SHORT REPORT

# Out of Left Tail:

## How adequate property and casualty insurance can improve the risk-adjusted return of your ultra-high-net-worth clients' portfolios

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As a premium insurer and industry leader, Chubb supports research to better understand and meet the needs of ultra-high-net-worth (UHNW) individuals and families. This paper serves as a short-form guide to the following research:

## Does Wealth Change the Way You Think?

Risk Tolerance, Tangible Assets, and Risk Management: Observations for Prosperous Families and Their Advisors

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The Wharton School
University of Pennsylvania

Download the full Wharton study

Chubb commissioned the Wharton School of the University of Pennsylvania to conduct a study assessing the impact of property and casualty insurance on the portfolios of UHNW investors. The 2021 study — referred to as “the Wharton study” throughout this guide — is built around an in-depth analysis of model portfolios and a survey of more than 400 UHNW investors and their advisors. In addition to analyzing portfolio outcomes, the Wharton study examines the preferences of UHNW clients when it comes to financial advising and management.

# Key findings

The Wharton study offers the following actionable insights for financial advisors seeking to enhance how they work with UHNW clients.

## 01

You can improve the risk-adjusted return of the portfolios of your UHNW clients with appropriate levels of property and casualty insurance.

## 02

There appears to be a significant gap between advisors to UHNW clients and the clients themselves when it comes to evaluating assets and coordinating risk management and investment activities. The data implies some UHNW investors consider tangible assets (such as real estate, art, personal possessions, and other insurable property) to be part of their wealth-management portfolio — but their advisors do not.

## 03

Whether you're a wealth manager, family office manager, or other financial advisor to UHNW clients, you may better serve your clients by consulting with a UHNW insurance advisor. An agent or broker who specializes in UHNW clients can play a critical role in more precisely evaluating tangible assets and risks, and helping you incorporate risk management strategies into balance sheets.

# UHNW clients seek a "total balance sheet" approach

## Advisors to UHNW individuals and families best serve their clients by developing a profound understanding of their clients' attitudes toward money and life.

Academic research confirms what many advisors have long recognized: UHNW clients view their wealth as more than a tally of their liquid assets. As the Wharton study illustrates, most UHNW families take a holistic view of their wealth that includes tangible non-financial assets, human capital, business cash flow, and sources of financial risk, as well as liquid financial assets. These multiple factors represent a family's total balance sheet. This complex, dynamic accounting provides a more accurate and useful picture of a family's wealth than the bottom line of a financial services account statement.

Understandably, financial advisors may focus largely or exclusively on the risks and returns of traditional financial assets such as stocks, bonds, private equity, and other financial instruments.

The Wharton study, however, finds that UHNW clients want their financial advisors to make tangible assets and risk assessment part of their advisory services. According to the study, advisors can improve how they serve their UHNW clients by:

### Recognizing clients' emotional connection to tangible assets

UHNW clients may assign "emotional value" to certain assets. An artwork can be enjoyed in the home, as well as function as an investment. Jewelry can be worn as well as sold or leveraged. Emotional value — and a client's willingness to dispose of or replace an asset — can impact insurance and investment decisions.

### Helping clients better assess all types of risk

Risks and risk management can be highly complex for UHNW clients who have a wide range of assets as well as idiosyncratic attitudes toward these assets. An advisor can help clients understand risk beyond the price or return volatility of liquid assets. For tangible assets, an advisor can enhance their services by helping clients understand potential losses, depreciation, and liability, as well as weigh risk-mitigation strategies.

### Revising risk management budgets to reflect the total balance sheet

When advisors develop a total balance sheet for a UHNW client, they may find that the client is underinsured and that asset allocations are imbalanced or suboptimal. The advisor may want to recommend financially prudent adjustments but should not recommend changes that disrupt the client's lifestyle or fail to acknowledge emotional value.

### Partnering with risk management experts

Financial advisors, investors, and family office managers may want to consider partnering with an insurance agent or broker specializing in UHNW coverage, who can provide special expertise and experience in hedging risks. The guidance provided by a UHNW agent or broker can enable advisors to incorporate asset valuation and liability into wealth management for UHNW clients.

# The value of property and casualty insurance as an investment tool

The research developed two case studies that demonstrate how insurance can improve the long-term performance of the portfolios of UHNW investors.

