

P.O.D. Accounts Restricting Bank's Right of Setoff

Banks generally have a right of setoff against funds they maintain on deposit in a customer's account that can be used to satisfy any obligations owed to the bank by that customer. This setoff right might come from common law or from a contractual provision in a deposit account agreement or other contract. There are few limits on a bank's right of setoff other than "mutuality of obligation," the result being that lenders are comfortable when individual debtors have accounts with substantial balances at the bank. While some banks may try to take a pledge and security interest in the deposit account, that is often not the case.

However, as evidenced by the cases described below, and by legislation enacted in Oklahoma and Texas, there is one type of deposit account that can pose a major issue for a bank seeking repayment of a loan following the death of a customer. "Payable on death" accounts, commonly known as "P.O.D. Accounts," are an increasingly common estate planning tool used by many individuals to avoid the hassle and expense of probate. Most state laws permit the designation of a deposit account as a P.O.D. Account. When a P.O.D. Account owner dies, the funds in the account transfer without probate to the P.O.D. beneficiary. A P.O.D. beneficiary designation is absolute; even if a will or living trust of the decedent gives the decedent's assets to a different beneficiary. Wis. Stat. § 705.04(3). The funds in the P.O.D. Account go to the beneficiary named on the P.O.D. Account, and not to the decedent's estate, unless the decedent's estate is designated as the P.O.D. beneficiary.

What if the deceased account holder owed the bank money? While a bank may think that its right of setoff applies before the money in the account is paid to the P.O.D beneficiary, in Wisconsin, that thought would be incorrect. Any money in the P.O.D. account is transferred by right to the beneficiary immediately upon the death of the account holder, eliminating any right the bank had to setoff, since there is no longer the required "mutuality of obligation" between the parties. For example, consider a situation where Holder A has a P.O.D. account that contains \$250,000 and also has \$100,000 outstanding on a personal unsecured loan from the same bank. When Holder A dies, the bank loses all right of setoff and the \$250,000 immediately becomes the property of the P.O.D. beneficiary. The bank then is stuck with only one option; it must go after Holder A's estate for the money due under the loan. If there is no estate, the bank could lose completely.

This situation is not just theoretical. In 2010, the Wisconsin Supreme Court held

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that P.O.D. Accounts passed to the named beneficiary upon the decedent's death, free of estate tax. In this case, a P.O.D. beneficiary received almost \$4,000,000 upon the death of the P.O.D. Account holder, and, as intended, the money bypassed the estate. The estate sued the beneficiary for reimbursement of federal and estate taxes generated by the P.O.D. account, but the Court found that obligation to pay the estate taxes fell solely on the estate. In other words, the decedent's estate was required to pay all estate tax due upon the decedent's death, including estate tax attributable to the P.O.D. Accounts. *Estate of Sheppard ex rel. McMorrow v. Schleis*, 2010 WI 32, 324 Wis. 2d 41, 782 N.W.2d 85.

As you can imagine, P.O.D Accounts are increasingly being used by estate planners to increase the money that goes to their client's beneficiaries and reduce the difficulties and costs of probate. Although an unintended consequence, this planning strategy is leaving creditors vulnerable and exposed, as they likely expected to be repaid from the funds on deposit.

Some states, such as Texas, Ohio and Oklahoma, have taken measures to protect lenders in these types of situations as more fully described below. We expect that other states would be responsive to state financial institution lobbies requesting changes to their deposit account laws to protect depository institutions that allow their customer's to open and designate P.O.D. Accounts.

At the request of the state bankers' association, Texas enacted a statute that allows banks to setoff against a P.O.D. Account the amount due under a loan, prior to the payout of any account balance to the P.O.D beneficiary. Tex. Est. Code, § 113.210. Additionally, Oklahoma enacted a statute that requires any party with a secured interest in a P.O.D Account to be paid off before the money goes to the beneficiary. Okla. Stat. tit. 6, § 901.

Although not a legislative change, the Ohio Supreme Court previously held that a bank had a right to exercise setoff before paying the P.O.D. beneficiary when the owner of a P.O.D Certificate of Deposit pledged such Certificate as collateral for a loan. The court reasoned that the beneficiary's interest was only as great as the account holder's interest. Since the account holder's interest was subject to the bank's rights to collateral, the beneficiary's interest was also subject to that right. *Jamison v. Soc'y. Nat'l. Bank*, 66 Ohio St. 3d 201, 611 N.E.2d 307, 309 (Ohio 1993).

Unfortunately, Wisconsin has yet to provide any assistance to lenders on this issue. Chapter 705 of the Wisconsin Statutes, which includes coverage of P.O.D.



Accounts and "how they work," makes no concessions. Ideally, Wisconsin would consider a statute similar to Texas and Oklahoma that assures that bank lenders can protect their interests before a P.O.D. beneficiary can take his or her stake of the account funds at the time of death.

Banks need to be vigilant and consider how P.O.D. Accounts will affect its security in, or repayment of, their loans. While almost all deposit account agreements contain provisions on a bank's right of setoff, few have included provisions that contemplate the issues identified in this article. Further, in our experience, banks rarely require binding pledges or grants of security interests for their deposit customers. However, some of the larger money-center banks are already hedging against this risk in their agreements. For example, a large, well-known bank has a provision in its agreement that states:

"[W]e are authorized to exercise our right of setoff or security interest rights against the funds credited to your balance after your death. We have these rights even if a "payable on death" payee has rights to the account."

However, without judicial guidance, it's unclear whether such a provision in an account agreement can trump the provisions of existing state law. Even so, this is a provision that every bank should consider including in its deposit account agreements. As estate planners increase their use of P.O.D. Accounts as a strategic tool, banks may be left with a false sense of security and uncollectible loans. If you have any questions about the foregoing or protecting your interests, please contact [Sara McNamara](#) or [Jim Sheriff](#).

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