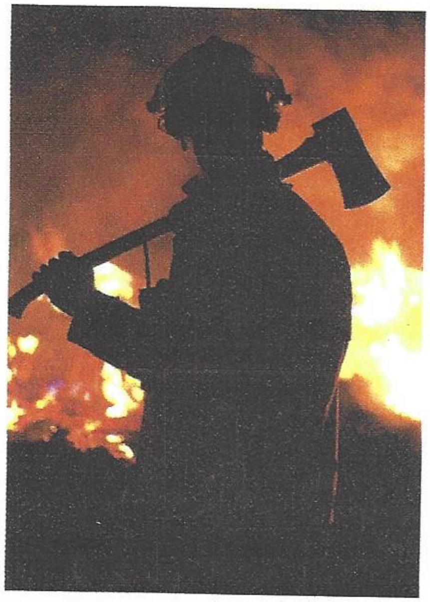
Misunderstood Liability

Many wealthy individuals are underinsured because they mistakenly believe it will make them less vulnerable in liability cases. BY JOSEPH WEISS

"LIABILITY"—THE RESPONSIBILITY FOR injury, death or damages to another—is a word that sends chills down people's spines. Anyone who owns a home, drives a vehicle, operates a business or engages in any number of normal pursuits faces liability exposure. If one is proved liable for an accident, the consequences can be devastating financially unless you are properly protected. Wealthy individuals face a disproportionate amount of exposure because they often own multiple homes and automobiles, investment properties, private aircraft and yachts.

Wealth management professionals are getting better at including property and casualty specialists in their practices to address such liability exposure, yet statistics show that many high-net-worth individuals still carry low liability coverage in their personal insurance. Why do successful people do this when it obviously puts their wealth at risk? The answer may lie in three factors. One is that people hold erroneous beliefs and misconceptions that lead them to carry lower limits. Second, there is even greater confusion about how the legal system works and what happens in the majority of liability cases. And third, clients who use mass-market insurers do not get access to the higher policy limits offered by specialty insurers.



Erroneous Beliefs

Even the savviest among us sometimes get bad information, and the subject of liability is no different. Many otherwise astute high-net-worth individuals, for example, believe there's a correlation between the size of judgments in liability cases and the amount of liability insurance carried by a defendant. People think that if you have high policy limits, the courts will go after all they can. This can be a particularly dangerous belief if it leads wealthy people to seek the minimal amount of liability limits on their policies. Because even though a plaintiff's attorney might find great comfort in knowing a defendant is well insured, it will be the facts of the case that determine the amount of a judgment.

In 2005, Lane McVicker LLC conducted a study of New York personal injury cases to determine if there were indeed some correlation between judgments and insurance coverage. Although the study was small in scope and did not count medical malpractice cases or instances in which private settlements were made, two significant factors became apparent. First, a surprising number of judgments over the previous five years were in excess of $5 million. Secondly, there was no correlation between judgments rendered and the amount of liability insurance carried. In the study's view, the facts of each case and the damages incurred by the plaintiff were the key settlement factors. The amount of the defendant's insurance coverage had no bearing.

One major inference that can be drawn from the study is that, when considering how many of the judgments were over $5 million, many people are likely to be significantly underinsured for liability.

Understanding The System

Wealth managers seeking to help their clients plan for liability exposure need to look at the realities of the legal system. If one is trying to use the public record of court settlements to help them determine a possible average amount of liability insurance to carry, they will find it very difficult to gather enough usable information.

The settlement amounts of most liability cases are unknown because most cases never make it to a jury or bench trial. Law firms specializing in these cases estimate that as few as 2% of them ever go that far. After the litigation process starts, most cases are settled through mediation and the amounts agreed upon do not go in the public record. The insurance companies who pay out those settlements are not inclined to disclose the amounts themselves. Even in cases that go to a full trial, the amounts of the judgments are not always made public. The public record is not a reliable source to help clients determine the amount of liability coverage they should carry. We'll examine better methods for doing so later.

Yet even if the legal system cannot help us determine proper policy amounts, it can dispel certain myths. The biggest of these is the one about how much information a plaintiff's attorney is allowed to find out about a defendant's net worth. This is probably the most misunderstood part of the whole process. Many people believe that financial records can be subpoenaed to see if the individual is worth going after. This is typically not the case. In most states, what the attorneys can ascertain is the policy limits of the individual's liability policy.

The statute in Florida, for example, allows a plaintiff's attorney to determine if a defendant has insurance and find out what the liability limits of the policy are. The attorney may also try to learn about a defendant's net worth through public records, though that is all he can do.

So when can a court go after records for the defendant's total net worth? If a case goes to full trial and a judgment is rendered—and if that judgment exceeds the policy limits of the defendant—then the court can go after the defendant's financial information. In other words, they can only go after net worth to execute a judgment. An important note here (one that further illuminates why there is no correlation between judgments and the amount of insurance carried) is that jurors in a trial do not know the policy limits of the defendants. In a jury trial, they base awards on the damages incurred by the plaintiff, not on insurance policy limits.

But wait, you say: We determined earlier that most cases never make it to trial and are settled through negotiation. Since they can know my client's liability policy limits at the outset, doesn't having high policy limits make my client a target? While there has been no specific study to answer this question, attorneys report that having high policy limits would make you a more attractive defendant to negotiate with than one with low policy limits. However, even a negotiated settlement outside of a court trial would be determined by the amount of the damages incurred by the plaintiff and not by the defendant's insurance. Therefore, one should select coverage limits based on the protection needed and not on the fear of being a target.

Somebody with high net worth and assets to protect should have higher policy limits for two additional reasons. Number one, in umbrella and excess liability policies, attorneys' fees are not subject to policy limits. So as your insurer is defending you, you are not incurring legal fees that you would be if you were defending yourself. Attorneys polled for this article report that even small cases settled out of court take considerable time and billable hours, which can seriously erode somebody's assets.

Secondly, umbrella liability policies have the lowest ratio of premium to maximum claim payout in personal lines insurance, making these policies a bargain for asset protection. One would be remiss not to recommend that high-net-worth clients use this relatively low-cost tool.

Conclusion

Now that you're armed with a better understanding about the reality of liability cases, what can you do to help protect your high-net-worth client?

First and foremost, if you run a successful wealth management practice or are in the process of building one, incorporate a good independent property and casualty agent into your team. This person should have access to high-end insurance providers that can underwrite luxury homes and autos and can offer high-policy-limit umbrella policies and excess liability policies. Mass-market insurers, by contrast, will not be able to address the needs of most high-net-worth clients. Your own team's agent and underwriters could help blunt many liability exposures with preventative measures at the outset of underwriting. They have the tools to assess risks—how likely those risks are and what kind of financial impact they can have. Furthermore, these agents can assess your client's risk tolerance and help figure out coverage amounts that will best serve the client's needs. Such specialists allow you to refine the wealth protection side of your practice.

Also, you should help your client see that the wealth protection side of wealth management is very important in itself—help them see insurance not as an expense but as an investment in liability protection. That said, clients need not overpay for insurance. Umbrella and excess liability policies are extremely cost effective for the coverage obtained. Meanwhile, the insurance industry is responding to the demands of the high-net-worth marketplace by creating higher limit policies and specialty products. Group personal excess/umbrella policies (GPEs) have recently come to the market to address liabilities for individuals in corporate situations. Their group pricing structure helps to lower costs while providing large coverage amounts.

As our court system and culture continue to expand the definition of liability, those people with assets to protect will need the services of wealth managers who include this crucial protection as a standard part of a sound financial plan. Rv

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