

Property and Casualty Risks for Affluent Clients: Helping Your Clients Avoid Disaster

by **Tim Waterworth, CFP®, CLU, ChFC**

As senior vice president with the Private Client Services practice at Marsh USA Inc., Tim Waterworth, CFP®, CLU, ChFC, leads the development of referral partnerships with financial advisors. He has more than 20 years of experience in the financial services industry, including delivering risk management solutions to affluent individuals and families.

Few financial planners would argue that losses attributable to an inadequate property and casualty insurance program wouldn't be financially devastating or that P&C risk management is not an important element of financial planning. The topic is part of the Certified Financial Planner certificant educational curriculum and is explicitly defined as one of the basic financial planning subjects in the CFP Board's code of ethics. Yet it seems to be the exception rather than the rule when it comes to financial planning professionals establishing an adequate property and liability risk-management program for their clients. As a result, planners are exposing themselves to added professional liability.

Whether attributable to a lack of competence in the subject matter, not meeting licensing requirements, or just general indifference to an uninteresting subject, the state of property and casualty insurance "review and comment" within the financial planning process is suffering from neglect by many financial planners. David M. Cordell summed up this neglect well in a recent *Journal of Financial Planning* article ("A Moving Experience in Financial Planning," September 2003): "The common advice from planners regarding

Executive Summary

- Affluent clients face greater complexity and greater risk than the average client when it comes to insuring their property and personal liability. Yet many financial planners gloss over this area, potentially exposing themselves to professional liability.
- A standard review of homeowner's, auto and umbrella coverage is not sufficient. Affluent clients may have multiple homes in multiple states, employees who work on their property, and collections that are difficult to value and replace.
- Financial planners have three alternatives for advising in this area: leave the responsibility in the client's hands, provide in-house services, or outsource to property and casualty specialists.
- The planner needs to coordinate a client's coverage of multiple properties in different states under different agents, and integrate it with auto and umbrella coverage.
- With collections and other valuable personal belongings, planners need to be aware of such issues as what is true value, repair versus replacement, and depreciation due to a partial loss.
- The affluent are more likely to be sued and have more to lose, including future income. Volunteers on non-profit boards may need directors' liability insurance.
- The affluent need a higher level of service than provided by the standard homeowner's insurer.
- Planners need to be aware of a state's required coverage for domestic workers, and coverage related to part-time and contract workers.
- Affluent clients may have unique property risks, such as a historic home, that require special coverage.
- The affluent are more apt to live in areas requiring natural catastrophe coverage.

P&C insurance is to find a good property and casualty agent, as if that were enough to exonerate the planner from any responsibility if anything goes wrong."

Financial planners who *do* offer support for their clients' property and casualty insurance issues often find that they can add great value to these relationships by doing so. The integration of services that protect clients from unacceptable property and casualty exposures is vital to safeguard clients and complete a comprehensive planning offer.

For many clients it is enough for the planner to simply review their needs and existing coverage, looking over the shoulder of the

client's present property and casualty insurance agent. The training provided in the CFP program is enough to enable a planner to effectively assess the adequacy of most clients' P&C insurance needs and to responsibly refer when appropriate.

A basic P&C review would include asking the following questions:

- Are homeowner's and auto insurance policies in place?
- Are the liability and uninsured/underinsured limits adequate?
- Is there an umbrella or personal excess liability policy in place and is it adequate?

“Financial planners have three basic alternatives for addressing their clients’ property and casualty insurance needs.”

CFP Board Code of Ethics and Professional Responsibility: Principle 3—Competence

A CFP Board designee shall provide services to clients competently and maintain the necessary knowledge and skill to continue to do so in those areas in which the CFP Board designee is engaged. One is competent only when he or she has attained and maintained an adequate level of knowledge and skill, and applies that knowledge effectively in providing services to clients. Competence also includes the wisdom to recognize the limitations of that knowledge and when consultation or client referral is appropriate.

- Are there activities the clients are involved in, aside from normal day-to-day activities in their work and at home, that might cause risk to their, or others’, life, limb or property?

While this type of review may suffice for some clients, it does not for clients with more complex needs. **Affluent clients can have far more liability and property risks than most people—and far more to lose.**

These risks include expensive property, property in different geographic areas, employees who maintain their property, assets and interests that create potential liabilities, and valuable collections that are often difficult to value and replace. The complexity of their situations makes crafting a solid personal risk-management plan more difficult and considerably more important.

