Insuring your business (and yourself) against loss

The affluent have a good bit to worry about — higher taxes, new uncertainty in the stock market. But for those whose greatest asset is their business, this recession brings an extra challenge. They need to keep their business solvent, while protecting it from losses and litigation beyond their control.

In this instance, doctors, architects, garment makers and hedge fund managers have something in common: their wealth is linked to the businesses they have built, and both could be at risk.

“At the end of the day, the head of a private company is the deep pocket,” said Donovan Nowell, senior vice president for Willis, an insurance broker. “If they don’t purchase enough insurance to cover a claim, the complainant is going to come after that person’s personal property.”

Lawsuits can come in various forms — for wrongful dismissal, bad advice, unpaid bills or even charitable work. As is often the case, there is insurance available to cover these risks, but it is expensive and often worded to exclude or reduce crucial coverage. The decision on whether to buy it is not easy. Without the right business insurance, owners could lose far more than they can afford, but paying a high premium will take even more money out of a business that is not booming.

Here are four things business owners should consider to protect their wealth:

THE MADOFF EXCLUSION Bernard Madoff has pleaded guilty to running a vast Ponzi scheme and is awaiting sentencing, but his deeds live on in insurance policies. Many money managers may find a “Madoff exclusion” in their errors and omission insurance, which generally covers them from a professional mistake.

“If you’re a money manager of any kind, you have the potential of having handled money in some sort of fund that made investments with Madoff,” said Michael Zeldes, a senior vice president for Hub International, a broker. “They’re very specifically excluding any lawsuit that comes down the pike.”

This matters for people who run their own funds because these are claims-made policies, meaning that whatever insurer is covering you when a claim is made has to pay it. The problem here is that at renewal time few people, even seasoned investors, read their policies closely — focusing instead on the premium. Mr. Zeldes said he had seen three different insurance companies bury the exclusion in their policies and had heard that many more were doing it. In the policy I read, Mr. Madoff’s name did not appear until the middle of the exclusion. But its intent was clear: it would not cover any loss related to any Madoff entity.

Money managers, however, are not alone in needing to review their coverage. In tight financial times, when the stress is high and budgets are tight, an architect, engineer, even an insurance broker could be sued for a professional error. If he has minimal coverage from better times, this could be a problem.

“Any litigious areas are going to be a challenge on the E. & O. side,” Mr. Nowell said, referring to errors and omissions. He said premiums had increased 25 to 30 percent in the last two years.

DEBT COLLECTORS Sometimes, chasing someone may be the only way to get paid — unless he has gone bankrupt. This is why credit insurance is becoming more popular.

Until recently, only large companies were willing to pay the high premiums — as much as 1 percent of sales. But now smaller, private companies are worried enough to consider it, both because of the weak economy and because there are fewer outlets for companies' products.

"With all of the consolidation that has occurred in so many industries, everyone is concerned," said Jim Dezell, senior vice president for Marsh. "Ten years ago, if you were selling PlayStation games, you had 10 major groups in the New York area; now you have one consumer electronics group."

He said companies with as little as $5 million in revenue can get credit insurance. Premiums vary by the size of a business and its industry. Anything associated with home building and furniture is higher given the slowdown in that sector, while an essential service like a grocery store would be less. He added that the terms of trade are a crucial factor: a company that makes clients pay in 30 days gets better terms than one that allows 180 days.

The fine print here, though, is that insurance companies are making the terms of coverage more restrictive, even while keeping premiums the same, said John Korpics, area senior vice president in Miami for Arthur J. Gallagher & Company.

"When the market was softer, an insurer may have given one client a $500,000 rolling credit and said you can extend terms out to 120 days," he said. "Now they'll say you only get $200,000 to this client and only 60 days to pay."

This leaves the insured company in a bind: does it trust that its clients will pay, or does it change the terms and risk losing them?

YOU'RE FIRED Donald Trump has elevated firing people to an art form. But the reality of letting someone go is much more complicated, particularly in an economy with an official unemployment rate of 8.9 percent, though that figure does not include people who have given up looking for work or those who have taken part-time jobs.

"When you have an unemployment rate of 5 percent, it's easy to find a new job," said Michael Lotito, a partner in the San Francisco office of Jackson Lewis. "When you have an effective unemployment rate of 15 percent and you don't have those opportunities to go someplace else, your full-time job is vengeance."

And that is when discrimination and wrongful termination claims increase. Some companies mitigate this with generous severance packages, ironclad employment-at-will provisions and employment practices liability insurance. But smaller businesses, particularly those that think of their employees as family, figure the expense is not worth it.

Yet a report in March from the Equal Employment Opportunity Commission said claims were up 15 percent last year, to 95,402, the highest number in the agency's 44-year history. Given that the unemployment rate continues to rise, claims this year may well rise, too.

While the premium for a manufacturer is less than that for an investment adviser, the risk to someone's wealth is still there. Oddly, the business owners who often overlook liability insurance are not the ones used to dealing with disgruntled employees but ones who know the need for insurance: doctors. Mr. Zeldes said he had been trying to show physicians how inexpensive the coverage was. A practice with 30 employees could get coverage for $3,300 a year.

CHARITY CASES In this time of economic need, being charitable is seen as a virtue. But litigiousness can strike nonprofits and board members can be personally exposed.

A member of a nonprofit board can buy a directors and officers policy to protect himself from litigation related to board decisions. A common lawsuit against a nonprofit board may come from not firing a director who repeatedly harassed other employees. But there are less obvious cases.

“With a synagogue, the board votes to do a major improvement but through poor planning it is too expensive and they can’t pay their staff and the religious school can’t operate and they lose the synagogue,” Mr. Zeldes said. “That’s a board mistake. It’s a breach of fiduciary duty.”

And the congregants could sue. Not only could such a mistake cost the board member the time and money he has donated, it could cost him personally.

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