NCUA Proposed Rulemaking Summary 2023-0082

NCUA Rules 745: Simplification of Share Insurance Rules

NASCUS Legislative and Regulatory Affairs Department
November 6, 2023

Background

The NCUA Board[1] approved NPRM NCUA 2023-0082[2]. Published in the Federal Register on October 25, 2023[3], the proposal, entitled *Simplification of Share Insurance Rules,* seeks to amend 12 CFR Part § 745 and relates to share insurance coverage of various accounts held by a trust, trustee, or an agent. Comments on the NPRM are due December 26, 2023.

The proposed amendments are intended to simplify NCUA share insurance regulations by establishing a new "trust accounts" category to provide aggregate Share Insurance Fund (SIF) coverage of both revocable and irrevocable trusts and provide clarification on coverage of mortgage service accounts (MSA) and lawyers' trust accounts (IOLTAs) deposited at federally insured credit unions. Proposed amendments also include changes to general recordkeeping requirements that permit NCUA to review records held in the normal course of business when those records are maintained by parties other than the federally insured credit unions or their members. Many of these changes would align with FDIC adopted amendments set to take effect April 1, 2024.[4]

Summary

The following summarizes the material changes proposed, as outlined within the NPRM.

Trust Rules Simplification

The NPRM proposes amendments covering share insurance of trust accounts to clarify insurance rules and coverage limits. Generally, the proposal would (1) merge the revocable and irrevocable trust categories; (2) apply a simpler, common calculation method to determine insurance coverage for funds held in trusts; and (3) eliminate certain requirements found in the current rules.

[1] Board agenda available at https://ncua.gov/files/agenda-items/simplification-share-insurance-rules-bam-20231019.pdf
[2] Available at https://www.govinfo.gov/content/pkg/FR-2023-10-25/pdf/2023-23481.pdf
[3] Available at https://www.federalregister.gov/documents/2023/10/25/2023-23481/simplification-of-share-insurance-rules
[4] 87 FR 4455 (Jan. 28, 2022).

Merger of Revocable and Irrevocable Trust Categories[5]

The NPRM proposes amending § 745.4 of its regulations, currently applying only to revocable trust accounts, to establish a new "trust accounts" category that includes both revocable and irrevocable trust funds deposited at a FICU. The proposed rule defines funds included in this category as:

> (1) informal revocable trust funds, such as payable-on-death accounts, in-trust-for accounts, and Totten trust accounts;
> (2) formal revocable trust funds, defined to mean funds held pursuant to a written revocable trust agreement under which funds pass to one or more beneficiaries upon the granter's death; and
> (3) irrevocable trust funds, meaning funds held pursuant to an irrevocable trust established by written agreement or by statute.

Calculation of Coverage

The NCUA is proposing to use one streamlined calculation to determine the amount of share insurance coverage for funds of both revocable and irrevocable trusts. The proposed method, already established relating to coverage for revocable trusts that have five or fewer beneficiaries, provides that a grantor's trust funds are insured in an amount up to the Standard Maximum Share Insurance Amount (SMSIA, currently $250,000) multiplied by the number of trust beneficiaries, not to exceed five beneficiaries.

Trust beneficiaries would only be considered for insurance coverage purposes if they are expected to receive funds held by the trust in a member account at the FICU. They would not be considered beneficiaries for share insurance purposes if expected to receive only non-deposit assets of the trust. This would, in effect, limit coverage for a grantor's trust funds at each FICU to a total of $1,250,000 or the equivalent of $250,000 per beneficiary. Under the proposed rule, account holders would still need to identify the grantors and the eligible beneficiaries of the trust to determine the level of insurance coverage applicable to funds held at the FICU.

The NPRM provides for the aggregation of funds held in revocable and irrevocable trust accounts for the purposes of applying the share insurance limit. Under the current rules, funds held in informal revocable trust accounts and formal revocable trust accounts are aggregated for this purpose.[6] As an example, all informal revocable trusts, formal

[5] The merger of these trust categories eliminates the need for §§ 745.4(h) through (i) of the current revocable trust rules, which may have historically caused some irrevocable trusts to be insured per revocable trust rules, while other irrevocable trusts were insured under the irrevocable trust rules depending on the living status of the grantor at the time of insurance review. The elimination of §§ 745.4(h) through (i) is intended to provide simplification and consistency of the application of insurance coverage and ensure credit unions and consumers fully always understand the coverage of such accounts after the account is initiated.

[6] See 12 CFR 745.4(a) (''All funds that an owner holds in both living trust accounts and payable-on death accounts, at the same NCUA-insured credit union and naming the same beneficiaries, are aggregated for insurance purposes and insured to the applicable coverage limits. . . .'').

revocable trusts, and irrevocable trusts held for the same grantor at the same FICU would be aggregated, and the grantor's insurance limit would be determined by the number of eligible and unique beneficiaries identifiable among all of their trust accounts.[7]

The share insurance coverage provided in the "trust accounts" category would remain separate from the coverage provided for other funds held in a different right and capacity at the same FICU. Under the proposed rules, some account holders who currently maintain both revocable trust and irrevocable trust deposits at the same FICU may have funds in excess of the insurance limit if these separate categories are combined.

