FDIC
Federal Deposit Insurance Corporation

July 20, 2021

MEMORANDUM TO: The Board of Directors

FROM: Bret Edwards
Deputy to the Chairman and Chief Financial Officer

Art Murton
Deputy to the Chairman for Financial Stability

SUBJECT: Notice of Proposed Rulemaking Regarding Deposit Insurance Simplification

RECOMMENDATION

Staff recommends that the Board of Directors (Board) approve the attached Notice of Proposed Rulemaking (NPR) and authorize its publication in the *Federal Register* for a 60-day comment period. The NPR proposes amendments to the FDIC's deposit insurance regulations that would: (1) simplify the coverage rules for deposits held in connection with revocable and irrevocable trusts; and (2) provide consistent deposit insurance treatment for all mortgage servicing account deposit balances held to satisfy principal and interest obligations to a lender.

I. Simplification of the Rules for Trust Deposits

Background

The Federal Deposit Insurance Act (FDI Act) establishes the key parameters of deposit insurance coverage, including the standard maximum deposit insurance amount (SMDIA), currently $250,000. In addition to providing deposit insurance coverage up to the $250,000 limit at each insured depository institution (IDI) where a depositor maintains deposits, the FDI Act also provides separate insurance coverage for deposits that a depositor maintains in different rights and capacities (also known as insurance categories) at the same IDI. Some of the deposit insurance categories are defined by statute, while others are defined through regulations issued by the FDIC. The FDIC currently recognizes three different insurance categories for deposits held in connection with trusts: (1) revocable trusts; (2) irrevocable trusts; and (3) irrevocable trusts with an IDI as trustee.

Revocable Trust Deposits

The revocable trust category applies to deposits for which the depositor has evidenced an intention that the deposit shall belong to one or more beneficiaries upon his or her death. This

Concur:

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General Counsel

category includes deposits held in connection with formal revocable trusts – that is, revocable trusts established through a written trust agreement. It also includes deposits that are not subject to a formal trust agreement, where the IDI makes payment to the beneficiaries identified in the IDI's records upon the depositor's death based on account titling and applicable state law. The FDIC refers to these types of deposits, including payable-on-death accounts and similar accounts, as "informal revocable trusts." Deposits associated with formal and informal revocable trusts are aggregated for purposes of the deposit insurance rules.

The calculation of deposit insurance coverage for revocable trust deposits depends upon the number of unique beneficiaries named by a depositor. If five or fewer beneficiaries have been named, the depositor is insured in an amount up to the total number of named beneficiaries multiplied by $250,000, and the specific allocation of interests among the beneficiaries is not considered.[1] If more than five beneficiaries have been named, the depositor is insured up to the greater of: (1) $1,250,000; or (2) the total of the interests of each beneficiary, with each such interest limited to $250,000.[2]

Irrevocable Trust Deposits

Deposits held by an irrevocable trust that has been established either by written agreement or by statute are insured under the irrevocable trust deposit insurance category. Calculating coverage for deposits insured in this category requires a determination of whether beneficiaries' interests in the trust are contingent or non-contingent. Funds held for non-contingent trust interests are insured up to $250,000 for each beneficiary, while funds held for contingent trust interests are aggregated and insured up to $250,000 in total.[3]

Deposits Held by an IDI as Trustee of an Irrevocable Trust

The FDI Act establishes separate insurance coverage for deposits held by an IDI in its capacity as trustee of an irrevocable trust. The FDIC's regulations relating to such trusts are found at 12 CFR 330.12. Given the statutory basis for coverage, the FDIC is not proposing any changes to these rules.

Need for Rulemaking

The trust rules often require detailed, time-consuming, and resource-intensive review of trust documentation to obtain the information necessary to calculate deposit insurance coverage. This information is often not found in an IDI's records and must be obtained from depositors after an IDI's failure. For example, insurance determinations for depositors of IndyMac Bank, F.S.B. (IndyMac) following its failure in 2008 were challenging in part because IndyMac had a large number of trust accounts. FDIC claims personnel contacted thousands of IndyMac depositors to

[1] 12 CFR § 330.10(a).

[2] 12 CFR § 330.10(e).

[3] 12 CFR § 330.13(b).

obtain the trust documentation necessary to complete deposit insurance determinations for their revocable trust and irrevocable trust deposits. In some cases, this process took several months.

Several factors contribute to the challenges of making insurance determinations for trust deposits. First, there are three different sets of rules governing deposit insurance coverage for trust deposits. Understanding the coverage for a particular deposit requires a threshold inquiry to determine which set of rules to apply – the revocable trust rules, the irrevocable trust rules, or the rules for deposits held by an IDI as trustee of an irrevocable trust. This may require review of the trust agreement to determine the type of trust (revocable or irrevocable). Second, even after determining which set of rules applies to a particular deposit, it may be challenging to apply the rules. For example, the irrevocable trust rules may require detailed review of trust agreements to determine whether beneficiaries' interests are contingent, and may also require actuarial or present value calculations. Third, the complexity and variety of depositors' trust arrangements adds to the difficulty of determining deposit insurance coverage. Trust interests are sometimes defined through numerous conditions and formulas, and a careful analysis of these provisions may be necessary in order to calculate deposit insurance coverage under the current rules. Arrangements involving multiple trusts where the same beneficiaries are named by the same grantor(s) in different trusts add to the difficulty of applying the trust rules.

