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ON FAMILY OFFICE MANAGEMENT

Demystifying family office insurance

BY CHARMAINE TANG
RICHARD WOLKOWITZ


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Ben Franklin said, "An ounce of prevention is worth a pound of cure."

Meetings of family office ownership, boards, committees, leadership and management are usually rich in substantive discussion and complex technical and personal topics. These conversations often require a pivot from the rational to the irrational, all while managing a great deal of interpersonal dynamics and family needs.

The engagement, focus, intensity and curiosity among participants is palpable. And with topics that are deeply impactful and meaningful to the family, meetings tend to run long, and "parking lot" conversations may continue thereafter. Without the meeting's leader (i.e., the chair) diligently managing conversations through a tight agenda, meetings often exceed the prescribed time.

And what is the quickest way to end such a meeting, suck the oxygen out of the family office meeting or stymie great family office conversation and dialogue?

Answer: Discussion that pertains to "insurance" or "risk mitigation."

THE WHY: PROBLEMS/CHALLENGES?

The lack of interest, energy and curiosity surrounding insurance or risk management occurs through a lack of understanding about the following:

- Purpose
- Underestimating threats, risks and vulnerabilities
- Consequences of a breach, claim or being "underinsured"
- The value of the coverage(s)
- The company is on "cruise control," and there exists a lack of attention and complacency
- "Chasing a ghost" — dismissive thinking that "this won't happen to us"
- The language contained in policy coverages, declarations, updates and exclusions and the probability that a possible claim is vague, amorphous or intangible
- Inability to control costs and helplessness — never-ending, year-over-year premium increases due to macro issues (i.e., industry sector, economy, weather, geography, geopolitical, etc.), even if your personal experience history has been limited or has no claims
- Lack of discipline or desire to review more than annually, at renewal
- Inexperienced, wrong or "finger-pointing" internal employees/external advisers reviewing the matters

- Time rush — discussing right before the renewal period with urgency as coverage is expiring
- Blurred boundaries with family and structure issues — business versus personal, which house (generation, branch, family, household, individual) is responsible to manage or has exposure (this challenge is more confusing in an embedded family office structure)
- Complexity of the types of matters converging simultaneously at renewal, only annually, and usually with short time to discuss business lines (especially if in many industry sectors, regulatory compliance requirements, and banking covenant requirements), personal lines, cybersecurity, life, flood, earthquake, workers' compensation, board, trustee, employment, medical, disability, representation and warranty coverages, real estate, force majeure, etc.
- Distinct and unique types of family office coverage — exotic travel destinations, security, kidnap and ransom, social engineering, reputation, estates, legacy properties, collections (often rare and unique), aviation, marine, terrorism, etc. — and layered with intertwined, international jurisdictional complexities
- Rushing to the conclusion without a detailed analysis — all of the complexity concerning risk mitigation eventually boils down to coverage need(s), premium mitigation and balancing deductibles
- Meaningless review of voluminous pages of nonnegotiable boilerplate; tiny, legalese print contained in policies, riders, declarations, exclusions (because insurance providers are excellent at mitigating and eliminating risk against themselves)
- Lack of trust between the client and the industry
- Lack of routine communication between the broker and client
- Lack of broker proactiveness (sometimes, laziness), and viewing the premium payments as a secure annuity
- Endless and uncoordinated premium payment invoices with mismatched maturity dates

One of the biggest pain points for family offices tends to be communication issues stemming from insurance, risk management and threat assessments. This communication breakdown often causes misclassification of insurance coverage, which can lead to gaps and overlapping coverages — "underinsurance" vs. "overinsurance" scenarios — neither of which are good. Therefore, the family and its assets are not fully protected, or they are overpaying for unnecessary coverage.

THE HOW: SOLUTIONS

With most issues, proactive open, honest, timely and comprehensive communication is the solution.

