



# How to Navigate the Death of a Member

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# Overview

- ▶ When a Member dies, if they have significant deposits or loans with the Credit Union, the process can be tricky to navigate and critical to get right.
- ▶ Several questions arise:
- ▶ (1) how does a deposit account owned by the deceased get into the hands of the person entitled to it?
- ▶ (2) how does an estate account get authorized and created? What are the Credit Union's obligations related to estate accounts.
- ▶ (3) What about specific situations, like accounts subject to a Power of Attorney or a Rep Payee Account
- ▶ (4) What about loans the deceased person owed to the Credit Union?
- ▶ Let's Start at the beginning....

# What happens (legally) when someone dies?

- ▶ Legally, deceased people can't own things.
- ▶ Any accounts or property held in that person's name only including car(s), house(s), and deposit accounts immediately become property of that person's estate.
- ▶ Much like bankruptcy or corporate law, the estate is a separate legal entity from the human beings each represents.
- ▶ Until an Estate Executor/Administrator is empowered by a court to take over the deceased's affairs, any remaining living person interacting with his belongings is technically trespassing or committing theft, including anyone withdrawing funds from his deposit accounts.
- ▶ Think of an account of a deceased person like a corporate account without an authorizing resolution. Unless and until you have an authorizing resolution, there's no one authorized to do anything with that account.

# The Basics

- ▶ What happens next, and how a party becomes authorized on an account, depends on if the deceased person died with a will. Or they died without one, which is known as “dying intestate.”
- ▶ If you die with a will, you have taken the opportunity to plan for what happens after you die, and you chose how and to whom your assets are distributed. This allows you to appoint a specific guardian for minor children, make a bequest to a charity, or account for people's specific financial situations in making a bequest.
- ▶ If you die “intestate” or without a will, there's no guidance from you on how to distribute your assets. In the absence of that, the law steps in and makes those decisions for you and determines how your assets will be distributed. All 50 states have statutes that dictate how assets should be distributed in the absence of a will, by typically making bequests to family members in a set order and hierarchy.

# The Basics

- ▶ An estate is opened by starting the process of “probate” which opens an estate. The executor will take the original will to the courthouse (in PA it's a specific division known as the “Register of Wills”) to complete some paperwork and make some certifications.
- ▶ If everything is in order, the court will issue documentation opening the estate and appointing the executor. In Pennsylvania this is known as a “Short Certificate”. If there's no will, it's Letters of Administration.
- ▶ At that point you have an estate that legally exists and a person authorized to act for it.

# The Basics

- ▶ Think of the administrator or executor as the “authorized signer” on behalf of a corporate entity.
- ▶ Much like a corporate resolution appoints an authorized signer with respect to a business entity, the short certificate or letters of administration appoint the human being authorized to act for the estate.
- ▶ If there are assets owned individually by the deceased person – house, car, bank account – to get those assets titled in the name of the person who inherits them, there needs to be an estate opened.

# The Basics

- ▶ The process of estate administration is where the executor or administrator winds up the estate, including distributing assets to appropriate beneficiaries, paying off debt, paying taxes.
- ▶ The executor/administrator does this with or without the assistance of legal counsel, often depending on the complexity of the estate.
- ▶ What is the role of a Financial Institution? It's twofold – 1) Making sure it handles pre-death customer relationships (loans and deposits) correctly and 2) Acting as depository for an estate account
- ▶ Once the estate is opened, either existing accounts may be converted to an estate account, or a new estate account can be opened. This allows the executor to pay creditors, maintain assets, and ultimately distribute funds and close the estate.

# What if there's just an account with a Small balance?

- ▶ What if the deposit account only has \$2000 in it and the surviving spouse needs the money, but can't take the time or money to open an estate?
- ▶ Unfortunately, there still needs to be an estate, and someone authorized to distribute the money.
- ▶ Many states allow for an alternative for small estates, e.g. in PA, estates under a certain amount in value can be probated on petition, but that still requires some order of the court authorizing that act, and appointing some specific human being to administer that process.

# Specific Considerations

- ▶ Why do people want to avoid probate?
- ▶ Convenience. The assets pass to the next in line automatically, without affirmative action, making the process faster and simpler.
- ▶ Privacy. The administration of an estate is a public record.
- ▶ Tax Savings. Probate assets are subject to estate or inheritance tax. Federal estate tax exemption is currently about \$11.5. However, state level inheritance tax is not subject to such an exemption. In PA, the amount of tax varied depending on the beneficiary and can be as high as 15% of the value of the asset.

# So what should you do when your member dies?

- ▶ Review the relationship in place at the time of death.
- ▶ You want to be certain you are handling all the assets and liabilities correctly, whether they are probate or non-probate assets in your possession.
- ▶ Get a handle on what account(s) you have, how they're titled and what special instructions or ownership requirements have to know what your obligations are related to the assets.

