

When Your Business and Reputation Are on the Line

Know Your Professional Liability Risks



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Understanding your risk is the crucial first step to safeguarding your business and your reputation.

Professional liability risk can pose a threat for specialists in just about any industry or profession, but high net worth (HNW) individuals often face even greater exposure. Over 82 percent of HNW households with more than \$5 million in investable assets believe their wealth can make them an attractive target for liability lawsuits.

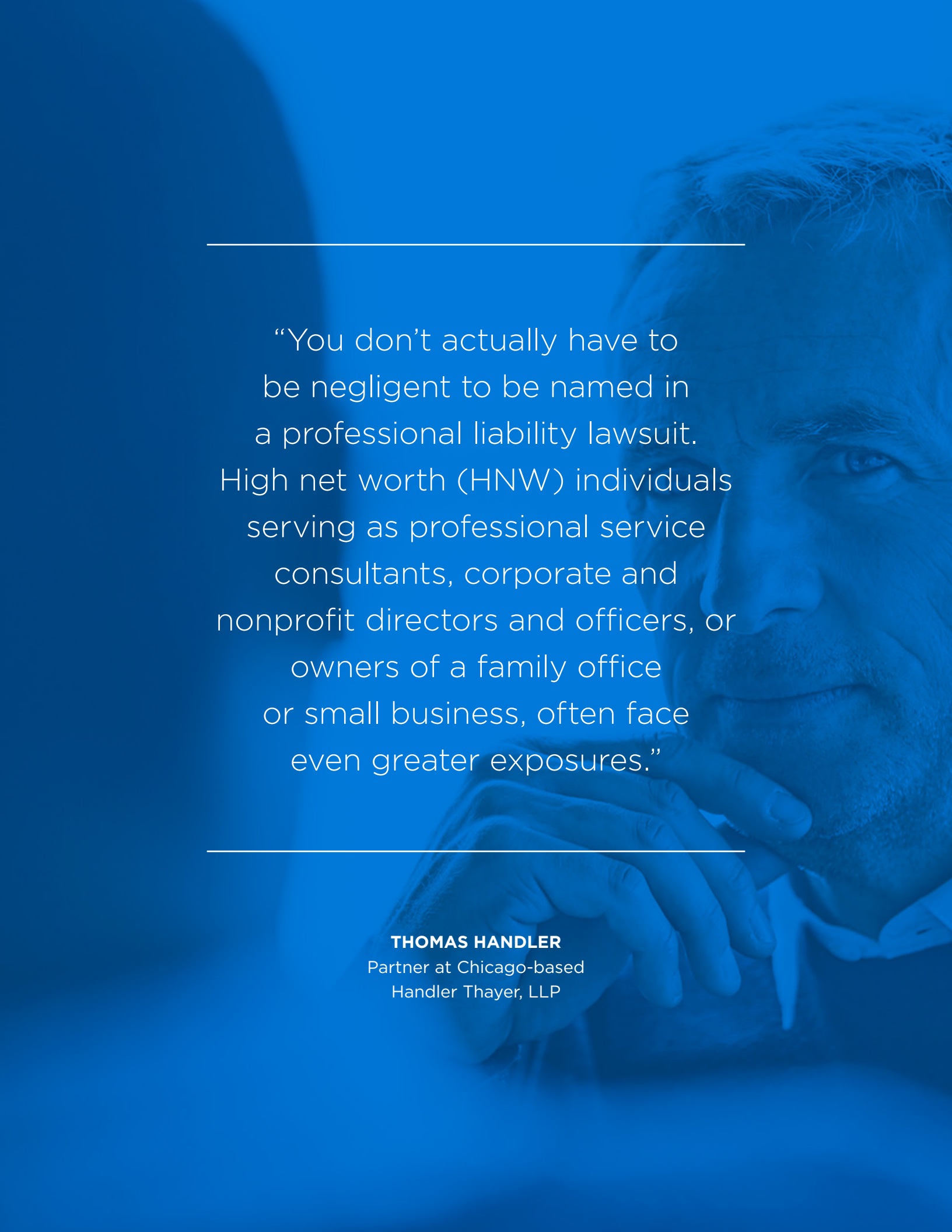
The fear is not unfounded. Professional liability insurance, also known as Errors & Omissions (E&O), has never been more critical than in today’s litigious business climate, yet many HNW individuals are underinsured. Nearly 23 percent of HNW individuals with more than \$5 million in net worth reported having less than \$5 million in professional liability coverage, while only 20 percent have umbrella coverage limits of \$10 million or higher.¹ This means that many HNW individuals face financial exposures in excess of their current liability insurance limits. Now is the time to understand your potential risk exposures, and know the parameters of your existing coverage.

