the owner’s death.” Id. Put simply, the trust cannot have a provision or condition that, if it occurs, would mean that the beneficiary will not receive his or her interest.

The living trust document specifies that the interests of the Settlor’s son and his brother are both subject to complete divestiture if either the Settlor’s wife or his daughter dies before he does. Since the interests of the son and the brother are contingent on both the wife and the daughter being alive at the time of the Settlor’s death, their interests are subject to a “defeating contingency” within the meaning of the rule. Accordingly, the interests of the son and the brother are not eligible for separate insurance, and would, instead, be added to any other individual accounts maintained by the Settlor and insured to a maximum of $100,000. 12 C.F.R. §745.4(b) and (e).

By contrast, the interests of the Settlor’s spouse and daughter are not subject to any contingencies, and are, therefore, both eligible for separate insurance, up to $100,000, separate from any individual accounts owned by either of them or by the Settlor. Id.

We note that the amount of the spouse’s and daughter’s interests will differ, depending upon whether the other is alive at the time of the Settlor’s death. This difference, however, only affects the amount, and does not defeat either’s right to receive funds. Their interests are not subject to a defeating contingency within the meaning of the rule.

We also note that, even if the interests of the son and the brother of the Settlor were not subject to defeating contingencies, the amount of separate insurance available would have been limited to the amount of their interest specified in the trust. This is because the terms of the trust provide for a specific dollar amount to be distributed to them. Even though each exhibits the degree of kinship to the Settlor required to support separate insurance, up to a maximum of $100,000, the fact that each one’s interest is only $1,000 would have limited the available insurance to that amount.

The result in this case, based on the information you provided about the accounts the Settlor holds, is that the living trust has $200,000 of insurance coverage, leaving approximately $65,000 uninsured. It appears, however, that, because the Settlor only has about $23,000 in his other individually owned accounts, the uninsured portion from the living trust would have coverage under the $100,000 available in the aggregate for all individual accounts.

Finally, we note that NCUA provides the same account insurance coverage for accounts created under living trust arrangements as that provided by the Federal Deposit Insurance Corporation. While living trust arrangements are increasingly popular among persons seeking an alternative to passing funds through probate, members who select this approach must ensure that they do not inadvertently include a defeating contingency in a trust agreement that would undermine the account’s qualifying for separate insurance. We recommend that members seek the advice of their own legal or financial planning advisers before establishing an account based on a living trust. For further information regarding the insurance coverage of living trusts, you may find it helpful to review OGC opinion letter 00-0943 (Dec. 5, 2000) and OGC opinion letter 99-0208 (April 6, 1999) available on the NCUA website.

Sincerely,

Sheila A. Albin
Associate General Counsel

OGC/RPK:bhs

03-0947
cc: Region V