Currently, the revocable trust rules provide that eligible beneficiaries include natural persons, charitable organizations, and non-profit entities recognized under the IRS Code of 1986.[8] The proposed rule would exclude from the calculation of share insurance coverage beneficiaries who would only obtain an interest in a trust if one or more named beneficiaries are deceased (contingent beneficiaries). This would codify NCUA's existing practice to include only primary, unique beneficiaries in the share insurance calculation.[9]

The proposed rule would also codify a current interpretation of the trust rules where an informal revocable trust designates a depositor's formal trust as its beneficiary. A formal trust generally does not meet the definition of an eligible beneficiary for share insurance purposes, but the NCUA has treated such accounts as revocable trust accounts under the trust rules.[10]

The current trust rules provide that, in some instances, funds corresponding to specific beneficiaries are aggregated with a grantor's single ownership deposits at the same FICU for the purpose of the share insurance calculation, including a grantor's retained interest in an irrevocable trust[11] and interests of beneficiaries who do not satisfy the definition of "beneficiary."[12] To implement the streamlined calculation for funds held in trust accounts, the NPRM proposes to eliminate these provisions. Under the proposed

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[7] For example, if a grantor maintained both an informal revocable trust account with three beneficiaries and a normal revocable trust account with three separate and unique beneficiaries, the two accounts would be aggregated and the maximum share insurance available would be $1.25 million (1 grantor times the SMSIA times the number of unique beneficiaries, limited to 5). However, if the same three people were the beneficiaries of both accounts, the maximum share insurance available would be $750,000 (1 grantor times the SMSIA times the 3 unique beneficiaries).

[8] 12 CFR 754.4(c).

[9] See NCUA Your Insured Funds at 42 (''The beneficiaries are the people or entities entitled to an interest in the trust. Contingent or alternative trust beneficiaries are not considered to have an interest in the trust funds and other assets as long as the primary or initial beneficiaries are still living, with the exception of revocable living trusts with a life estate interest.'').

[10] See 74 FR 55747, 55748 (Oct. 29, 2009).

[11] See 12 CFR 745.2(d)(4).

[12] 12 CFR 745.4(d).

rule, the grantor and other beneficiaries who do not satisfy the definition of "eligible beneficiary" would not be included for the purposes of the share insurance calculation.[13]

Trusts often contain provisions for the establishment of new trusts upon the grantor(s) death. The proposed rule would clarify share insurance coverage in these situations to outline that if a trust agreement provides that trust funds will pass into one or more new trusts upon the grantor(s) death, the future trust(s) would not be treated as beneficiaries for the purposes of the calculation. Instead, the future trust(s) would be considered mechanisms for distributing trust funds, and the natural persons or organizations that receive the funds through the future trust(s) would be considered beneficiaries for the purposes of the share insurance calculation, consistent with NCUA's current interpretations.

Consistent with the current revocable trust rules, the proposed rule would continue to require beneficiaries of an informal revocable trust to be specifically named in the account records of the FICU.[14]

The NPRM also outlines that funds held in an account for a trust established by multiple grantors are presumed to be owned in equal shares, unless otherwise specified in a FICU's account records consistent with current revocable trust rules.[15]

The NPRM would continue to exclude coverage under § 745.4 for certain trust funds that are covered by other share insurance regulations. As an example, employee benefit plan accounts are insured pursuant to current § 745.9–2. Additionally, if the co-owners of an informal or formal revocable trust are the trust's sole beneficiaries, funds held in connection with the trust would be treated as a joint ownership account under § 745.8.

Finally, the NPRM is proposing to remove the appendix to part 745, which provides examples of share insurance coverage. The NCUA plans to update its *Your Insured Funds* brochure to reflect any amendments made to part 745.[16] The NCUA is also proposing to remove references to the appendix in the heading of part 745 and § 745.0, § 745.2, and § 745.13. This would mean that provisions of the appendix would no longer satisfy the notification to members/shareholders requirement in § 745.13. Instead, FICUs would have to make available either the rules in part 745 of the NCUA's regulations or the *Your Insured Funds* brochure.

Elimination of Certain Requirements found in the Current Rules

The proposed simplification of the calculation for insurance coverage for trust account funds would also permit the elimination of § 745.2(d) of the regulations addressing the valuation of trust interests. The description of non-contingent interests in

[13] In the unlikely event a trust does not name any eligible beneficiaries, the NCUA would treat the funds in the trust account as funds held in a single ownership account. Such funds would be aggregated with any other single ownership funds that the grantor maintains at the same FICU and insured up to the SMSIA of $250,000.
[14] See 12 CFR 745.4(
[15] See 12 CFR 745.4(f).
[16] https://mycreditunion.gov/sites/default/static-files/insured-funds-brochure.pdf

§§ 745.2(d)(1) and (2) would no longer be relevant to trust accounts under the proposed rule.