“In the current environment, it’s become an almost amoral situation where plaintiffs’ lawyers don’t care if you had anything to do with the case. The routine is increasingly becoming when someone who has an unsuccessful investment, for example, in addition to the investment advisor, will sue the wealthy lawyer that handled the transaction, the accountant that prepared the return and so on,” said Thomas Handler, partner at Chicago-based Handler Thayer, LLP. “In the current litigation environment, people can make almost any outrageous claim they want — even if none of it is true.”

Because even meritless lawsuits must be defended, they can not only threaten your business assets, but without proper professional liability insurance, can put your personal assets at risk as well. This can include a liquidation of assets, beginning with savings and investments (although retirement plans and trusts can provide some protection), followed by real estate holdings and personal property, including targeting vacation homes and rental properties.

Because each HNW individual and family office will have different exposures and there’s no way to prevent being named in a lawsuit, putting best practices in place and ensuring that you have the right professional liability coverage can minimize your risk, as well as the time and stress involved in a potential legal defense, should the need arise.

¹ ACE Private Risk Services (March 2012). Targeting the Rich: Liability Lawsuits and the Threat to Families with Emerging and Established Wealth. [acegroup.com/us-en/assets/ace_personalliabilitywhitepaper_mar-2012.pdf](https://www.acegroup.com/us-en/assets/ace_personalliabilitywhitepaper_mar-2012.pdf)



“You don’t actually have to be negligent to be named in a professional liability lawsuit. High net worth (HNW) individuals serving as professional service consultants, corporate and nonprofit directors and officers, or owners of a family office or small business, often face even greater exposures.”

THOMAS HANDLER

Partner at Chicago-based
Handler Thayer, LLP

Professional Services

HNW professionals who operate private businesses are expected to have extensive knowledge or training in a particular area of expertise. But what happens when the business fails to meet their client's expectations or provides advice that turns sour? They can potentially be held responsible for any harm this "poor" performance has caused their client's or a third party's business.

Errors and omissions lawsuits cost businesses an average of \$180,400. As many as 9 percent of executives in companies who provide services for a fee believe that an E&O lawsuit could cause "the most financial damage to their company."²

While professional liability policies are tailored to the specific HNW professional's service industry, like architecture, engineering, and medicine or dentistry, these individuals should also consider purchasing an additional Employment Practices Liability (EPL) policy. An E&O policy can protect businesses against liabilities arising from an act deemed neglectful, including an error or omission in the performance of their professional service, or a breach of contract. But small business owners with employees can use EPL insurance to cover potential claims in harassment, discrimination and wrongful termination.

Professional Liability Insurance

- Protects against losses arising from a covered error, omission or negligent act committed in the conduct of your business.
- Covers judgments, settlements and defense costs.
- Policies vary widely; consult with a HUB advisor.

² Chubb (2013). Worth the Risk? <http://www.chubb.com/businesses/csi/chubb12192.pdf>

HNW Investment Management Firm Owner

One East Coast-based investment management firm with six employees serves as a third-party investor for eight HNW families. Upon initiation of work, the family office's best practice is to create individualized investment policy statements with its client, outlining specific goals, objectives and risk tolerances, or places to avoid. This helps the firm maintain a conflict-free relationship over many years of service.

"Because our business is customized and consultative, our clients know what's going on. However, we sought the advice of HUB to mitigate any unforeseen surprises," said the owner. "What if our client dies and we find we're dealing with another family member?"

In business since 2008, the company reached out to HUB two years ago for its own HNW family office investment advisor professional liability coverage.

"The relationship we have with our HUB broker is important because she gives us a good flavor and texture for what is going on in the commercial insurance base — what other family and multi-family offices are doing," said the owner. "Because she checks in several times a year, we have an opportunity to re-evaluate and discuss any changes in our business climate as necessary."