It found that, modeled over a 40-year period, ***adequate liability insurance and property coverage can improve the risk-adjusted return*** on assets of total balance sheet portfolios that include a family's business, property, and possessions.

As usual, past performance is not indicative of future results, and all expectational or historical data or analysis presented here based on such data should not solely be relied upon to form any investment or risk management opinion, position or portfolio. Expectations referenced herein are construed over high-level asset classes and not any particular portfolios. Investors cannot invest directly in indexes. In addition, expectations are forecasts and therefore are subject to error. No guarantee can be made that they are accurate.

CASE STUDY 1

# Liability insurance

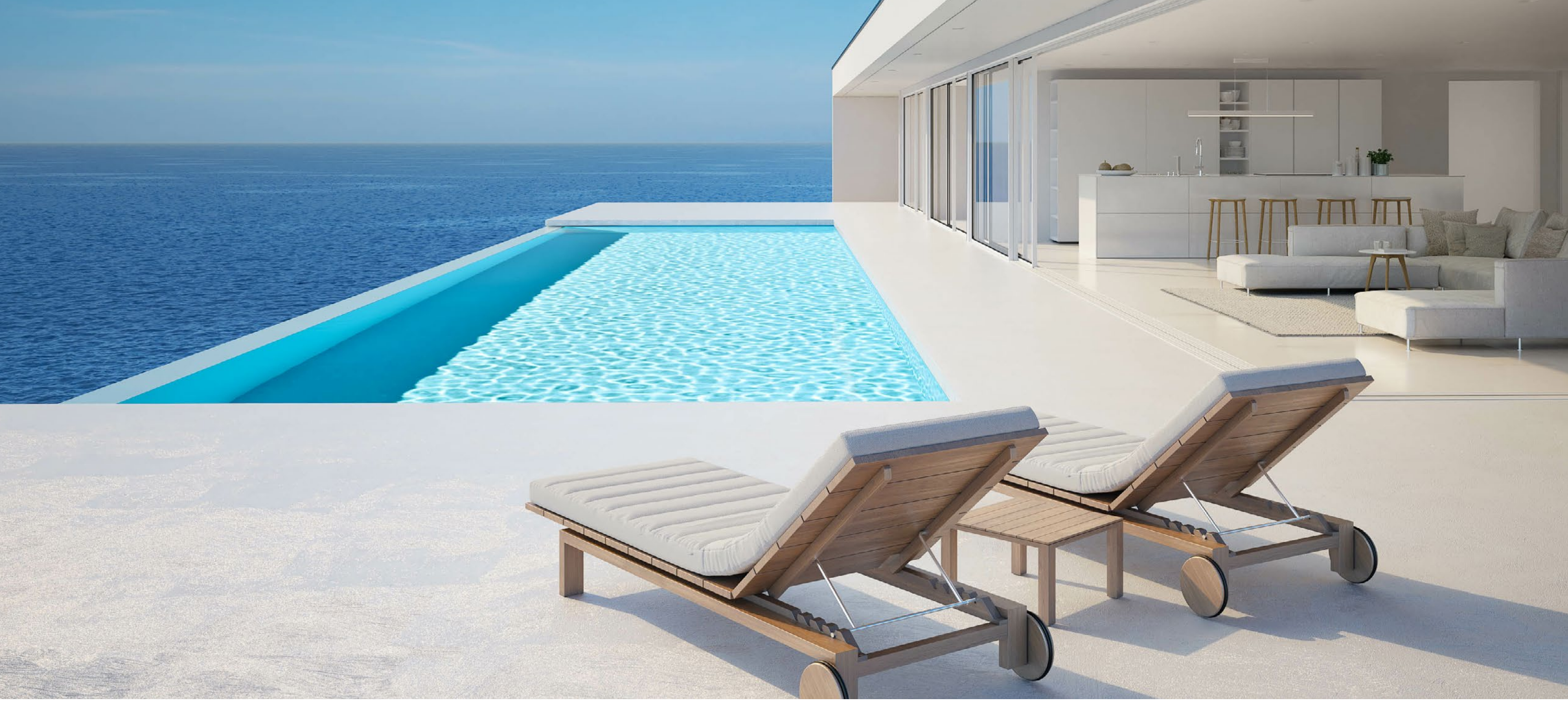
Case study 1 evaluates the portfolio of a hypothetical UHNW family with $30 million of net assets spread between a family business and non-business assets, such as stocks, bonds, real estate, commodities, and other investments. The illiquid family business represents 38.5% of assets and cannot be rebalanced.