The purpose of this article is to first offer an overview of the factors to consider before addressing property and casualty risk-management issues with your clients. Then we will outline the unique property and liability risks that make affluent clients’ P&C needs more complex. Finally, we will provide a useful tool you may want to incorporate into your client data gathering and periodic reviews.

What Is a Financial Planner to Do?

Financial planners have three basic alternatives for addressing their clients’ property and casualty insurance needs. A planner may incorporate one or a combination of these three alternatives:

1. Leave the responsibility for P&C insurance in the client’s hands
2. Develop in-house capabilities
3. Outsource the delivery of P&C insurance solutions

If you decide not to include property and casualty risk management as part of your personal financial planning services, it is advisable to explicitly disclose that to your clients, preferably in writing, and have them acknowledge with their signature. In your engagement agreement or meeting, be sure to advise them to look elsewhere for competent counsel on P&C insurance issues.

If you decide to include P&C risk management in your personal financial planning services, you will need to evaluate your competence to address these issues (see sidebar regarding Principle 3 of the CFP Board’s code of ethics). In addition, you must assess the P&C licensing requirements in the state where your clients reside to determine if the level of advice and fee structure you are contemplating requires licensing or other registration or disclosure requirements. For example, if you give your client advice about P&C insurance and charge your client a fee for that advice, do you need to be licensed as a consultant? In some states, this is the case.

In addition to competence and licensing, the type of property and casualty insurance services you provide should also be defined by what you are willing to do. Will you collect copies of your client’s insurance policies and evaluate their current P&C insurance program for adequacy and appropriateness? Will you evaluate their current agent and

insurers for quality of service and financial solvency? Will you work with your client’s insurance agent to fine tune and monitor the client’s insurance coverage?

For clients with relatively straightforward risks, you may be comfortable with the cursory review outlined above. But other clients with complex risk profiles will require the counsel of a qualified P&C expert. In such cases, you will need to establish alliances with qualified individuals to outsource these clients’ needs.

Unique Risks of the Affluent

Most advisors would never consider giving affluent clients a commodity solution to their wealth management needs. Yet many of these clients rely on standard homeowner’s insurance that may leave them grossly under-insured. **In fact, according to *Insurance Age* magazine (March 5, 2002), an estimated 80 percent of high net worth individuals and families who should be protected by specialized P&C policies are not.**

“The right coverage is not always a matter of obtaining more costly insurance.”

To recognize where a risk might exist, keep in mind these unique aspects of the affluent risk profile and some common errors in coverage.

Patchwork plans. Most affluent clients are busy people and do not take the time to coordinate their insurance coverages. For example, clients with property in several states may have bought separate coverage for each property, often from different agents and underwriters. If a client buys insurance from one company in New York and another in Florida, who is to determine whether the two policies work together and whether there are overlaps or gaps in the coverage?

The use of multiple insurers or brokers can lead to potentially costly gaps in coverage. Frequently, the underlying policy liability limits are not properly integrated with excess (umbrella) liability coverage. For example, if the auto policy has a liability limit of \$250,000 and the umbrella policy doesn't respond until \$500,000, the client could be forced to pay \$250,000 out of pocket to satisfy a judgment.

In addition, clients with multiple sources for their insurance may have policies with different expiration dates. Besides making it difficult to administer and track billing, this approach can again lead to gaps in coverage. One way to resolve this problem is to consolidate coverage and coordinate the dates when policies renew.

Collections and other valuable belongings. A standard homeowner's insurance policy may be inadequate for high net worth individuals. The most serious drawbacks are the limitations (policy sub-limits) on property coverage. Few clients realize that valuables, including furs, antiques and

jewelry, have special limits of coverage for certain losses—sometimes as low as \$1,000.

An agent or broker unfamiliar with the needs of the affluent may attempt to remedy this limitation with scheduled coverage for particularly valuable items. However, scheduling may not solve many potential pitfalls, including:

- *A dispute over value in the event of a claim.* A current, professional appraisal at the time of the scheduling is essential for establishing the item's market value.
- *Replacement versus cash.* Some insurers will not pay cash in the event of a loss, but will insist that the item be replaced, sometimes through vendors that they choose. This may be inappropriate for an item with sentimental value that the client does not wish to replace.
- *Repair versus replacement.* It is sometimes less expensive to replace a damaged item than it is to have it repaired by a specialist. But it should be up to the client—not the insurance company—to determine whether the item should be repaired or replaced.
- *Depreciation in the event of a partial loss.* When a valuable antique is damaged, scheduled coverage usually will pay to repair it. But the insured may need additional protection against the lost value of an item that is no longer in mint condition.
- *Blanket coverage.* A client may have a collection that is valuable in total, but individual items in the collection may not have enough value to merit individual scheduling. A wine cellar is a good example. A specialized policy will pro-

vide the client with blanket coverage, so clients need not call their broker every time they add or consume a bottle from the collection.