Top Five Tips for Purchasing Professional Liability Coverage

Typically sold in increments of \$1 million, a professional liability insurance policy will act as your defense policy should someone find fault in your actions or services. When searching for the right policy and broker, keep these five tips in mind:

1. Engage an independent broker who specializes in working with HNW individuals and their businesses to ensure that you can choose the policy that's right for you, without being caged into one carrier's product.
2. Make apples-to-apples comparisons of the potential coverage options available to you. Resist the temptation to choose a policy based solely on price. Ask your broker to help weigh the differences in carriers and their policy options.
3. Tailor the coverage to your specific personal and business needs. Since there are dozens of HNW insurance carriers out there, there are even more policy options and services. Make sure the one you choose will cover potential legal defense costs and reduce the hassle of a lawsuit for you, your family and your business.
4. Revisit all of your liability insurance — from auto to home, umbrella and more — to make sure each policy can work hand-in-hand, covering you and your business seamlessly. Talk to your broker about streamlining your existing coverage and whether it's possible or even advantageous for you to consolidate policies.
5. Purchase coverage that meets extreme cases, not just those that are likely. Because professional liability settlements and verdicts have been known to exceed \$10 million, you must plan for the least-expected, worst-case scenario.

Private, Midwest National Marketing Company

One boutique Internet marketing firm was defending themselves against the false accusation that they provided legal services without a license to practice law. The claim, filed by a single competitor in each of the 35 states where the company does business, put the firm's entire business on the line. If they were restricted from working in any jurisdiction, their total services would no longer be effective, and therefore, they'd be forced to close their doors. Three years later, after racking up \$1.2 million in legal fees and expending significant resources to defend themselves from the erroneous claim, the company prevailed. While their professional liability insurance policy with HUB covered the fees, after they met their \$25,000 deductible, the carrier subsequently dropped their coverage after paying the claim. HUB was able to find them a new carrier without any lapse in coverage.





Best Practices

Regardless of your greatest professional liability risk, there are a few best practices, transcending the industry and the market, that must be considered to limit your exposure.

CREATE AND MAINTAIN STRONG INTERNAL CONTROLS

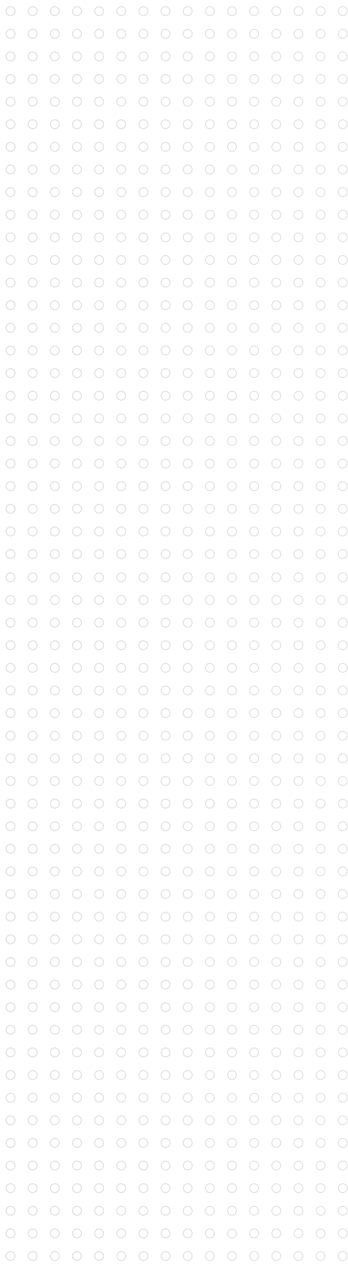
In any small business or nonprofit — and especially the family office — make sure to segregate duties; verify and hire reputable internal and third-party service providers with necessary experience to make key decisions; have financial statements audited; safeguard assets with a big-name bank; and build a strong management team with experienced professionals.