"The vast majority of issues, whether in your corporate life or with your family, are communication issues. This increases to about 99.9% when you're in a family office because often those two worlds have come together," said Bobby Hotaling, founder of Hotaling Insurance Services. Hotaling believes that when it comes to the complexity of family offices, there needs to be a cadence for establishing a consistent dialogue between the family office team members and the risk manager.

The frequency with which these families purchase/sell assets and move money can also be problematic for risk management. The velocity of transactions — such as buying artwork, collecting rare cars and selling/purchasing homes — can be a challenge to maintain. Without consistent tracking and frequent review of coverages, there is significant risk.

"We typically have a quarterly standing call with our clients to review any changes and conduct a check-in," said Dan DiLella, managing partner at Hotaling Insurance Services. "Our general guideline updates are meant to inform us if you acquire or sell anything of significant value. These quarterly meetings can help mitigate many potential concerns."

Hotaling and DiLella walked us through a case study where communication and complexity came into play: A robust Midwest generation-three family with principals in their late 50s were using a very reputable insurance firm as their broker. It was only their third year with this firm. In the past seven years, they have changed brokers twice due to the acquisition of their previous broker and then poor service with the next one.

"Whenever we first meet a family, we always begin with an audit of plans in place. This is to review the language of the contracts and ensure they match with what is going on with reality," said Hotaling. So, this meeting began with a focus on analysis and an in-depth dialogue with the family office.

The findings were stark. Two ranches had commercial operations on them but were insured only for personal risk. One ranch with a few operations happening had zero coverage or no mention at all in the policies. One home with $15 million in artwork carried no insurance. The insurance did not renew three years prior and was not caught. Another subset of art was underinsured due to lack of appraisal. A watch collection valued over $3 million was insured for a fraction of that. Plus, a collection of cars was wildly underinsured.

"Situations like this are common," DiLella explained. "Broker A initially wins the business, but then Broker B comes in later, finding a way to save money by switching carriers, so the family moves their business. However, Broker B is unaware that Broker A did not properly ensure a specific part of the plan, leading Broker B to build on a faulty foundation. This issue compounds over time until it is either caught or a claim is filed and goes unpaid."

CHECKLIST OF TO-DOS

- Be proactive, not reactive
- Governance — create separate time and space (perhaps a formal risk management committee) to discuss and analyze; establish a cadence of communication, conduct cursory review and deep audit meetings; assemble the right technical and knowledgeable people (family, nonfamily, internal employees and external advisers)
- Understanding the structure of your family office could be improved or is causing potential exposure that can be either mitigated or eliminated
- Transparency — provide your broker with your financial statements, strategic business and family plans, list of business and personal assets, and require a physical inspection of sites/assets
- Establish expectations for your broker
- Update immediately and review and audit quarterly — establish a culture that is sensitive to risk mitigation and threat assessments — appoint someone in the organization to be responsible and accountable for knowing what is happening and to update transactions and incidents immediately
- Every three years, conduct an RFP for services to keep the current broker alert and obtain second set of eyes and opinions
- Align renewal, maturity and premium payments so that it eases the burden on your family/staff in order to have a clearer picture of coverages, as well as consideration of gaps and needs
- Create "risk prevention" key performance indicators in your organization with incentives (both economic and noneconomic) to drive a culture of importance, awareness, safety, inclusiveness and teamwork.
- Create a cadence of training and education that supports a culture of importance and awareness

When it comes to complex multigenerational families, talk of insurance just doesn't capture the interest or attention required, unfortunately. What is required for the complexity of these dynastic multigenerational families is nonstop threat-risk assessments, management and mitigation (or elimination).

As with many things in life, communication is key. Order of operation is key. Governance works and brings this all together.

In the family office world, ensuring that your risks, threats and exposures are proactively assessed and managed in an ever-changing and complex environment requires focus, prioritization, understanding the fundamentals, a fully invested client-broker relationship, and attention by the right substantive people to discuss at the right cadence.

In other words, an ounce of prevention is through governance.