- *Automatic coverage for new items.* When your clients are traveling, the last thing they will think to do is call their insurance advisor to report the purchase of a new bauble. Specialized insurance will cover new purchases for a set period until they can be properly scheduled.
- *Valuables on loan, in transit or in storage.* The average household doesn't generally lend its artwork to museums or galleries, but it is not uncommon among the affluent. Clients often are not aware of the important nuances of insuring such valuables, including what is insured and when, and who is responsible for insurance—the museum or the owner? If a piece is damaged while on loan or in transit, is it insured and for how much?
- *Valuables outside the home.* Most homeowners have coverage for the valuables located at their primary residence, but the affluent can have valuable items in many places—at multiple residences, including locations abroad, on yachts, with children at school, while traveling and so forth.

The right coverage is not always a matter of obtaining more costly insurance.

For example, specialized policies for antique cars often are much lower in cost than those for comparably valued new cars. That's because the antique cars generally are not driven every day, so the risks of accidents are lower. But coverage for antique cars needs to be updated on a regular basis because, unlike new cars, they often appreciate in value over time.

More to lose and more likely to be sued. Keep in mind that not only are your clients' assets at risk from lawsuits, but so is their future income. Excess liability provides protection above homeowner's and automobile policies. In addition to provid-

TABLE 1

State Workers' Compensation Laws

States in which domestic employees are specifically excluded from workers' compensation:

- Georgia
- Louisiana
- Virginia

States in which workers' compensation for domestic workers is voluntary:

- Alabama
- Arkansas
- Arizona
- Florida
- Idaho
- Indiana
- Maine
- Mississippi
- Missouri
- Montana
- Nebraska
- Nevada
- New Mexico
- North Carolina
- North Dakota
- Oregon
- Pennsylvania
- Rhode Island
- Tennessee
- Texas
- Vermont

In all other states, workers' compensation is compulsory for domestic workers who meet the threshold for compulsory coverage. This threshold ranges from 16 hours per week in Massachusetts and \$160 per quarter in Ohio to employer payroll of \$20,000 for all workers in Kansas.

- California
- Colorado
- Connecticut
- Delaware
- District of Columbia
- Hawaii
- Illinois
- Iowa
- Kansas
- Kentucky
- Maryland
- Massachusetts
- Michigan
- Minnesota
- New Hampshire
- New Jersey
- New York
- Ohio
- Oklahoma
- South Carolina
- South Dakota
- Utah
- Washington

Source: Insurance Information Institute, May 2003 (www.iii.org/media/hottopics/insurance/workerscomp/)

TABLE 2

The 10 Most Costly Catastrophes in the United States

Date	Peril	Cost
September 11, 2001	World Trade Center	\$40 billion (estimate)
August 1992	Hurricane Andrew	\$15.5 billion
January 1994	Northridge, California, Earthquake	\$12.5 billion
September 1989	Hurricane Hugo	\$4.2 billion
September 1998	Hurricane Georges	\$2.9 billion
June 2001	Tropical Storm Allison	\$2.5 billion
October 1995	Hurricane Opal	\$2.1 billion
September 1999	Hurricane Floyd	\$1.9 billion
March 1993	20-State Winter Storm	\$1.75 billion
October 1991	Oakland, California, Fire	\$1.7 billion

Source: Insurance Services Office, May 2003

ing higher dollar coverage for bodily injury or property damage that may be caused by an insured, the policy can provide coverage for suits for defamation and invasion of privacy. It also can provide limited coverage for bodily injury or property damage liability resulting from service as an officer on a nonprofit board of directors. In addition, it may pay for defense costs in the event of a lawsuit, which is a key point to investigate. It is important to know if the defensive

costs are part of the total policy coverage amount or if they stand alone.

The fact that excess liability insurance may provide only limited protection for liabilities arising out of service as a director or officer on a nonprofit board leaves some board members particularly concerned about their potential risks. To address this exposure, individuals with board responsibilities should consider a separate directors' and officers' liability insurance policy, which would

cover such additional liabilities as errors and omissions, misstatements or breach of duty.

What about liabilities that may be created by employees such as household workers or personal assistants? A properly structured insurance program would respond.

