

# THE NAVIGATOR

A FINANCIAL PLANNING RESOURCE FROM  
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*For many individuals, an Umbrella insurance policy is an important form of added protection; for affluent individuals, such coverage can be critical. The maximum possible loss that can impact a policyholder's possessions is generally quantifiable and limited by their value; loss from liability to third-parties is both unknown and potentially devastating. An Umbrella policy serves to greatly reduce this exposure and can be an essential part of an individual's portfolio of personal protection coverages.*

## PERSONAL LIABILITY PROTECTION: UMBRELLA INSURANCE FOR HIGH NET WORTH INDIVIDUALS

BY MATTHEW BLUME, CFA

### WHY SHOULD ONE CONSIDER PURCHASING UMBRELLA LIABILITY COVERAGE?

Umbrella insurance serves two important purposes. Umbrella insurance greatly increases the coverage level typically offered under homeowner's policies and auto policies, and it expands the breadth of insurance coverage to situations unrelated to either homes or autos.

### THE LIMITS OF PRIMARY INSURANCE POLICIES<sup>1</sup>

The basic homeowner's insurance policy typically provides coverage for third-party liability incurred by the policyholder

<sup>1</sup> Collectively, homeowner and auto policies are known as "primary" policies.

and family members while those family members are living at home or away at college. Liabilities arising from use of automobiles are excluded by the homeowner's policy and covered under the auto policy. Liability coverage provided by the homeowner's policy offers important protection; it covers liability for damage to third-party property and for injury sustained by a third-party. It also typically includes liability for personal injury which extends to intangible harm such as libel or slander.

The basic auto policy fills in the gap left by the homeowner's policy, providing coverage for third-party liability incurred by the policyholder arising from use of an automobile. Liability coverage under an auto policy is similar to that provided under a homeowner's policy in that it covers liability for damage to property of a third-party and for injury sustained by a third-party in an accident.

*It should be noted that the limits of liability provided by the homeowner's policy and the auto policy will rarely exceed \$1 million. Liability losses higher than \$1 million are not uncommon; an auto accident resulting in serious injury or death easily has the potential to exceed the limits of the primary auto policy. Similarly, a fire or water problem in a multi-family apartment or condominium building is also likely to exceed \$1 million in damages. If your net worth exceeds \$1 million, then the typical liability limits of your primary policies may not be sufficient.*

### UMBRELLA INSURANCE COVERS EXCESS LIABILITIES

To protect policyholders against such large but not uncommon losses, a special excess liability can be purchased, commonly referred to as an Umbrella policy. This policy provides additional limits on top of both the auto and the homeowner's policy limits.

For example, the Umbrella policy may be for a limit of \$2 million, which, combined with the primary limits of \$1 million, provide a total liability protection of \$3 million.



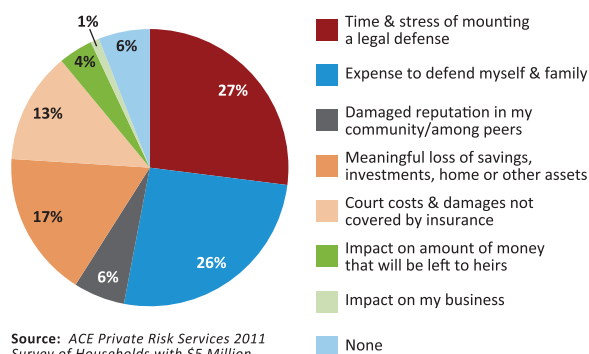
Umbrella policies typically only respond after the primary policies have been exhausted by payment of loss, and the Umbrella policy language usually incorporates a feature that in some instances allows it to pay a loss that is not covered by the primary policies.

Umbrella policies are available from \$1 million to amounts as high as \$100 million: as expected, greater wealth typically requires higher limits. A rule of thumb is that the total limits of liability should approximate the amount of an individual's net worth that could be exposed to creditors and claimants, which is the amount that a plaintiff's attorney will undoubtedly be targeting in a lawsuit. It is noteworthy that assets held in creditor-protected trusts and 401K plans (if creditor-protected) are usually not included in the calculation of net worth. That said, we recommend that your coverage level be prudently modulated depending on the cost of coverage.

One very important component of both primary and Umbrella liability coverage is the payment of legal defense costs. Legal expenses can quickly escalate for even the simplest lawsuit, and, without appropriate insurance coverage, the policyholder could incur significant and potentially devastating legal bills, regardless of fault. Umbrella insurers of affluent individuals will typically provide defense costs that do not count against policy limits, leaving the policy limits to pay any actual third-party damages.

Some of these claims can be extraordinarily large and potentially devastating to an underinsured person's financial condition. For example, in 2013, an Illinois jury awarded \$9.3 million to the family of a machine worker who was killed in a head-on crash with a driver who claimed she was forced to swerve into the middle of the road to avoid striking a dump truck that was making a left turn off the road. The driver had an insurance policy with a \$1.25 million limit – clearly, not enough to address this devastating liability.