Additionally, § 745.2(d)(3) regarding the deemed pro rata contribution of settlors to a trust would be replaced by proposed § 745.4(b)(4), which would presume equal allocation. Section 745.2(d)(4) defining a "trust interest" would be replaced by the proposed definition of "irrevocable trust" in § 745.4(a)(3).

Regarding non-contingent interests, the proposed rule would move the current description of a non-contingent interest in § 745.2(d)(1) to the definitions section of part 745. The new definition of "non-contingent interest" in § 745.1 would remain substantively the same but would now only be relevant to evaluating participants' noncontingent interests in shares of an employee benefit plan under § 745.9–2(a). The proposed definition of "noncontingent interest" would add language to include any present worth or life expectancy tables that the IRS may adopt that are like those set forth in § 20.2031–7 of the Federal Estate Tax Regulations (26 CFR 20.2031–7) to provide flexibility should the IRS make any changes.

Finally, the NCUA proposes to remove the reference to § 745.2 in current § 745.9–2. and to redesignate current § 745.9–2 as § 745.9 to reflect the elimination of current § 745.9–1 governing irrevocable trust accounts. The reference in § 745.9–2(a) to § 745.2 would also be removed to reflect the elimination of the description of a non-contingent interest in current § 745.2(d) and adoption of a definition of "non-contingent interest" in proposed § 745.1.

Mortgage Servicing Account Rule Amendments

Share insurance coverage regulations also include specific rules on accounts maintained by FICUSs for mortgage servicers.[17] The proposed amendments in this area would create parity with changes made by the FDIC in early 2022[18] and scheduled to become effective in April 2024. Specifically, the amendments would address servicing arrangements that may permit or require servicers to advance their own funds to lenders when mortgagors are delinquent in principal and interest payments, and servicers might commingle such advances in the mortgage servicing account (MSA) with related payments collected directly from mortgagors.

Under the NPRM, accounts maintained by a mortgage servicer in an agency, custodial, or fiduciary capacity, which consist 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 limit of the SMSIA per mortgagor. Mortgage servicers' advances of principal and interest funds on behalf of delinquent borrowers would therefore be insured up to the SMSIA per mortgagor, consistent with the coverage rules for payments of principal and

[17] 12 CFR 745.3(a)(3).
[18] 87 FR 4455 (Jan. 28, 2022).

interest collected directly from borrowers. 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 even if those proceeds are not paid directly by a mortgagor, an issue with which the current rule is silent.

Under the proposed rules no changes would be made to insurance coverage provided for MSAs comprised of escrow payments from mortgagors for taxes and insurance premiums. These accounts would continue to be insured separately, by the mortgagor in aggregate, from the principal and interest-related accounts.

Recordkeeping Requirements

The NCUA's regulations governing share insurance coverage include general principles applicable in determining insurance of accounts.[19] Among these general principles are provisions addressing recordkeeping.[20]

Under the current § 745.2(c)(2), records maintained by an agent or nominee on behalf of the member principal or beneficial owner may not clearly meet the requirements as "records of the members" for ascertaining interests in the account if the names of agents or nominees are not added as required under § 745.3(a)(2). While the NCUA's Office of General Counsel (OGC) has previously issued a legal opinion where an agent or custodian that "has an agreement with the beneficial owner/member to maintain custody of the beneficial owner/member's records", would be considered as "records of the member" within the meaning of § 745.2(c)(2)[21], changes proposed in the rules more closely compare with language adopted by the FDIC[22] and ensure codification of the legal opinion principle.

Additionally, § 745.2(c)(3) of the current regulations provides that account records of a FICU trust account disclose the name of both the settlor (grantor) and the trustee of the trust and contain an account signature card executed by the trustee. This requirement goes beyond the recordkeeping requirements of § 745.2(c)(1) through (2) and poses an unnecessary burden on FICUs and their members. Further, the FDIC previously eliminated a similar requirement.[23] Therefore, the proposed amendments would eliminate the requirement in § 745.2(c)(3).

Finally, § 745.14(a)(2) notes that interest on lawyers' trust accounts (IOLTAs) and other similar escrow accounts are subject to the recordkeeping requirements of § 745.2(c)(1) and (2). In doing so, § 745.14(a)(2) provides an example of how the details of the relationship between the attorney or escrow agent and their clients and principals must

[19] 12 CFR 745.2.
[20] 12 CFR 745.2(c).
[21] NCUA Legal Op. 97–0909 (Feb. 6, 1998), available at https://ncua.gov/regulation-supervision/legal-opinions/1997/pass-through-insurance.
[22] 12 CFR 330.5(b)(2).
[23] 51 FR 21137 (June 11, 1986).

be ascertainable from the records of the FICU or from records maintained, in good faith and in the regular course of business, by the member attorney or member escrow agent administering the account. The NCUA proposes to amend this description to conform the change to § 745.2(c)(2) to explicitly state that the records detailing the relationship and the interest of other parties in the account must be maintained, in good faith and in the regular course of business, by (1) the FICU or (2) the member attorney or member escrow agent, or a person or entity acting on their behalf.