Proposed Rule

The proposed rule would merge the revocable and irrevocable trust categories into a new "trust accounts" category. This category would include: (1) informal revocable trust deposits, such as payable-on-death accounts; (2) formal revocable trust deposits; and (3) irrevocable trust deposits. The deposit insurance coverage provided in the "trust accounts" category would continue to remain separate from the coverage provided for other deposits held in a different right and capacity at the same IDI.

Under the proposed rule, the calculation of insurance coverage for trust accounts would be similar to the rule currently used for revocable trusts with five or fewer beneficiaries, which has been the most straightforward for bankers and the public to understand. A depositor's trust accounts would be insured in an amount up to $250,000 multiplied by the number of trust beneficiaries, not to exceed five, regardless of whether the trust is revocable or irrevocable, and regardless of contingencies or the allocation of funds among the beneficiaries. This would, in effect, limit coverage for each grantor's trust deposits at each IDI to a total of $1,250,000. The proposed rule's $1,250,000 per-grantor limit balances the objectives of simplifying the trust rules, promoting timely payment of deposit insurance, facilitating resolutions, ensuring consistency with the FDI Act, and limiting risk to the Deposit Insurance Fund (DIF).

II. Amendments to the Mortgage Servicing Account Rule

Background

The FDIC's deposit insurance rules also define a separate insurance category for mortgage servicing accounts (MSAs) that are comprised of principal and interest funds. The FDIC's rules governing coverage for MSAs were adopted in 1990 following the transfer of responsibility for insuring deposits of savings associations from the FSLIC to the FDIC. Under the rules adopted

in 1990, funds representing payments of principal and interest were insured on a pass-through basis to mortgagees, investors, or security holders. In adopting this rule, the FDIC focused on the fact that principal and interest funds were generally owned by investors, on whose behalf the servicer, as agent, accepted principal and interest payments. Payments of taxes and insurance were insured to the mortgagors or borrowers on a pass-through basis.

In 2008, after identifying that securitization methods and vehicles for mortgages had become more complex, the FDIC amended its rules to provide coverage to lenders based on each mortgagor's payments of principal and interest into the MSA, up to the SMDIA per mortgagor. The FDIC did not amend the rule for coverage of tax and insurance payments, which continued to be insured to each mortgagor on a pass-through basis and aggregated with any other deposits maintained by each mortgagor at the same IDI in the same right and capacity.

Need for Rulemaking

The current rules do not specifically address a common servicing arrangement utilized in the industry. Specifically, some servicing arrangements may permit or require servicers to advance their own funds to the lenders when mortgagors are delinquent in making principal and interest payments, and servicers might commingle such advances in the MSA with principal and interest payments collected directly from mortgagors. The 2008 amendments to the rules for MSAs did not provide for the fact that servicers may be required to advance their own funds to make payments of principal and interest on behalf of delinquent borrowers to the lenders.

The current rule provides coverage for principal and interest funds only to the extent "paid into the account by the mortgagors"; it does not provide coverage for funds paid into the account from other sources, such as the servicer's own operating funds, even if those funds satisfy mortgagors' principal and interest payments. As a result, such advances are not provided the same level of coverage as other deposits in an MSA comprised of principal and interest payments directly from the borrower, which are insured up to the SMDIA for each borrower. Instead, the advances are aggregated and insured to the servicer as corporate funds for a total of $250,000. Additionally, the current rule does not address whether foreclosure collections represent payments of principal and interest by a mortgagor. The FDIC is concerned that this inconsistent treatment of principal and interest amounts could contribute to financial instability during times of stress and could further complicate the insurance determination process.

Proposed Rule

Under the proposed rule, accounts maintained by a mortgage servicer in an agency, custodial, or fiduciary capacity, which are comprised of payments of principal and interest, would be insured for the cumulative balance paid into the account to satisfy principal and interest obligations to the lender, whether paid directly by the borrower or by another party, up to the SMDIA per mortgagor. Mortgage servicers' advances of principal and interest funds on behalf of delinquent borrowers would therefore be insured up to the SMDIA per mortgagor, consistent with the coverage rules for payments of principal and interest collected directly from borrowers.

The composition of an MSA attributable to principal and interest payments would also include collections by a servicer, such as foreclosure proceeds, that are used to satisfy a borrower's

principal and interest obligation to the lender. Thus, under the proposed rule foreclosure proceeds used to satisfy a borrower's principal and interest obligation would be insured up to the SMDIA per mortgagor.

The proposed rule would make no change to the deposit insurance coverage provided for MSAs comprised of payments from mortgagors of taxes and insurance premiums. Such deposits would continue to be insured based on the ownership interest of each mortgagor in the account and aggregated with other deposits maintained by the mortgagor at the same IDI in the same capacity and right.

CONCLUSION

The proposed rule would simplify deposit insurance coverage for revocable and irrevocable trust accounts and provide consistent deposit insurance treatment for all MSA deposit balances held to satisfy principal and interest obligations to a lender. Staff recommends that the Board approve the proposed rule for publication in the *Federal Register* with a 60-day comment period.

STAFF CONTACTS

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