# Specific Considerations – Deposit Accounts

- ▶ Part of estate planning is titling ownership of assets during life so that they will not be included in probate assets after death.
- ▶ For example – assets that have a beneficiary designation are non-probate assets, including:
  - ▶ 401K
  - ▶ Life Insurance
  - ▶ Assets held in certain trusts
- ▶ Bank accounts can be titled as a TOD or POD (Transferrable or Payable on Death) which for tax purposes is known as a “Totten Trust” and the asset automatically transfers at death and avoids probate.

# Specific Considerations – Deposit Accounts

- ▶ Another way to accomplish avoiding probate with assets that would otherwise need to be probated by an estate is the title to the assets during life.
- ▶ ROS or TBE designation. “Right of Survivorship” or “Tenancy by the Entireties.”
- ▶ When an asset (home, car, bank account, etc.) is titled as “John and Mary with a Right of Survivorship”, this is a form of joint ownership in which each owner owns an undivided 100% interest during life, and upon the death of either, the survivor automatically becomes the owner.
- ▶ Legally that means if John dies first, Mary, by operation of law immediately upon his death, takes title to 100% of the asset individually

# Specific Considerations – Deposit Accounts

- ▶ Tenancy by the Entireties is a form of ownership with a right of survivorship that can only be accomplished by married individuals.
- ▶ In addition to the benefits of the right of survivorship, there is significant asset protection rights under the law that applies to tenancy by the entireties ownership. Property owned jointly by spouses cannot be attached to satisfy debts and obligations owed by either spouse individually
- ▶ Joint ownership by two spouses is presumed to be owned as tenants by the entireties.

# Specific Considerations – Deposit Accounts

- ▶ As deposit accounts are frequently titled jointly with a ROS or as TBE, operationally, when you learn of the death of a member, you will often need to confirm the account ownership.
- ▶ If one of these two ownership structures is present, the surviving owner takes title to the account without the need for an estate to be opened.
- ▶ This occurs as a matter of law the moment the first owner dies.
- ▶ Only accounts owned individually by the decedent or jointly without a right of survivorship become estate assets requiring an executor to authorize an estate account.
- ▶ Credit Union Specific Issue: Ownership of the Share Account vs. Ownership of the deposit account.

# Specific Considerations – Deposit Accounts

- ▶ Know what, if any, specific considerations apply in your state when a depository becomes aware of the death of a depositor
- ▶ For example in PA, (1) depositaries are permitted to release funds on deposit that total less than \$10,000 to certain enumerated family members for the purpose of paying funeral costs, if an invoice is provided,(2) certain notices must be provided to the Department of Revenue upon the death of a joint account owner, and (3) specific rules apply to safe deposit boxes when the renter of the box dies, and how the financial institution can provide access.

# Specific Considerations – Deposit Accounts

- ▶ What happens when the sole authorized signer on a corporate account dies? You need a new resolution, authorizing a new party.
- ▶ What if the sole owner dies? Ownership interests in an entity held by the individual are probate assets. There needs to be an estate opened to get the assets transferred.
- ▶ Exception is if the operating agreement provides for a different process.
- ▶ The law (in PA) provides the executor the ability to wrap up the affairs of the single member LLC and appoint new authorized parties, but if that isn't completed within 180 days, the LLC is deemed to be dissolved.

# Specific Considerations – Deposit Accounts

- ▶ What about an account that is subject to a power of attorney? This will depend on applicable state law, but for example in PA, a POA doesn't survive the death of the principal. The agent is no longer permitted to act for the deceased pursuant to the POA.
- ▶ What about a Representative Payee Account?
- ▶ Under federal law, the depositary FI is obligated to "return any benefit payments received after the [FI] becomes aware of the death or legal incapacity of a recipient or the death of a beneficiary, regardless of the manner in which the [FI] discovers such information."

# Specific Considerations Deposit Accounts

- ▶ When can you honor checks presented after the death of the account holder? Section 13 Pa. C.S.A. Section 4405 provides that “even with knowledge [of the depositor’s death], a bank may for ten days after the date of death pay or certify checks drawn on or before that date unless ordered to stop payment by a person claiming an interest in the account.”

# Why is it important to get this right?

- ▶ Litigation in connection with probating an estate is incredibly common, and costly.
- ▶ The issues involved are 1) entitlement to inheritance and 2) decades long familial relationships and associated personal baggage.
- ▶ Do you want your institution in the middle of that?
- ▶ You'll be perceived as the deep pocket – If something goes wrong and a financial institution is in any way connected, involved parties and their counsel will be doing everything they can to come up with an argument as to why you should be liable.
- ▶ So once you transition the assets from the pre-death status to the post death status, what happens next?