Excess liability can be bought in amounts ranging from \$1 million to \$50 million. How much excess liability coverage is enough depends on several factors, mainly the client's risk profile. Consider these questions when assessing a client's risk profile: Are they in the public eye? Do they have interests and avocations that expose them personally? How "deep" are their pockets? What is their prospect for future earnings?

There is also a need to be aware of liabilities to employees. In one instance, an individual whose regular driver was unavailable was picked up by a new driver. When the driver became lost, the client thought she was being kidnapped and took action by striking the driver with her cell phone. He sued her for \$10,000 in damages. Her insurance paid the claim.

Demand a higher level of service.

Another serious gap with standard homeowner's coverage is the potential for poor handling of claims. People with million-dollar losses do not want to deal with an insurer's toll-free claims processing center. They require personal attention and the fast settlement of claims. Insurance companies that specialize in the needs of the affluent are more likely to provide this level of service.

Certain insurers, especially those serving the affluent marketplace, also provide better service before claims are made. Many offer valuation services that help determine coverage requirements. They may have specialists on staff who provide loss prevention guidance, such as suggesting additional security measures or methods to conserve valuable artwork by protecting it from humidity, high temperature and other hazards.

Domestic help and personal employees.

Affluent individuals are more likely to have personal assistants, as well as employees assigned to work in the household and on the grounds. Individuals with employees need to provide workers' compensation insurance. Even though this insurance is not required in all states (see Table 1), coverage is advisable in any case. For affluent homeowners, the risk of an uncovered domestic worker is considerable. If one of their employees is injured on the job, the employee could sue for medical expenses and lost wages. Should an employer elect not to secure workers' compensation insurance, an injured employee could legally pursue personal injury prosecution in addition to workers' compensation benefits.

Other employment-related issues involve whether part-time and contract workers have their own insurance or whether they will be covered under the client's insurance policy. If a nanny or other employee drives a car provided by the client's family, the client will need additional coverage. They need to be sure that auto insurance and liability coverage will protect them if an employee is involved in an accident while driving the insured's car or hurts a guest who is visiting the insured's home. Additionally, the area of employment practices liability—insurance for accusations of wrongful termination, sexual harassment and misconduct—needs to be addressed.

Unique property risks. The affluent are more likely to own an estate or historic home—which, should a fire or other loss occur, can cost 40 percent more to rebuild than an equivalent new home. *Standard homeowner's insurance, even if it guarantees replacement cost, tends to cap coverage.* These policies generally are not geared to the spiraling expense involved in hunting down rare materials or finding the people who know how to work with them. Historic home insurance not only provides the cash for the repairs, but also often gives access to the special-

ized materials and artisans needed to make them.

Even homes that are not historic—just old—may involve special insurance considerations. For example, building codes change and not all homeowner's insurance policies cover the costs of bringing a house up to code when it is rebuilt. If the current building code requires a higher grade of electrical wiring than that available when the house was first built, an inadequate policy would pay only for the cost of replacing the lower grade wiring in the event of a claim. For such potential risks, coverage that addresses the cost of maintaining compliance with laws and ordinances should be secured.

The affluent may be more likely to have homes in areas prone to certain types of natural catastrophe risks—along the seashore, on tropical islands exposed to hurricanes or in earthquake zones (see Table 2). Standard homeowner's insurance does not cover flood or earthquake—specialized underwriters may be needed to secure adequate coverage.

In addition, country homes may be in remote areas, far from fire stations. In one case, an insurer would cover only an insured's home, which was located in an isolated wood, after the insured installed a pond on the property that could potentially be used by firefighters.

Other risks are unique to city dwellings. Condos or co-ops, for example, have unique insurance requirements, such as matching individual unit coverage to the association's master policy. Second, third or additional homes that are usually left uninhabited raise security issues, while renting property raises liability issues.

The wealthy even have different issues concerning the outdoors. Standard coverage for landscaping or outdoor structures (such as garden structures used for parties or weddings) may not be sufficient for many estates. Ownership of a pool creates serious liability concerns—some insurers won't provide any coverage if a pool has a diving board or slide.

Insurance programs are not monitored or updated frequently enough. The affluent aren't the only policyholders who need to keep their policies up to date, but they are more likely than most people to buy new cars and other items that need to be insured. Serious collectors may buy and sell items regularly. Valuations change—an appraisal that is more than three years old often is well below current market value, and that value can change quickly. For example, if an established artist passes away, the value of their artwork can increase substantially.