PRESERVE TRANSPARENCY

The trend in today's marketplace is toward transparency. This could mean identifying all the parties involved in a particular business deal up front, or identifying any pre-existing conflicts before a business deal, nonprofit event or campaign, including promoting open communication between the family office and its beneficiaries, which could be in the form of monthly letters to the family about their trust funds and investments. If and when the waters begin to rumble, be open and responsive, send a letter or email with a copy of the policy statement. Dealing with an issue or claim in a forthright, prompt manner can help facilitate a quicker and more private resolution.

KEEP CONFLICTS IN CHECK

A conflict check may be required to ensure that you and or the members of your organization don't have a conflict of interest in either a potential business deal or nonprofit partnership. When applicable, make sure to have a conflict disclosure and subsequent labor documents in writing. For example, when creating a long-term estate and tax plan for a family office, make sure to cover three to four generations and any potential conflicts they will have with each other.



USE CONTRACTS WHEN APPLICABLE

Some business scenarios may not be covered under professional liability insurance, including lawsuits alleging that your business lured away one of your client's customers, for example. The best way to protect against these claims is to establish clear guidelines, including the rights and responsibilities of all parties through the use of contracts.

BUILD STRONG CUSTOMER RELATIONSHIPS

Small businesses, family offices, directors and officers and nonprofit board members that continuously demonstrate a genuine commitment to their customers, benefactors and third-party business associates will be less likely to be named in a lawsuit, even when something goes wrong.

REVISIT YOUR COVERAGE ANNUALLY

The annual review is an opportune time to discuss professional liability coverage with your insurance broker. What types of professional services does your small business offer? Has your position in the public company changed from member to director or officer? Are you still on the nonprofit board? Have you joined any new boards lately?



Family Office Liabilities

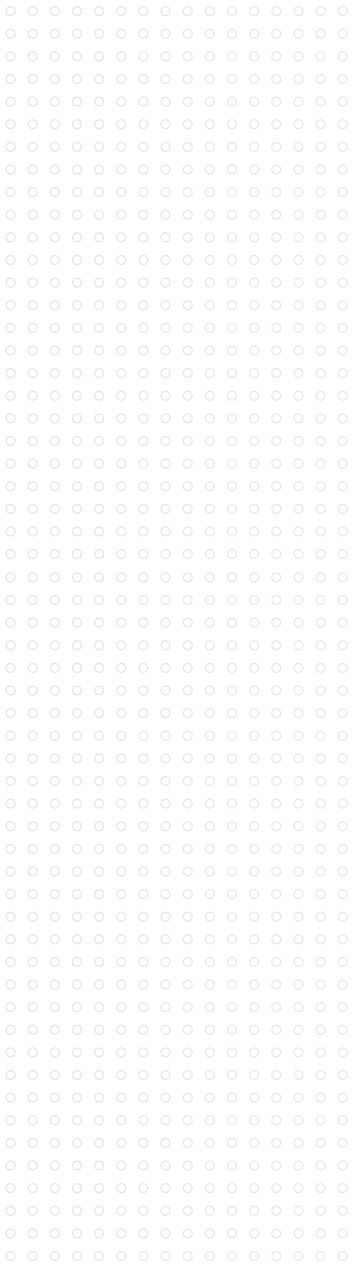
The primary obligation of any employee working in a family office is to lead and manage the HNW family’s affairs to their best interest — from the day-to-day operations of their company to the long- and short-term investment of their assets. But family office executives can be held liable in the same way as those working in a public company, should their judgments conflict with those of any member of the family office.

For this reason, individuals running family offices must take out professional liability insurance for their employees.

“Family offices have to protect their employees’ financial assets from liabilities arising from the normal course of business. How else will a family office retain top professionals if such individuals’ personal assets are at risk?” said John Meade, underwriter of executive liability for AIG. “Typically there’s a vast accumulation of wealth being managed, and family office professionals are tasked with managing these assets on a daily basis. Due to the complexity of family offices, and the plethora of professional services provided on behalf of the family, there are obvious risk exposures that relate to the oversight of a family’s wealth. These risk exposures can lead to large legal disputes.”

Meade warns that it’s not usually the matriarch or patriarch who brings the claim, but a distant family member uninvolved in the day-to-day operations, who may sue the family office professional and family members actively involved in the family office operation.

