

SELECTING LIMITS OF LIABILITY

We are often asked what limits of liability are appropriate for a practice. As underwriters, we always recommend that you select the highest limit of liability the underwriter will offer and that you can afford.

Here are a few questions that may help you to understand how limits of liability work in the insurance policy and whether your practices falls on the higher or lower end of the exposure spectrum.

1. What is your insurance objective and how risk averse are you? Do you want to have a low deductible on your E & O so that you transfer more financial risk to the insurance company in the event of claim? Are you more interested in having the E & O for the unforeseen catastrophic claims? If you are not worried about the smaller claims and are willing to assume more financial risk and transfer less risk to the insurer by electing a higher deductible, you receive a premium credit. Make sure to check the premium savings between deductibles to see if the credit you receive for taking a higher deductible really compensates you for the additional risk you assume. In the event of a claim, you will be asked to write a check in the amount of the deductible to the insurance carrier.
2. In what state are you located and in what states are your clients located? How litigious are these states? Ask your attorney.
3. Know that whatever limit you choose, it is REDUCED by the amounts spent by the insurance company in defending you. It's not unusual that 50% or more of all loss dollar spent can be used up on defense costs.
4. What services do you render? Fee only financial planning presents a lower exposure than discretionary asset management. Discretionary asset management using no loads presents a lower exposure than that using listed stocks. Do you sell commissioned products – are they mainstream products or alternative products?
5. Who are your clients and where do they come from? High net worth or middle income? Known or referred to you or cold calls? For practices concentrated in retired clients, do the potential heirs agree with the client's objectives or will they have a different opinion of your services after the client's death?
6. If you are managing assets, do you have a common security running across portfolios that might lead to multiple claims from different clients if the security gets in trouble? Clients rarely sue for the entire amount of the portfolio. Claims generally center around one type of investment. Another type of claim is "peak to trough". The client calculates the demand as the difference between the portfolio value at the height of the bull market less the current low of the bear market.
7. Select your clients carefully. Do you have clients that do not elect to follow the recommendations you have made which are necessary steps to achieving their goals? If so, and you elect to continue to serve as advisor, you have a much higher exposure to loss. Are you considering a prospective client that walks in the door with a preset, and often unrealistic, return expectation that can only be achieved by very aggressive portfolio techniques? If so, you may wish to consider declining such a client.

8. If you personally have a high net worth, are you concerned about whether the veil can be pierced placing your personal assets at risk? Check with your attorney for the laws in your state. If you are a registered representative you have a much greater risk of being personally liable for the loss regardless of whether you have formed a corporate entity.
9. Do you act in multiple capacities to the client? Are you doing accounting work as a CPA and investment advisory work as an RIA for the same client? If so, the client will regard you with a higher degree of trust and will have high expectations for the standard of care. Do you have ERISA clients? If so the standard of care required is higher and the Department of Labor regulations are far reaching. These clients present a higher degree of exposure.
10. Are you in regulatory compliance with the state and federal requirements? Is your ADV up to date? Are your fees correctly stated? Is your practice accurately disclosed in your Form ADV and client contracts? If not, you have a higher degree of exposure since misunderstandings over these issues can lead to suits for misrepresentation.
11. Have you checked your marketing materials carefully to determine what standard of care you are establishing in the client's mind? Are you holding forth as "experts"? Do you use words of totality like "always" or "never"? If you do, you have created an impression in the client's mind of an increased standard of care that can be used against you in a claim.
12. How does your fee structure compare to the marketplace? If you are higher than the norm- can you demonstrate why to the client? How many fee disputes have you had and how are they resolved? Unresolved fee disputes often lead to lawsuits because the client is so upset over the unresolved or poorly resolved fee dispute they go looking for "errors" the advisor has made in the rendering of services. This can lead to allegations of breach of fiduciary duty.
13. Talk to your insurance broker – what insight can they give you in their experience in your state or in the professional liability line of insurance?
14. At this time, approximately 60% of our policyholders carry limits of \$1,000,000 per claim and \$2,000,000 in the aggregate.
15. Are you worried about one big claim or a series of interrelated claims that would result in one per claim limit being applied to the loss? Severity (the largeness of one claim) argues to a higher per claim limit. If are you concerned about several unrelated claims made and reported during an annual policy period (frequency) this would argue to a higher aggregate limit.