Although most homeowner's insurance contracts require notification of home improvement projects, it is a common mistake to overlook doing so or to not be aware that notification may even be necessary. Furthermore, clients often do not provide their insurance professional enough advance notice to secure course-of-construction coverage before the start of a project. Another common oversight is not checking the adequacy of the contractor's liability coverage. If someone gets hurt on the job, is the homeowner adequately protected?

Changes in lifestyle and family situations also can trigger new insurance needs. Having a child, getting married, a death or divorce may involve retitling of property. Because coverage is often extended to spouses under many policy forms, after a couple changes their marital status, it is very likely that their insurance policies need to be adjusted.

Changes in titling or registrations of assets due to the implementation of an estate plan need to be reflected in property and casualty insurance contracts. Just as when a life insurance policy is owned by the irrevocable trust, assets that have been conveyed to a trust or limited liability entity need the insurance contracts amended to reflect changes in legal ownership as well.

Need for specialized coverage. While most people may not need kidnap and ransom insurance, it may be advisable for

TABLE 3

Financial Advisor Checklist—'Red Flags' Indicating that Clients May Need Additional Risk Protection

When reviewing a client's financial situation or meeting with a new client, you may want to consider the following questions. A "yes" answer to any question may indicate the need for a comprehensive review of the client's risk management program by a qualified property and casualty risk professional.

Does the client...

<input type="checkbox"/> ...have relationships with multiple insurers, brokers or agents?
<input type="checkbox"/> ...own multiple, high value homes in multiple states?
<input type="checkbox"/> ...own a home in a foreign country?
<input type="checkbox"/> ...own a condo as a second residence or investment?
<input type="checkbox"/> ...own property located in a catastrophic loss area?
<input type="checkbox"/> ...plan to remodel or expand an existing home?
<input type="checkbox"/> ...own a home with unique features or building materials?
<input type="checkbox"/> ...have a guest house, pool, or other structure of high value?
<input type="checkbox"/> ...co-own or have property in trust?
<input type="checkbox"/> ...have significant collections of art, cars or other valuables?
<input type="checkbox"/> ...own antique cars that are used on a limited basis?
<input type="checkbox"/> ...own aircraft, large boats, or thoroughbred horses?
<input type="checkbox"/> ...have domestic help (either full- or part-time)?
<input type="checkbox"/> ...have a child away at school?
<input type="checkbox"/> ...have a high-visibility career/lifestyle?
<input type="checkbox"/> ...serve on boards of profit or nonprofit organizations?

individuals in the public eye or those who travel to countries where they may be at risk. These policies include payment for ransom demand, the fees of experts who can help manage kidnap events, and coverage for threats to corporate property and products.

Other specialized insurance policies unique to wealthy individuals and families include coverage for family offices, yachts, aircraft and thoroughbred racehorses. For example, yacht insurance specialists will consider factors as diverse as navigational limits, chartering exposures, medical coverage for crew, fine art on board, and ancillary craft, including seaplanes and helicopters.

Conclusion

If it has been more than two years since a client has had a professional review of

their overall property and casualty risks, they are due for an analysis of their insurance policies. Their personal risk-management program should be evaluated, paying special attention to deductibles, adequacy of limits, potential gaps in coverage, quality of contracts, carrier financial stability and carrier claims-settlement practices.

While this article does not cover all of the potential pitfalls in an affluent client's risk-management plan, it should create an understanding of the complexities that need to be addressed when considering personal property and casualty insurance as part of an overall financial plan. (See Table 3 for a checklist of "red flags" that could indicate the need for additional insurance protection.)

As the point of contact for the professional services and products your affluent clients need, one of your challenges is to

Web Sites for Further Research

- Insurance Information Institute—www.iii.org
- National Association of Insurance and Financial Advisors—www.naifa.org
- American Insurance Association—www.aiadc.org
- Insurance Networking News—www.insurancenetworking.com
- LOMA—www.loma.org
- Insurance Institute of America—www.aicpcu.org
- Chartered Property Casualty Underwriters Society—www.cpcusociety.org

provide integrated solutions to the many financial challenges they face. Even if you, or your firm, do not directly provide a personal property and casualty solution, your clients should be made aware of the risks and be given advice on how those risks are best managed. Adding personal risk management into your practice will enhance your position as a trusted advisor to your clients, one who can oversee the spectrum of personal financial planning subjects.

Don't overlook sound risk-management planning for property and casualty exposures. Protecting your client's wealth from a property or liability loss also protects the valuable relationship you have with your clients.

For more information, visit www.marsh.com/pcs



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