ARNOLD & PORTER LLP

PIECES OF THE PUZZLE

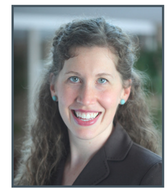
A Newsletter from Arnold & Porter's Private Client Services Team

December 2014

# Addressing Risk Exposure for High Net Worth Individuals

*By Laura A. Jeltema*

**Contact:**



**Laura A. Jeltema**
**Washington, DC**
+1 202.942.6664
Laura.Jeltema@aporter.com

Most high net worth individuals have estate planning structures in place that focus primarily on mitigating taxes and protecting assets from creditors. As part of this planning, it is common for high net worth individuals and their advisors to spend time examining the utility of life insurance as a tool to preserve wealth and accomplish estate planning objectives (for example, by providing for estate taxes, protecting illiquid assets, and satisfying testamentary gifts). As a result, such individuals tend to be adequately (and often over) insured with respect to life insurance. At the same time, an individual's current insurance portfolio and estate planning may be inadequate to manage the risks posed by the particular lifestyle and circumstances of the individual, or the individual may be paying more than necessary for the coverage. Substantial wealth often produces distinctive challenges - in addition to investment, life insurance and estate planning solutions, it is also prudent to analyze whether specialized property and excess liability insurance is appropriately in place to help confront such challenges.

## Recognizing Exposures

High net worth individuals may be exposed to unique liabilities as a result of the assets they own and activities in which they engage. However, these same individuals may not be aware of the aspects of their lifestyle that can increase the likelihood of liability lawsuits or other types of risk. For example, consider the following situations which increase exposure to risk:

1. Ownership of unique, high value assets, such as luxury homes, fine art, collector cars, wine, aircraft and watercraft;
2. Employment of household staff (housekeepers, drivers, nannies, etc.);
3. Participation in fiduciary roles (officers and directors of for-profit and non-profit organizations, or trustees of trusts);
4. Having minor children whose activities (operating vehicles, social media, and recreational activities, for example) may pose a risk to parents as a result of vicarious liability[1]; and
5. Families with substantial personal wealth may be viewed as easy targets for liability lawsuits.

1 Parents may be held vicariously liable for actions of minor children in the same way an employer may be held liable for actions of employees (*i.e.*, liability even if a parent has no direct role in the act).

## Existing Protection and Planning

Although an individual may believe he or she is adequately covered, it is worth taking the time to analyze whether this is true. For example, existing homeowners or workers compensation policies may not cover lawsuits by household staff based on wrongful termination, sexual harassment, discrimination and other alleged wrongful employment acts. In addition, although owning assets as tenants-by-the entirety may offer protection in the case of a lawsuit filed against just one of the spouses, in many situations both spouses could be sued (which would defeat the utility of tenancy by the entirety ownership for creditor protection purposes). As an officer or board member of a non-profit or for-profit organization, the individual assumes a level of responsibility for the organization and, as a result, may be exposed to claims from third parties, shareholders, other officers or directors, or staff. The non-profit or for-profit company for which an individual serves as an officer or director may not have adequate (or may have no) liability insurance to cover such claims. Finally, although an individual may have insurance for each property, this coverage is often cobbled together over time on an ad hoc basis as new property is acquired. As a result, the individual may be paying more than necessary for the coverage or there may be gaps in coverage as a result of the lack of coordination among coverage.

## Useful Solutions

As a result of the heightened exposure to risk, high net worth individuals should seek to adopt a range of solutions to alleviate such exposure. Among other strategies, two solutions include:

*Obtaining Appropriate Insurance Coverage.* Consider whether the individual has adequate insurance to cover potential losses and analyze the coverage on a periodic basis. The types of insurance that should be considered include:

1. Excess liability insurance – In general, excess liability coverage, also known as casualty or "umbrella" coverage, should match net worth.

2. Specialized property insurance (fine art, collectibles, wine, etc.) – Although many of the assets owned by high net worth individuals may seem difficult to value, valuation experts today are able to place values on every type of asset.

3. Renter's insurance for a child living away from home - This type of insurance offers coverage for loss on the value of personal property contained within the child's residence as well as personal liability protection for activities occurring inside the residence.

4. Trustee liability insurance – This type of insurance protects the trustee and anyone assisting the trustee in the event of a lawsuit (for example, lawsuits by beneficiaries); amount of coverage depends upon the value and complexity of the assets of trust.

5. Directors and Officers ("D&O") liability insurance - D&O insurance (which is normally carried by the non-profit or for-profit company) provides protection to past, present and future officers and directors in the event of claims of alleged or actual wrongful acts.

*Creating Coordination Among Coverage.* Advisors should communicate regularly so that all parts of the planning are working together. At a minimum, it often makes sense to consolidate insurance with one carrier who can analyze the overall picture. Estate planning attorneys can recommend specific insurance brokers who will conduct a full scale analysis of existing coverage, identify gaps in coverage, and offer cost saving strategies. In addition there may be untapped opportunities to prevent loss that one advisor working alone may not recognize. For example, involving an estate planner in the analysis may result in additional strategies to better utilize the insurance coverage and offer greater levels of asset protection. He or she may recommend owning certain assets in limited liability companies, trusts or in other more simple but effective forms of titling.

Most importantly, advisors need to be aware that high net worth individuals may have heightened exposure to risks, and these risks should be managed as part of the overall estate, tax and investment planning.