When you’re transferring the risk to the professional liability insurance carrier, Meade suggests first determining what type of professional services are being provided to the family office by its employees, and making sure that the policy supports this list of services. For example, if the family office has a large real estate portfolio, you’ll want to make sure there’s coverage for professional services as it relates specifically to real estate advisor services and consulting. Common amendments, including adding a family trustee onto the policy, can and should be made up front.



Directors & Officers for Board Positions

Liability exposure for today's corporate directors and officers (D&O) has increased dramatically due to stricter government compliance standards and the heightened risk of litigation from fellow employees, policyholders, shareholders, customers, creditors and competitors. In fact, lawsuits and enforcement actions triggering coverage under D&O policies have increased by 17 percent since the Great Recession.³

Liability lawsuits can be brought against directors and officers of any size of company, holding them personally liable for any type of infraction. For this reason, D&O insurance is a necessity for all companies today, as well as individuals serving in the capacity of a director or officer. Should the company become insolvent, it may not have the resources to indemnify its directors and officers. HUB recommends that directors and officers consider purchasing a separate D&O policy with a dedicated limit of liability for individuals that provides personal indemnification, regardless of any ongoing legal or other restraints.

Beyond the corporate arena, HNW individuals volunteering their time and business expertise to serve as directors or officers of nonprofit boards must also be covered by D&O insurance, as a variety of risks are present that could put the personal assets of the HNW volunteer at risk.

For example, an employee at a park district could allege sexual harassment by someone on staff, and the park district's board could be brought into the lawsuit for not exercising sufficient control in the working environment. Or the PTA president of a school could find herself named in a lawsuit alleging defamation during a contentious public hearing.

As many as 62 percent of HNW individuals serve or have served on the volunteer boards of nonprofit organizations, and at least 35 percent of them aren't covered by a dedicated D&O policy.³ Most assume the nonprofit organization would protect them.

Directors & Officers Insurance

- Protects against monetary judgments or settlements for negligence or breach of duty.
- Additional individual coverage protects your personal assets if your company's D&O policy limits are unable to adequately protect you. Remember that D&O limits are shared with other individuals and the company itself.
- Nonprofit board members need D&O coverage as much as their public and private company counterparts.

³ Advisen Ltd. (January 2014). D&O Claims Trends: 2013 Wrap-Up & Possibilities for 2014.
<http://www.advisenltd.com/wp-content/uploads/quarterly-d-o-claims-trends-aig-2013-10-17.pdf>

Midwest Nonprofit Board Member

When one Midwest nonprofit organization went bankrupt, its creditors sued the board of directors for outstanding debts. Unfortunately, the nonprofit had low D&O limits. Luckily for one HNW board member, his private company's liability insurance, written by HUB, included an outside directorship liability extension as well, which protected him in the event the nonprofit insurance was unable to respond.



“People assume that the nonprofit has adequate coverage, and oftentimes they don’t. The policy limits may fall short for catastrophic claims, or the contract language may leave gaping holes in protection,” said Scott R. Konrad, HUB International Northeast’s Not-for-Profit Business Practice Leader. “Nonprofits seldom have professional risk managers, so they’re challenged to discern the qualitative differences between complicated D&O products. All too often, low price is the lure, especially in a belt-tightening environment.”

If you are on a nonprofit board and don’t serve as a director or officer, you may be covered under your personal umbrella policy. If you are a director or officer, however, you must purchase additional D&O coverage, which can typically be added onto your existing umbrella policy for very little cost. If you are the director or officer of multiple boards, make sure your umbrella policy includes multiple positions. However, even additional D&O coverage doesn’t cover fiduciary decisions surrounding nonprofit employee benefit plans. Nonprofit directors and officers serving as fiduciaries of group health and welfare plans, should ask the nonprofit to purchase separate fiduciary coverage for them.

“The other thing to consider about being on a board, especially a prominent one, like a hospital or arts board, is that your name is published on all of the organization’s materials, increasing your exposure,” said Konrad. “People may believe that, if you’re associated with such a board, you have deep pockets to pick.”

