Liability insurance: the strongest pillar in an asset protection plan

"Asset protection" has remained a hot, though oftentimes mysterious, term in the legal field for some time now. Many times, it carries with it a dirty connotation (e.g. a texting driver blows a red light going 80 mph in his Aston Martin, causing a fatal accident in Chicago, then two days later, transfers all of his assets to his brother in California as "a gift").

Absurd and egregious attempts such as this occur often, but thankfully, are not effective and would be quickly unwound by a court. Offshore trusts, domestic asset protection trusts and complex self-settled trusts are judged heavily on the surrounding facts, timing and motives involved.

Liability insurance stands as one of the oldest, strongest and most reliable pillars of any asset protection plan.

Most successful people are nearing retirement when their assets are at their peak. They have full equity in their home or, more likely, homes and have amassed enough savings to live comfortably for the remainder of their lives. Liability insurance-based asset protection is critical to a successful retirement. Below are a few steps that will help prevent a significant blow to net worth:

1. Purchase adequate umbrella liability coverage. When your assets are at a peak, so too is your attractiveness as a target for a liability lawsuit. What if you're not near retirement but have a young driver in the house? Couple that young driver with a fast sports car. The readers of the Daily Law Bulletin do not need a reminder how large jury verdicts can get.

If your insurance coverage falls short, a court can order the liquidation of assets. Some inherited trusts and retirement assets may be shielded from reach, but ordinary savings and brokerage accounts are not. Despite the high risk exposure and low cost (a $2 million umbrella policy may cost less than $400 a year) many wealthy households have no umbrella coverage at all.

1.5 Purchase adequate umbrella liability coverage. I cannot stress enough the importance of step number one above.

2. Consult with an independent insurance agent. Independence is good. Working with an independent insurance agent puts that agent in your corner and allows them to shop for what's best for you in your current life situation.

Knowing your insurance agent is great, but do you know the products which he or she is authorized to sell you? What you're really buying is the coverage and service behind the insurance policy you've purchased.

If you're working with a direct agent who only sells one company's policies, you're limiting your coverage to only what that company offers. In essence, you're limiting yourself to shopping on a shelf or two within a specific aisle of a store that's otherwise full of options. It's likely you'll never hear of other products or services available, especially if your current insurance agent is not authorized or "appointed" to sell coverage offered by another company.

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3. Use a valuables policy for jewelry, art, wine and other collections. Individuals near retirement — particularly high net worth clients — have had the time to accumulate sizeable collections of jewelry, art, wine or other valuable items. Many of these assets are underinsured.

Homeowners policies have specific restrictions on the amount of coverage for jewelry, furs, firearms, collections, musical instruments and bottles of fine wine. In a standard policy, the limits may equal only a few thousand dollars. For this reason, collectors should supplement the coverage provided by their main policy with a valuables policy, which allows the owner to insure ("schedule") the collection for its full replacement value.

4. Name trusts and limited liability companies (LLCs) on your insurance policies. Wealthy individuals often use trusts and LLCs to shield assets and leverage the transfer of wealth to future generations. When a bright estate planner suggests that ownership of an asset be transferred to a trust or other entity, the entity receiving the asset should be named on the insurance policy (names may be added as "additional insureds").

If you change the ownership, be sure to revisit and update the corresponding policy. Otherwise, you could lose insurance coverage on transferred assets. For example, a home is transferred into a trust, but the owner fails to name the trust on the insurance policy. If a visitor to the home suffers serious injury, the visitor plaintiff will likely sue both the individual "homeowner" and the trust.

The insurance policy may provide for the defense of the individual, but not the trust, leaving the home vulnerable to defense costs as well as any settlements or judgments associated with the case.

5. Seek full replacement cost coverage for the home. In many cases, a client's home represents a significant — and often times the largest — egg in the net worth basket. Therefore, homeowners should secure "full replacement cost" coverage (also called "guaranteed replacement cost" coverage) for the home structure. This coverage will usually pay to rebuild the home with similar quality materials and craftsmanship, even if the cost exceeds the coverage limit in the policy.

Many people incorrectly assume they have this level of protection. The best companies and policies not only provide full replacement cost coverage for the home structure, but also for structures such as the driveway, fence, walkway, pool and detached garage.

6. Consider liability-rich hobbies. It's vital to examine the risks originating from certain recreational activities. Horseback riding, personal aviation, hunting and sport shooting are all common hobbies of the affluent.

These hobbies, while greatly entertaining, also expose the owner to far greater risks than, say, crocheting or reading. Each piece of an insured's life should be examined to be certain that all bases are covered and that no flank is left exposed as an easy target.

I do not sell liability insurance. However, it's important to be sensitive (and to sensitize the client) to these issues and potential gaps in the asset protection armor.

So, the next time you're golfing at Bushwood CC and your partner brings up the next best asset protection plan his lawyer recommended, bring him back to the basics of beefing up his liability coverage, consulting with an independent insurance agent and helping him to realize that all insurance policies are not created equal. It will be more valuable than any "gimme'" putt you offer all day.

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