# So you have an Estate Account...

- ▶ Let's say the executor wants to open the estate's bank account with your institution, you've gotten the short certificate and death certificate, and you have an estate account. What next?
- ▶ The good news is that the executor has a fiduciary duty with respect to his actions in administering the estate.
- ▶ This means he has a duty to act in the best interest of the estate and its beneficiaries.
- ▶ The good news is also the relationship between a depository and its customers is not fiduciary in nature – it's a debtor/creditor relationship. You don't owe the estate a duty to oversee the actions of the executor to be sure that he's doing what he should.
- ▶ Nevertheless, you don't have a free pass as a depository holding an estate account.
- ▶ To see why, we need to look at Article 3 of the Uniform Commercial Code.

# Section 3-307 of the UCC

13 Pa.C.S.A. § 3307

## § 3307. Notice of breach of fiduciary duty

### Currentness

**(a) Definitions.**--As used in this section, the following words and phrases shall have the meanings given to them in this subsection:

"Fiduciary." An agent, trustee, partner, corporate officer or director or other representative owing a fiduciary duty with respect to an instrument.

"Represented person." The principal, beneficiary, partnership, corporation or other person to whom the duty stated under the definition of fiduciary is owed.

# Section 3-307 of the UCC

(b) General rule.--If an instrument is taken from a fiduciary for payment or collection or for value, the taker has knowledge of the fiduciary status of the fiduciary and the represented person makes a claim to the instrument or its proceeds on the basis that the transaction of the fiduciary is a breach of fiduciary duty, the following rules apply:

(1) Notice of breach of fiduciary duty by the fiduciary is notice of the claim of the represented person.

(2) In the case of an instrument payable to the represented person or the fiduciary as such, the taker has notice of the breach of fiduciary duty if the instrument is:

(i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary;

(ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary; or

(iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.

(3) If an instrument is issued by the represented person or the fiduciary as such and made payable to the fiduciary personally, the taker does not have notice of the breach of fiduciary duty unless the taker knows of the breach of fiduciary duty.

(4) If an instrument is issued by the represented person or the fiduciary as such to the taker as payee, the taker has notice of the breach of fiduciary duty if the instrument is:

(i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary;

(ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary; or

(iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.

# Section 3-307 of the UCC

2. Subsection (a) defines the terms "fiduciary" and "represented person" and the introductory paragraph of subsection (b) describes the transaction to which the section applies. The basic scenario is one in which the fiduciary in effect embezzles money of the represented person by applying the proceeds of an instrument that belongs to the represented person to the personal use of the fiduciary. The person dealing with the fiduciary may be a depositary bank that takes the instrument for collection or a bank or other person that pays value for the instrument. The section also covers a transaction in which an instrument is presented for payment to a payor bank that pays the instrument by giving value to the fiduciary. Subsections (b)(2), (3), and (4) state rules for determining when the person dealing with the fiduciary has notice of breach of fiduciary duty. Subsection (b)(1) states that notice of breach of fiduciary duty is notice of the represented person's claim to the instrument or its proceeds.

Under Section 3-306, a person taking an instrument is subject to a claim to the instrument or its proceeds, unless the taker has rights of a holder in due course. Under Section 3-302(a)(2)(v), the taker cannot be a holder in due course if the instrument was taken with notice of a claim under Section 3-306. Section 3-307 applies to cases in which a represented person is asserting a claim because a breach of fiduciary duty resulted in a misapplication of the proceeds of an instrument. The claim of the represented person is a claim described in Section 3-306. Section 3-307 states rules for determining when a person taking an instrument has notice of the claim which will prevent assertion of rights as a holder in due course. It also states rules for determining when a payor bank pays an instrument with notice of breach of fiduciary duty.

# What does this mean?

- ▶ When a depositary has knowledge that the fiduciary is breaching his duty to the beneficiary, the UCC imposes liability for that breach of fiduciary duty on the depositary.
- ▶ This is because when you accept a check for deposit, if you take it, knowing that the depositor is breaching his fiduciary duty, you take it subject to the claims of the rightful beneficiary.
- ▶ Intermingling fiduciary assets with personal assets of the fiduciary or otherwise using such assets for the fiduciary's personal benefit constitutes a breach of fiduciary duty.
- ▶ Permitting a check payable to an estate or to an executor in his capacity as executorial to be deposited into the executor's personal account imports knowledge to the depositary that the fiduciary is breaching his duty.

- ▶ That means if the estate beneficiaries are harmed by the executor taking those estate proceeds and using them for his own personal gain (And the odds are they will be) by taking the check, under the UCC, you open yourself up to the same liability that the executor would have for breaching his duty.
- ▶ Again, you'll be seen as the deep pocket. Those beneficiaries and their counsel will be chomping at the bit to have the ability to shift liability to you.
- ▶ Don't give them one. Don't make it easy.