TOP FEAR OF BEING SUED



Source: ACE Private Risk Services 2011 Survey of Households with \$5 Million or More in Investable Assets

## UMBRELLA INSURANCE COVERS OTHER LIABILITIES

While homes and automobiles are two of the most common and important liability exposures that most of us face, there are a number of other ways in which people can potentially be exposed to material liability. Below is a list of some other, less common liability coverages that might be appropriate for certain clients and which may be a part of a customized Umbrella policy.

- **Watercraft liability**
- **Employment practices liability:** This type of coverage is typically available by endorsement to the Umbrella and protects and provides defense against employee claims such as sexual harassment, wrongful termination and discrimination.
- **Uninsured, and Underinsured (UM/UIM) motorist liability**
- **Uninsured, and Underinsured general liability:** This coverage supplements inadequate general liability limits carried by an at-fault third party.
- **Distracted driving liability:** losses caused by cell phone use for talking or texting.
- **Social media liability:** Ten years ago social media was barely heard of and used. Now millions of people daily use Facebook, Instagram, and Twitter; with the explosion of social media, "cyber bullying" has evolved as a new form of attacking individuals. There is limited data available on social media claims, because they are so recent, but according to a 2013 report by General Reinsurance Corporation, the average loss arising from social media was more than double that of the average traditional personal injury loss. A personal Umbrella policy may include coverage for liability arising from social media usage.
- **College student liability:** There is always risk to parents when students leave home for college. Parents will almost always be named in lawsuits over damages from unsupervised students hosting parties, even if on university premises. There have been cases where guests have fallen over balconies, or overloaded balconies have collapsed, and even though the landlord would be the primary target in these suits, lawsuits will generally attach to the parents of the party hosts as well.
- **Caregiver liability:** Injuries sustained by a hired caregiver in the home of a policyholder will typically be covered by an Umbrella policy. Liability arising from situations



such as an auto accident involving a hired caregiver in the policyholder's vehicle may also be covered, though it will likely depend on the specific language of the policy.

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## WHO SHOULD CONSIDER UMBRELLA INSURANCE?

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The best candidates for Umbrella insurance are high net worth individuals whose wealth is held in vehicles that are not protected from creditors. Assets held in creditor-protected trusts, pension plans, and employer-sponsored 401K or other retirement plans are exempt from bankruptcy cases, as well as garnishment orders resulting from lawsuits. In addition, some states have laws protecting IRA funds in the same way.

For individuals who hold the bulk of their wealth in vehicles that protect their assets from bankruptcy and garnishment orders, Umbrella insurance may not make sense, as the protections that it affords would be materially less valuable than they would be for someone whose assets reside in personal investment accounts, bank accounts, etc.

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## COST OF EXCESS LIABILITY COVERAGE

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The cost of Umbrella insurance coverage is reasonable relative to some other types of sometimes prohibitively expensive insurance (such as long-term care insurance).<sup>2</sup> While exact premium rates will depend on the policyholder's unique circumstances and the level of policy customization, the table below provides sample annual rates for varying levels of coverage in order to give one a rough idea of how much they could expect to pay for such coverage.

SAMPLE ANNUAL EXCESS LIABILITY RATES

	Coverage Amount				
	\$5 M	\$10 M	\$15 M	\$20 M	\$25 M
1 Residence 1 Driver 1 Vehicle	\$511	\$855	\$2,625	\$5,250	\$8,250
1 Residence 2 Drivers 2 Vehicles	\$638	\$978	\$3,794	\$6,319	\$9,269
2 Residences 3 Drivers 4 Vehicles 3 Boats	\$1,238	\$1,913	\$5,721	\$8,346	\$11,346
3 Residences 2 Drivers 6 Vehicles	\$1,116	\$1,843	\$4,494	\$6,994	\$10,093

<sup>2</sup> <http://www.pekinhardy.com/the-navigator/pdf/PSS-Nav-2015-5-13.pdf>

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## CONCLUSION

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While Umbrella liability coverage certainly is not appropriate for everyone, it can be a very powerful risk management tool for high net worth individuals with significant amounts of wealth that are not protected from creditors. As your trusted advisor, we aim to not only help you grow your wealth, but also to help you protect your wealth. That may or may not mean advising you as you consider various types of insurance coverage in implementing a broader financial plan. We can help you to determine whether or not Umbrella liability coverage might make sense as a part of your financial picture, and, if so, we can provide you with some next steps to help you get this protection in place. If you would like to discuss whether or not Umbrella insurance might be appropriate for you, please do not hesitate to reach out to us.

*The purpose of the Navigator series is to provide our clients with expert advice on a broad range of financial planning topics relevant to their lives. In certain cases, in order to give our clients the best possible guidance, we may consult outside subject matter experts whom we trust to provide accurate and unbiased information.*

*For this issue of the Navigator, Rebecca Woan, Founder and CEO of Chartwell Insurance Services, provided material assistance in our development of the content. Ms. Woan has more than 20 years of professional experience in providing umbrella insurance to high net worth insurance clients.*

*Pekin Hardy Strauss does not sell insurance products, nor do we receive any kind of direct or indirect compensation for referring clients to insurance providers.*

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