

LIABILITY RISK MANAGEMENT – THINK “DOWNSIDE”

We have often discussed with our clients the importance of managing the risks in their investment portfolios. In general, prudent investing demands diversification among asset classes. Sound fixed income investing requires management of interest rate and credit risk by diversification of portfolio maturity and issuers. Conservative equity investing requires management of risk by diversification among investment styles, equity issues, sectors, and managers.

Of course, other potential hazards to one's financial health exist as well, and should be managed with similar care. These include personal liability risks, which are often addressed by carrying appropriate levels of property and casualty insurance, and risks attributable to loss of earned income, which are addressed by carrying disability insurance and life insurance.

There are, however, certain personal liabilities that may not ordinarily be fully or adequately covered by insurance and should be considered when reviewing the potential for loss in one's financial position. These liabilities may include professional liabilities, business related liabilities, and fiduciary liabilities. The purpose of this memorandum is to call your attention to methods that may be utilized to protect assets from the claims of future potential creditors related to these activities.

The most common method for insulating assets from such potential creditors is to transfer assets to a spouse. Future creditors, for example, could not reach assets that were transferred to a spouse provided such transfer was not in fraud of then existing creditors.

Another commonly used method for insulating assets from future potential creditors is the transfer to a trust for the benefit of one's spouse and issue. The transferor/grantor of the trust could retain a limited power of appointment to cause distribution of assets to a spouse and/or issue at his or her sole discretion. Because the assets are not reachable by the grantor and the grantor does not have any beneficial interest in the trust, the assets held in trust would not be reachable by future creditors, again provided that at the time of transfer, such transfer was not in fraud of then existing creditors.

Some states have enacted trust laws that insulate trust assets from the claims of the grantor's creditors even though the grantor is a beneficiary of a trust. The grantor (even a non-resident of that state) may create a trust with a situs in the subject state, in which the grantor is a discretionary beneficiary of the trust. Trust assets will not be reachable by future creditors of the grantor provided that any distributions to the grantor are at the discretion of an independent trustee and the transfer of assets to the trust was not in fraud of then existing creditors at the time of the transfer.

Finally, offshore trusts in certain jurisdictions may be utilized to accomplish the same goal as the aforementioned domestic trusts.

KLS is generally not in a position to be aware of, or assess the extent of, all potential exposures for which our clients may be at risk. For example, many clients are trustees of substantial trusts. Others are directors or officers of public corporations. Others are professionals with exposure to high profile transactions or health care professionals with potential liabilities that exist due to the nature of the profession. In each case, a judgment as to the real potential for future liability, and an appropriate action plan, will turn in significant part on the specific facts involved.

As litigation is prevalent in today's world, we thought it appropriate to raise this issue and acquaint you with methodologies which could be utilized should you have any future potential liability concerns. Please call your KLS Managing Director to discuss any or all of these matters.

KLS Professional Advisors Group is a firm of wealth management experts committed to building effective long-term relationships based upon trust. We offer advice and counsel on every aspect of each client's financial affairs in pursuit of strategies designed to preserve and build their family's wealth. For further information about KLS, please contact Carlton B. Klapper, Managing Director, at (212) 355-0346, or e-mail us at gpangle@klsadvisors.com.