

Will State Farm Be There? Often Overlooked Property And Casualty Insurance Aspects Of Common Estate Planning Transactions



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Practitioners who treat property and casualty insurance as an afterthought risk exposing their clients to liability.

A NUMBER OF THE MOST COMMON estate planning techniques recommended by practitioners involve the transfer of a client's personal residence to an entity such as a limited liability company, limited partnership, or trust. Estate planning attorneys recommend such transfers for a number of reasons, including protection from creditors, avoidance of probate, facilitating gifting of fractional interests in a residence, and providing a mechanism for the management of property owned by multiple individuals or families. Transferring residential property to a qualified personal residence trust also remains a popular and effective strategy for gifting.

When implementing these "bread-and-butter" estate planning techniques, practitioners often neglect a crucial aspect of the transaction—restructuring the property and casualty insurance that is in place to reflect the transfer of ownership of the residence to an entity. In the event of a loss, the failure to address this issue could have unintended and potentially devastating consequences. This article focuses on the need to properly structure homeowner insurance policies, which are commonly used to protect residences that are transferred to an entity.

PROPERTY & CASUALTY INSURANCE 101

• Many practitioners operate under the logical but false premise that a policy insuring a residential property—a homeowner policy—covers the actual home. In fact, the party that receives the benefit of coverage is the named insured. The following is a common definition for named insured in a homeowner policy: *“Insured means you and residents of your household who are your relatives, or other persons under the age of 21 and in the care of any person mentioned above.”*

A homeowner policy generally offers the named insured protection from two important categories of loss—property damage and liability. Coverage for property damage protects the insured from damages to a residence and its contents caused by perils such as wind, fire, water, and theft, while liability coverage protects the insured when his or her actions or omissions cause losses to others, including bodily injury and property damage.

The broad liability coverage that is provided by a homeowner policy is often overlooked, yet serves as a critical form of asset protection by covering losses the insured incurs anywhere in the world. In addition, regardless of the merits of any lawsuit brought against the insured, liability protection also obligates the insurance carrier to provide the insured with a legal defense.

Since the contract language used in homeowner policies was developed when individuals, not entities, owned homes, a traditional homeowner insurance policy does not convey any contractual benefits to any party other than an individual. Given this background, it is evident that if residential property is transferred from an individual to an entity and no adjustments are made to coverage, the unfortunate and unintended consequence is that the insurance coverage that protected the individual who previously owned the property may not be available to protect the new entity-owner. Especially when asset protection is among the primary reasons for transfer of property, the potential

absence of important insurance protection is especially ironic and problematic.

TAILORING INSURANCE PROTECTION TO MEET NEED

• To avoid gaps in coverage, attorneys must ensure that insurance policies are structured to protect the interests of all parties who have an insurable interest—that is, something to lose—in the event of a property or liability claim. These may include a number of different individuals and entities, for example: the trust, limited liability company, or limited partnership that owns the residence; the trustee, manager, general partner, or other fiduciary of the entity; and the individuals who occupy the residence, who are often the beneficiaries or owners of the entity.

Given the complex nature of negotiating appropriate insurance coverage, attorneys should seek assistance from an experienced, independent insurance agent to assess coverage requirements, which will depend on several different factors, but most particularly, how a residence will be used. In determining coverage requirements, the following questions should be considered:

- Who will occupy the residence?
- Is any business conducted on the premises?
- Has the trust, limited liability company, or other entity been created for purposes other than ownership of the residence?
- Does the entity own other property?
- Who are the parties to the trust, limited liability company, or other entity?
- Are there other forms of liability protection covering the property?

By way of example, consider the following fact pattern that describes a common risk profile for an entity-owned residence: (i) a trust, limited liability company, or limited partnership is formed in order to hold a family residence; (ii) the family who has transferred ownership of the residence to the new entity continues to live in the residence; (iii) the family retains personal ownership of the furniture,

furnishings, and other contents of the home; and (iv) the family occupants are closely connected to the entity—as grantors, trustees, and beneficiaries, in the case of a trust, or as managers, general partners, members, or limited partners, in the case of a limited liability company or limited partnership. The table below identifies the insurable interests of each party for this common risk profile and illustrates the wide range of coverage needs:

Party with Insurance Interest	Coverage Requirements
Entity (Trust, LLC or LP)	Dwelling—owned by the Entity Other Structures—owned by the Entity Premises Liability—Entity can be named in a suit
Fiduciary (Trustee, Manager, General)	Premises Liability—Fiduciary can be named in a suit
Occupants	Contents—Owned by occupants Additional Living Expenses (loss of use)—occupants would incur costs to reside elsewhere after a covered loss Liability—Occupants’ negligence may cause them to be named in a suit; coverage required for this location and elsewhere

Unfortunately, many insurance carriers find it challenging to understand and underwrite the risks associated with entity-owned residential property and have been reluctant to offer comprehensive insurance to entities, particularly liability coverage. Even in the case of the common risk profile described above, most insurance carriers do not offer adequate coverage for all parties with insurable

interests. The endorsement most commonly used by carriers—*Residence Held In Trust HO 05 43*—covers only a residence held in a trust. However, a select group of carriers that specialize in meeting the residential coverage needs of high-net-worth clients—AIG Private Client Group, Chubb Group of Companies, and Fireman’s Fund Insurance Companies—offer a range of endorsements which, when properly structured, can provide coverage in virtually any situation.

Below is an example of an “additional insured” endorsement that can be used to structure coverage to protect the insurable interests of each of the parties in the common risk profile described above:

Additional Insured – Residence Premises

Name and address of person or organization:

The definition of insured in this policy includes the person or organization named above with respect to:

Coverage for Damage to Your Property

Dwelling and Other Structures; and

Coverage for Liability and Medical Payments to Others

The person or organization named above is covered for Liability and Medical Payments to others but only with respect to the residence premises and only where the person or organization is held liable for an act or failure to act by any insured.

INSURANCE PROTECTION SHOULD NOT BE AN AFTERTHOUGHT • Attorneys generally

exercise great care in structuring estate planning transactions to avoid exposing their clients to unintended tax consequences. However, an informal survey of practitioners who routinely recommend estate planning techniques involving the transfer of residential property to entities indicates that many attorneys are not exercising the same care when it comes to protecting their clients from exposure to liability for uninsured losses. In many cases, it may not be sufficient for an attorney to merely advise the client to have his or her coverage reviewed by the local insurance agent. Many agents do not have

the requisite resources or experience to adequately identify and address the coverage needs of all parties with an insurable interest. Consequently, it is important for attorneys to develop their own relationships with property and casualty insurance professionals who specialize in servicing high-net-worth clients—and who can provide substantive risk management advice when needed.

In conclusion, the take-home message is that attorneys should avoid approaching property and casualty insurance protection as an afterthought in the estate planning process. Instead, such insurance should be viewed as an important tool for protecting and preserving a client's estate.

PRACTICE CHECKLIST:

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- Consider the benefits of working with an independent insurance broker who is licensed to represent the buyer, as opposed to a direct agent who is contractually aligned to represent the interests of a single carrier.
- To better understand the scope of risk management services that are available, explore the Independent Insurance Agents and Brokers of America web site, www.iiiaa.org. This site also offers guidance on choosing and identifying an independent agent or broker.
- Research and identify the carriers that offer the type of coverage your clients need.
- Contact the branch office of the carriers whose coverage your clients may want and ask the branch manager to recommend a broker who has the specific skills and experience you seek.
- Interview two or three brokers to determine if their approach to risk management meets your and your clients' expectations. In addition, discuss their expectations, ask for specific examples of the expertise they can provide, and request references from professionals they have assisted.

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