# Specific Considerations - Loans

- ▶ When a person dies, part of administering an estate is satisfying the deceased party's debts out of the estate assets, if there are any.
- ▶ Much like a bankruptcy, if you are a secured creditor, you will fare far better than an unsecured creditor, given the leverage the collateral provides you.
- ▶ How you will approach this will also be determined in large part if the loan is a commercial or consumer loan.

# Specific Considerations – Commercial Loans

- ▶ It is likely that the documents evidencing the commercial loan explicitly state that the death of the individual borrower constitutes a default under the loan.
- ▶ In the event the borrower dies, this gives you significant leverage to work with the estate to either 1) get yourself in a better collateral position by requiring the estate to offer additional collateral, 2) liquidate estate assets on which you have a lien, or 3) take steps to better protect yourself based on the leverage the default provides

# Special Considerations – Commercial Loans

- ▶ If the commercial borrower is an entity and the individual owner dies, if you required that owner's personal guaranty, the loan documents likely provide that the guarantor's death is a default.
- ▶ If the business is to be continued by family members or other stakeholders that you are satisfied from an underwriting perspective are able and willing to continue operate the business and satisfy the debt service on the loan, the ability to call a default for the guarantor's death will give you leverage to shore up the loan terms, including requiring new guarantees from the new owner/operators of the business, or requiring additional collateral.
- ▶ Note: you can only use the death as a default if the loan docs explicitly provide for it.
- ▶ Note: If you live in a state that permits confession of judgment, the ability to confess judgment against an individual dies with them.

# Specific Considerations – Consumer Loans

- ▶ Consumer Loans are trickier, because they are often subject to state and federal consumer protection statutes.
- ▶ For example, for federally backed mortgage loans secured by the deceased person's principal residence (non HELOCs), a lender can generally not use the death of the borrower to call a default and foreclose on the loan, unless there is an additional payment default.
- ▶ This federal law specifically exists to prevent surviving family members who are not delinquent on loan payments from losing their family home.

# Policies and Procedures

- ▶ Since these issues involve significant potential risk, and often turn on intricate aspects of state law, the best way to approach this is to have detailed policies and procedures that provide guidance to your deposit ops, loan ops and other internal stakeholders so they have certainty and clarity in what to do.
- ▶ These are often fraught situations. Someone has lost a loved one. Families are fighting and mourning simultaneously.
- ▶ Vague broad policies that lack details and clear procedures don't help your employees or your members navigate the process.
- ▶ You'll never be able to plan for everything, so keep updating procedures as you learn.
- ▶ Be sure that what you decide as a matter of policy and procedure is consistent with your membership account

# Policies and Procedures

- ▶ Should address:
- ▶ What immediate steps do you need to take?
- ▶ Initial review of the Member Relationship – what to look for and what it means.
- ▶ Terminating ATM/Debit Cards/Credit Cards
- ▶ Verifying any recurring government benefit payments – generally credits can be accepted after death – except for government benefit payments.
- ▶ Determine ownership of accounts
- ▶ Set up limits and warnings based on the depositor's death, e.g. permitting payment of checks and ACH Payments authorized prior to death
- ▶ Comply with any applicable notice requirements

# Policies and Procedures

- ▶ What to do with estate accounts?
- ▶ Documents you need to open an estate account.
- ▶ Guidance for what to look for when the executor may be violating his fiduciary duty to the estate
- ▶ Does this mean you have an affirmative obligation to monitor the account? No but you want to be sure you have procedures directing your front line folks what to look for and what to do, and **train them on those policies**

# Policies and Procedures

- ▶ Make sure your policies and procedures applicable to defaulted loans (consumer and commercial) provide guidance on what to do when a borrower, or owner of the business dies.
- ▶ When can you set off default loans against accounts using death as the default? Be very careful as there are a lot of moving parts. There are three types of setoff rights – common law, contractual (consensual) and statutory.
- ▶ There must be a default (mature), mutuality of obligation, funds must be general deposit (i.e. not held for a specific purpose), and must belong to the debtor.
- ▶ Turn on issues of account titling, terms of the loan documents, and applicable law (e.g. credit cards issuers are prohibited under Reg Z from setting off against deposit accounts).

# Conclusion

- ▶ While the death of a member can be difficult to navigate, solid policies, process and procedures can help you navigate the process and mitigate risk to the Credit Union.
- ▶ Just remember to train your internal stakeholders on the policies and processes and don't be afraid to modify what you need to when you learn from experiences.



Thank you for your time and  
Attention.  
Questions or Comments?