

Doing a Good Deed Can Sometimes be Costly

In the post-Enron world, trouble can await the rich when they serve as board members or trustees. They need to research the principles of personal risk they might assume.

By Charles J. Maxwell, Jr. – as seen in the Star Tribune
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To paraphrase a famous Minnesotan, F. Scott Fitzgerald, the wealthy are different.

They also are more vulnerable to risk when, as a favor to family or to a friend, they act as a trustee or they serve -- even with the noblest altruistic intentions -- on nonprofit and for-profit boards. The wealthy often assume an incredible amount of risk and don't even blink an eye. What distinguishes them in these instances is that they simply have a lot more to lose.

In the post-Enron and WorldCom world, successful people and wealthy retirees need to spend more time understanding the principles of personal risks that they unknowingly assume but often fail to protect against when engaged in the charitable activities. Many business executives and business owners spend a great deal of time planning for the successes of their businesses. But this same group will generally spend less time on their personal financial planning and almost no time on their personal risk management. By failing to understand these risks they may put their financial lives in unnecessary jeopardy.

We now live in a time of greater public scrutiny about private wealth, a period when recent headlines are giving boardrooms and their directors pause. News stories about the apparent backdating of stock options for select CEOs in the Twin Cities and others around the country could eventually mean personal liability for board members.

While expensive business insurance and indemnification of officers and directors are smart practices that savvy boards employ against such claims, unfortunately few insurance companies understand the complexities that are associated with significant personal wealth. The industry currently offers few solutions to transfer the personal risk that these board members may assume.

Insurance firms that specialize in covering the complicated risks associated with wealth are beginning to realize that these select consumers need newer products to address these types of risks. Hopefully, as demand continues to grow, the insurance industry will respond by developing cost-effective products.

Until they do, a strong fail-safe position is to plan well in advance for such personal risk, according to Tom Keller, an expert on such issues and a partner at the law firm of Moss & Barnett.

“An individual that agonizes over a certain investment being down against the benchmark for a single quarter is also sitting on two boards of directors and a non-profit board,” Keller says, “and has never asked what his or her personal risk is -- or what coverage the company or charity has to protect their interests.”

Favor can be costly.

The same scenario applies in the case where someone is asked to serve as a trustee. It's one of those activities that seems so innocent, but is loaded with liability.

“What many people fail to realize is that as a trustee you have a fiduciary responsibility to the trust and the trust alone,” Keller said.

“Say your best friend asks you to be trustee of some trusts set up for his or her kids. Guess what? You just picked up a major responsibility -- and personal liability.”

The press is full of examples of where beneficiaries of trusts have sued the trustees, including family members, over failure to meet fiduciary duties. A common mistake occurs when someone assumes that their personal liability insurance policy will cover the risk for such activities. They are often surprised to learn that it is not the intent of a typical personal liability policy to cover this exposure.

Serving as a trustee or sitting on a board comes with the territory of being successful and wealthy, and in Minnesota we have robust Fortune 500 companies, world-class arts organizations and generous charities to prove it.

But by successfully analyzing and managing personal risk exposure as part of a total wealth management strategy, the wealthy among us can continue to make a difference.

And, as unpleasant as risk planning may sound, it is critical to understand the risks one assumes even with the best intentions.

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