Senior Officer of a Private Midwest Company

One senior officer of a small corporation was investigated by a federal agency for allegedly colluding with a third party to steal money from the company. While the defendant was able to prove his innocence, the multi-year-long investigation and litigation cost the corporation’s D&O insurance company a half million dollars, after the company’s \$25,000 deductible, to prove the federal agency wrong, not to mention its other price tag — the officer’s time, anguish and now tainted reputation. Because the company had broad D&O coverage with HUB, they were able to meet their obligation to indemnify the officer.



Beyond the Office: Domestic Help Can Cause Additional Exposure

HNW individuals often employ domestic help that can be the cause of additional risk well beyond the private office setting, as in-house employees may be subject to the same benefits as their private office counterparts.

Some HNW individuals will pay their domestic staff from their business account, opening themselves up to potential exposure. When this is the case, the domestic staff employee is subject to all of the same remuneration as an in-office employee — including health benefits, hiring practices and vacation policies — as well as the same hiring and promotion policies.

“If you have an employee handbook that says employees are subject to a review every six months to determine a promotion, you have to do the same with your domestic staff being paid out from your business account,” said Marcy Hall, Senior Vice President and Family Office Practice Leader, HUB International. “When you have to fire the nanny because they’re not meeting your expectations, they could get an attorney who will ask you if you follow the same performance guidelines for the nanny as you do the rest of the employees on your payroll.”

To avoid this scenario, Hall says some HNW individuals will set up a small LLC to pay their domestic staff.

Additionally, while some families go through a third-party vendor to find their domestic help, others just hire them and don’t perform background checks.

“If you have someone taking your kids back and forth to school and you haven’t seen their motor vehicle report, that could be a red flag,” said Hall. “You have every right to ask them what their driving history looks like.”

If the domestic employee is in a car accident, the other party can sue you. Alternatively, if the employee is hurt, you may be responsible for their medical care.

Similarly, in-house elder care is subject to the same principles. Have you conducted a background check on your elderly mother’s home help? Is this new employee independently insured, or does a third-party vendor back their services? If this employee gets hurt on your property, you could be liable for their medical bills. Check with your insurance carrier, as they may perform background checks on your behalf.

Because no two situations are alike, and each state will have its own set of laws regarding domestic help, including the employee’s rights and your rights as an employer, it is critical to examine each potential risk. Ask your insurance professional about your employment practices liability insurance coverage.



Conclusion

While today's litigious world may not provide any guarantees, understanding your areas of business and personal risk, engaging in best practices to limit liability, and purchasing the right, individualized professional liability policy are all a part of a critical risk management strategy for any professional services business, corporate directors and officers, directors and officers of a nonprofit, and family office employees.


But such policies can provide more than just peace of mind, including a new partner to work with hand-in-hand when combating the stormy business climate filled with professional liability risk.

"The benefit of having a reputable, independent insurance company and broker behind you is that they do this on a regular basis — they can be objective and businesslike," said Handler. "That is a true advantage over the long haul, both before and during a professional liability case. It is the objectivity of the third party that's not impassioned, and the experience and professionalism of people who deal with this on a daily basis, that will get the job done."

Private Canadian Company with U.S. Offices

One privately owned shredding company regularly picks up bags of their clients' discarded documents for shredding and disposal. However, instead of shredding two bags of documents — one from a bank and another from a hospital — one employee in the company's Texas office decided to drop the bags into an empty field. Because the information in the bag's documents might have been compromised, the company was required by way of the federal HITECH Act of 2009 and Texas state law to provide notification and credit monitoring to the affected peoples, costing over \$1 million. Thanks to the cyber insurance policy the company had through HUB, they paid their \$25,000 deductible and the policy took care of the difference. This case study illustrates that a claim can be brought against a company even without a formal lawsuit, often requiring the company to comply with government regulations and meet a high price tag.



A woman with short blonde hair is shown in profile, looking towards the right. She has her hand near her mouth in a thoughtful pose. The entire image is covered with a semi-transparent blue filter. Two horizontal white lines are positioned above and below the main text block.

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Partner at Chicago-based
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Looking out for you. Looking ahead for you.

HUB International Personal Insurance, a specialized practice within HUB International, is dedicated exclusively to serving the insurance and risk management needs of individuals. As one of the largest privately held personal insurance practices in North America, we provide detailed guidance to help protect the people and possessions that are important to you.

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