An Umbrella for Unsuspected Liabilities

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With spring showers quickly replacing snow flurries in the northeast, we're reminded of the importance of having a good umbrella in the car or near the front door of the house. A good umbrella is typically a necessity on the golf course, and as the season changes towards summer heat, you can find them staked alongside beach blankets at the shore to provide much needed shade.

The term "umbrella" was adopted by insurance carriers to depict a type of liability insurance coverage. More often than not, umbrellas are grabbed on the way out the door when there is a *chance* of showers. If the weatherman indicates a 30-40% probability of rain, that is normally enough for most folks to keep one close. Even the cheap $5 umbrellas sold at city newsstands can provide much needed temporary coverage from unexpected downpours to protect business dress or evening social attire.

So why are umbrellas worth discussing as it pertains to financial planning? The reason is that, while there is a minimal chance that we'll ever be named as a defendant in a lawsuit, there is still a chance. We often decide to insure against relatively low risk occurrences, such as home fires or pre-mature death. Dollar-for-dollar, a personal umbrella liability policy may be the least expensive insurance premium you will ever pay.

Most of our clients are familiar with our planning process. We spend a lot of time talking about individual financial goals, gathering data, analyzing different scenarios and presenting results. Through our financial independence analysis, we can run multiple scenarios showing the financial impact of different courses of action. Often heard in these conversations is the phrase "worst case scenario…." For example, "Worst case scenario, I end up working 5 more years," "Worst case scenario, I downsize my home at retirement," or "Worst case scenario, I spend $10,000 less per year during retirement."

Do these types of examples really sound like a "worst case scenario?" How about this example:

> "Worst case scenario, a family member accidentally runs a stop sign and slams into a school bus and I get sued for $3 million."

While most people would not like to envision this type of outcome to their financial plan, this is the type of event that can occur which would render years of planning and saving useless. Umbrella liability insurance is the blanket of protection that can cover the costs of these rare, but potential, financial disasters.

Umbrella liability insurance is designed to cover liability expenses above and beyond the underlying coverage which already exists in your home and auto policies. Typically, those policies may cover a few hundred thousand dollars of liability and a separate amount for property damage. Coordination between the underlying liability coverage is very important. For example, if your auto policy has a liability limit of $300,000, but your umbrella policy kicks in at claims of $500,000 and greater, then you would have $200,000 of exposure if you were to be sued for a high dollar amount.

Another important planning thought is to maintain your home, auto and umbrella liability policies with the same carrier. Not only would this provide a potential discount in bundling of coverage, but it would also ensure that there would be no disputes between claims adjusters from multiple carriers if you needed to submit a claim.

Finally, maintaining the right amount of coverage if of utmost importance. The risk of liability is probably one of the most difficult things to quantify in financial planning. There are rules of thumb that the appropriate amount of liability should be a multiple of net worth (protect as much as you are able to lose.) The problem with that assumption is that legal settlements are not limited to net worth, and sometimes can include future wage garnishment. Frequently, we see clients with $1 million of umbrella liability insurance and, quite often, this is not enough.

Statistics on liability lawsuits are often not readily available. One reason is that many liability suits are settled out of court with no official documentations of awards and settlements. Regardless, it's important to know some of the risk factors that can increase your likelihood of being named liable in a lawsuit. Property features, such as pools, increase the risk of injury. Expensive "toys" such as boats, sports cars and aircraft also increase the odds. Many insurers agree, however, that teenage drivers tend to be the biggest factor when pricing out premiums. It should go without saying that high net worth individuals are, and will continue to be, targets for lawsuits.

Even when the skies are blue, we can never truly predict what life may throw our way. We encourage our clients to discuss their current insurance coverages and risk exposures with their wealth managers. We don't claim to be expert in all areas of insurance, and we would be happy to bring your insurance advisor into the conversation or refer you to someone qualified to handle your risk management needs.

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