



## TRUSTS & ESTATES SECTION

THE STATE BAR OF CALIFORNIA

### ***CALIFORNIA EXEMPTION TO TERMINATION OF TITLE INSURANCE ON TRANSFERS TO REVOCABLE TRUSTS***

#### **LEGISLATIVE PROPOSAL (T&E-2012-06)**

TO: Saul Bercovitch, Legislative Counsel  
State Bar Office of Governmental Affairs

FROM: Patrick A. Kohlmann, Trusts and Estates Section Executive Committee

DATE: June 20, 2011

RE: California Exemption to Termination of Title Insurance on Transfers to Revocable Trusts  
A proposal to add new Division 2, Part 6, Chapter 1, Article 9, Section 12419 to the Insurance Code.

#### **SECTION ACTION AND CONTACTS:**

Date of Approval by Section Executive Committee: June 18, 2011

Approval vote: For: 22 Against: 1 Abstain: 1

<b>Contact:</b>	<b>Section Legislative Co-Chairs:</b>
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## **SUMMARY OF PROPOSAL**

### **INTRODUCTION**

The recent decision in *Kwok v. Transnation Title Insurance Co.* (2009) 170 Cal. App. 4th 1562 (“Kwok”) has raised concern over the continuance of policy coverage when transfers involving revocable living trusts occur. Specifically, the issue in Kwok was the definition of the term “insured” found in subparagraph (a) of Part II, Conditions and Stipulations under the CLTA Standard Coverage Policy (1990). The CLTA Standard Coverage Policy defined the insured as “the insured named in Schedule A, and, subject to any rights or defenses the Company would have against the named insured, those who succeed to the interest of the named insured by operation of law as distinguished from purchase including, but not limited to, heirs, distributees, devisees, survivors, personal representatives, next of kin, or corporate or fiduciary successors . . .”

In Kwok, the Court of Appeal held that the transfer by members of a limited liability company to themselves as trustees of their revocable living trust was voluntary and hence terminated coverage under the policy as a matter of law. Significant to this proposal is the fact that some title insurers have interpreted the Kwok decision to hold that property owners who transfer property to a revocable living trust do not succeed as insureds under the terms of the CLTA Standard Coverage Policy (1990) because the transfer of property to a revocable living trust is a voluntary act and one that does not arise as an operation of law. Accordingly, some title insurers have cited Kwok as a basis to deny coverage when such a transfer occurs.

Although an endorsement is available to extend such coverage to transfers to trusts, it is the experience of trusts and estates practitioners that such endorsements are not readily known of by either practitioners or the public, and are therefore rarely obtained. Furthermore, the understanding of trusts and estates practitioners has been that title insurance companies would not mandate that an endorsement be obtained when an insured transfers title of property to the insured’s revocable living trust. However, some practitioners are now finding that a reason being provided by insurers to deny coverage is that precisely such a transfer has occurred without an endorsement.

The Trust and Estates Section Executive Committee believes that the addition of a statute confirming that title insurance shall continue to the transferee when title to real property is transferred into a revocable living trust would conform with the public’s general understanding.

### **ISSUES AND PURPOSE:**

The following paragraphs provide a detailed explanation of the proposed statute.

#### **Extension of Coverage to Transfers to Revocable Living Trusts**

The proposed statute would provide that coverage under a policy of title insurance issued after enactment of the statute will continue from the named insured to a transferee when title to property is transferred by the insured to the trustee of a revocable trust of which the insured is a

beneficiary with the power to revoke. Likewise, in situations where title to property is transferred from the trustee of a revocable living trust to the trust's settlor, such as when title is conveyed from a trust back into the name of the insured when refinancing a mortgage, the proposed statute would continue coverage upon reversion to the insured. The rationale for extending such coverage is the fact that the insured, whether he or she holds title individually or whether his or her trust holds title, has remained the equitable owner of the property.

As support for this position, it should be noted that revocable living trusts (also sometimes identified as inter vivos trusts) are the most commonly used trusts by the public. They are considered grantor trusts under the Internal Revenue Code and accordingly ignored for income tax purposes. A transfer of real property by a settlor to his or her revocable living trust is not a taxable event, and does not result in a change in beneficial ownership of the subject property for property tax purposes. Indeed, the settlor retains the power of revocation in revocable trusts and hence the ability to revoke the trust and convey the property back to himself or herself without causing a change in beneficial ownership.

Such a statute is not unheard of. For example, in California, the standard instrument used to impose an encumbrance on real property to secure an obligation of the owner is a deed of trust. Most deeds of trust and the notes they secure contain a "due-on-sale" clause that purports to give the lender a right to accelerate the secured obligation if the owner transfers the property. In the past, this raised the issue of whether a transfer to a revocable trust triggered the clause.

Accordingly, California enacted a statute excepting such transfers from the effects of due on transfer clauses under deeds of trust. Civil Code section 2924.6(a)(4) provides that an obligee may not accelerate the maturity date on loans executed or refinanced on or after January 1, 1976, that are secured by residential real property (defined as real property containing one to four housing units) if the property is transferred into an inter vivos trust in which the obligor is a beneficiary.

Revocable living trusts are becoming increasingly common as the estate planning vehicle of choice to hold real property during individuals' lifetimes. The public would benefit from a statute which ensures that trust transfers do not inadvertently cause the loss of title insurance.

#### Statute Prospective Only

The proposed statute is not retroactive, and therefore would not affect any title insurance policies issued prior to the effective date of the new statute.

#### **HISTORY:**

There have not been any prior legislative proposals on this topic.

#### **IMPACT ON PENDING LITIGATION:**

As the proposed statute would apply only to policies issued after the date of enactment, no known pending litigation would be impacted by this legislation.

**LIKELY SUPPORT & OPPOSITION:**

The Executive Committee of the Trusts and Estates Section anticipates support from estate planners and members of the public with real property who have transferred or may transfer title to that property into a revocable living trust.

The California Land Title Association may oppose the proposed legislation on the basis that the transferee may purchase an endorsement.

**FISCAL IMPACT:**

Unknown fiscal impact.

**GERMANENESS:**

This proposal requires the special knowledge, training, experience and technical expertise of the members of the Trusts and Estates Section Executive Committee because it relates to estate planning matters which are the special purview of the Committee.

**TEXT OF PROPOSAL**

SECTION 1. Article 9, Section 12419 is added to Division 2, Part 6, Chapter 1 of the Insurance Code, to read:

ARTICLE 9. Exemption to Termination of Title Insurance on Transfers to Revocable Trusts

12419. (a) Coverage under a policy of title insurance shall continue to the transferee when title is transferred to a trustee of the insured's revocable living trust of which the insured is a beneficiary with the power to revoke, or, if the trustee of a trust is the insured under the policy, when title is transferred by the trustee to the trust's settlor in his or her individual capacity.

(b) This section applies only to a policy of title insurance issued on or after January 1, 2013.