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Wealthy Americans Turn To Trusts To Shield Assets

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Executive-liability insurance is often the first line of financial defense for executives and directors caught up in litigation such as investor lawsuits. For others without such coverage, asset-protection trusts are the way many insulate their wealth from claims.

“For a businessperson who’s in a competitive environment in which you see a lot of business litigation, I would say it’s prudent planning,” said Duncan Osborne, a partner with Osborne, Helman, Knebel & Deleery LLP in Austin, Texas. “That lawsuit’s coming sooner or later.”

> “A proper asset-protection plan is like a warship that has multiple bulkheads. If one takes a hit the others that are self- contained won’t go down with it.”
> - *Joe McDonald, Concord Trust Company*

Wealthier households use the asset-protection trusts, umbrella insurance and holding assets through special corporations to shield their legacies if they’re sued, according to estate planners such as Osborne. Trusts are “far and away the most popular strategy,” said Joshua Husbands, a partner with Holland & Knight LLP in Portland, Oregon.

Trusts often are funded with liquid assets such as stocks and bonds, and may be appealing because individuals who establish them may also take distributions if they need to, while the assets are generally out-of-reach from future creditors. They won’t offer protection if a defendant creates a trust after a potential claim has already arisen.

Directors and officers increasingly are being named in investor lawsuits. About 64 percent of federal securities class- action suits filed in 2011 named board members as defendants, compared with about 35 percent in 2008, according to New York- based PricewaterhouseCoopers LLP. Asset-protection trusts are sometimes used to supplement their liability coverage, also called directors and officers insurance.

Directors Sued

A California pension fund sued more than two dozen current and former directors and officers of Wal-Mart Stores Inc. (WMT) on May 3, alleging the company covered up the

results of an internal bribery probe. Wal-Mart takes its responsibilities to shareholders seriously and has been investigating the issues raised by the lawsuit, said David Tovar, a company spokesman.

The Federal Deposit Insurance Corp. has authorized lawsuits against 176 directors and officers for their roles in bank failures, this year through May 15, placing the FDIC on track to surpass the 264 individuals it named last year.

Directors and officers liability insurance generally covers defense costs against lawsuits and protects up to the policy limit for awards against a company's or nonprofit's key current and former individuals, said Evan Rosenberg, senior vice president of Chubb Corp. (CB) Policies vary, and some companies may buy as much as $500 million or more in coverage, he said.

Virginia Governor Bob McDonnell on April 4 signed legislation permitting asset-protection trusts in his state, bringing the number of states offering them to 13, including Delaware, Nevada, New Hampshire and Alaska.

Residents of states that don't permit them, such as New York and New Jersey, may set up the trusts by using a trustee in a state that does recognize them.

50 Percent Limit

Clients generally shouldn't put more than 50 percent of their net worth into the trusts, because drawing income should be considered a last resort, said Daniel Lindley, president of the Northern Trust Company of Delaware, a unit of Chicago-based Northern Trust Corp. (NTRS)

For trusts based in Delaware or Alaska, assets also may be protected from divorce proceedings provided a trust was established before a couple married, said Gideon Rothschild, a partner with Moses & Singer LLP in New York.

Individuals who are no longer in a high-risk position may be able to liquidate the structure when they retire or change fields, Rothschild said. It's generally up to the trustee's discretion, he said.

Retitling Assets

Starting an asset-protection trust in the U.S. may cost from $5,000 to $10,000 in initial fees, plus about $3,000 to $5,000 per year, said Joe McDonald, cofounder of the Concord Trust Company, based in Concord, New Hampshire. Initial costs depend on the attorney's rate and continuing costs generally vary with the level of assets in the trust, he said.

For a married couple, if one spouse is more vulnerable to potential claims than the other, it may make sense to retitle assets so that they're solely owned by the other spouse, Husbands said. This situation may arise in instances such as when one spouse is a doctor or serves on a board.

"You have to do it with forethought, and while things are still above board," meaning before any incident that could trigger a claim, Husbands said. "You also run the risk that if you get divorced, you've given everything away."

Affluent individuals should be sure they take advantage of all available federal and state exemptions for their assets, such as a federal exemption that generally insulates employer- sponsored retirement plans like 401(k)s from creditors' claims, McDonald said.

Unlimited Exemptions

Some states, including Florida and Texas, generally offer unlimited exemptions for primary residences. Others, including Oregon, put a dollar-value cap on the exemption for a home. New Hampshire and Texas generally protect the cash value of life- insurance policies. Maine has an exemption for fishing boats.

Families may consider putting additional assets into multimember limited-liability companies that are owned together by family members, said Mark Haranzo, a partner with Withers Bergman LLP in New York. Taking over one family member's partial interest in such a company may be an unappealing option for creditors because they generally have no control and limited rights to draw income. That means the strategy can be used as leverage for negotiating a settlement should a future claim arise, Haranzo said.

About 38 percent of affluent families said they feel they're more likely to be sued in the aftermath of the 2008 to 2009 economic and financial crisis, according to a study of households with $5 million or more in investable assets released in March by Ace Private Risk Services, a unit of Zurich-based insurer Ace Ltd. (ACE) About 82 percent of respondents said their wealth makes them vulnerable to liability lawsuits.

Timing Is Everything

"High-net-worth families are acutely aware of the fact that they have the proverbial target on their back," Husbands said.

By the time a credit claim is on the horizon it's generally too late for individuals or families to protect themselves, he said.

“About 90 percent of the time when I get a call about asset-protection planning I turn it down,” because an incident that could trigger a claim or precede a bankruptcy, such as a car accident or falling behind on mortgage payments, has already happened, Husbands said.

That’s because transferring or retitling assets at that point could be viewed as intentionally attempting to defraud creditors if a claim goes to court, McDonald said.

After-the-Fact

“At the very best you’re throwing good money after bad, because those actions are likely to be undone. At the worst you’re conspiring to defraud somebody,” McDonald said.

That prospect doesn’t always stop people from trying to reorganize their affairs after-the-fact.

John Goodman, founder of a polo club in Palm Beach, Florida, in March was convicted for vehicular homicide for the 2010 death of a man whose car Goodman hit. After the accident, Goodman adopted his girlfriend Heather Hutchins, potentially enabling her to take distributions from a trust he and his former wife had set up to benefit their children. In February a Palm Beach County judge ruled that part of the trust could be considered among his assets in a related civil suit.

Daniel Bachi, an attorney for Goodman, declined to comment.

Umbrella insurance offers wealthy households an additional way to protect assets, McDonald said.

“A proper asset-protection plan is like a warship that has multiple bulkheads. If one takes a hit the others that are self- contained won’t go down with it,” McDonald said.

The insurance generally provides liability coverage in addition to traditional homeowner and auto-insurance policies, which may have limits of $500,000.

Higher Premiums

A typical umbrella policy might cost $383 in annual premiums for a coverage limit of $1 million that would cover one home, two cars and two drivers, or $999 in annual premiums for a similar policy with a $10 million limit, according to the report by Ace.

Costs vary regionally and depend on the policy limits and the number of homes and insured drivers, said Mary Boyd, chief operating officer for Ace Private Risk Services.

High-profile individuals could pay as much as four times more for an umbrella policy than another person, said Jeff McCarthy, a branch manager in Woburn, Massachusetts, for Harrington Insurance Agency Inc. He works with one player for the Boston Red Sox and said his client has to pay a higher premium for his coverage.

“If he rear-ends someone in traffic that person sees the celebrity get out of the car and sees dollar signs,” he said. “You might as well have painted ‘Sue Me’ on the side of his car.”