The case study's model portfolio represents average allocations based on data previously collected by the Wharton Global Family Alliance.[1] The total portfolio has greater volatility than the portfolio only of liquid assets due to the lack of diversification arising from the inclusion of the family business.

The family faces the potential of a substantial direct loss from a left-tail event — an infrequent, potentially catastrophic event, such as an accident and accompanying lawsuit. The analysis models a 1% probability per year that the UHNW client will lose 50% of their wealth. In the face of this risk, the UHNW investor who self-insures or underinsures may take on greater risk in liquid investments to compensate for a real or potential loss. In this scenario, the investor compensates an unhedged or under-hedged liability risk with riskier investment allocations.

Insurance enables the UHNW family to avoid the devastating financial impact of a left-tail event — at a minor cost relative to the total balance sheet. With appropriate liability insurance — hedging approximately 80% of the potential liability — the same expected total portfolio return can be achieved with lower risk. An uninsured or underinsured left-tail risk may also possibly lead to overly cautious investment decisions — e.g., leaving wealth in cash to compensate for the risk — thus impacting returns.

1. Amit, Raffi, (2018). "Wharton Global Family Alliance 2018 Family Office Benchmarking Report Executive Summary." Available at https://wgfa.wharton.upenn.edu/wp-content/uploads/2018/03/WGFA-2018-Benchmarking_EXEC-SUMMARY.pdf.



CASE STUDY 2

# Property insurance

Case study 2 similarly examines a hypothetical family with a net asset worth of $30 million. In this case, personal real estate and high-value contents account for 17.5% of the family's wealth or $5.25 million.

Primary residences and their contents are frequently underinsured, with substantial gaps between market value and replacement costs. The case study analysis indicates that this gap can be inexpensively closed by acquiring proper levels of insurance, not only reducing financial risk to the total balance sheet but also offsetting the cost of time, energy, and psychological pain associated with the loss of property and possessions.

As in case study 1, insurance improves the optimal expected risk-adjusted return. Because the risk in this scenario is related to the replacement value of a complex range of properties, it could be important to utilize an insurer who specializes in serving UHNW clients and accurately assessing property such as homes, fine art, and jewelry. The Wharton study's findings underscore the importance of insurance carrier stability, proper home replacement cost coverage, and adequate liability limits. Carrier instability increases the risk that insurance will not be effective, which in turn impairs the overall total balance sheet investment strategy.

# Understanding UHNW clients' insurance priorities

Financial advisors understandably seek value for their clients. They may feel an ethical and professional obligation to seek the lowest-priced insurance or heavily weigh price-for-value when they evaluate insurance options.

This prioritization of cost, however, runs counter to the preferences of UHNW clients. The Wharton study found that a large majority of UHNW clients — approximately 80% of the survey's UHNW respondents — prefer appropriate coverage and service, even if accompanied by a higher cost. This figure increases to 95% for clients at the $50 million (or higher) wealth level.

# Risk management (insurance) preferences

| Wealth class | Rank | Preferences ($30MM-$50MM) |
|---|---|---|
| **UHNW** | First | Stability |
| | Second | Handle complexity |
| | Third | Most experience |
| | Fourth | Pays covered claims fastest |

| Wealth class | Rank | Preferences (less than $30MM) |
|---|---|---|
| **Not UHNW** | First | Stability |
| | Second | Pays covered claims fastest |
| | Third | Most experience |
| | Fourth | Handle complexity |

While all categories of wealthy clients rank financial stability as the top criterion for evaluating an insurer, UHNW clients also highly value the ability of insurers to handle complexity. Simply put, UHNW clients have more complex balance sheets combining a wide range of risks and assets, including family businesses and valuable tangible assets, and they prefer insurers who can better respond to this complexity.

Fundamentally, UHNW clients are looking for advisors and insurers who understand the complexity of their wealth and coordinate all assets and risks. According to the Wharton study, the lack of coordination may represent an industry failure, though there is a growing trend toward family office services, financial planning services, and outcomes-based wealth management that entail a total balance sheet approach. In other words, as a financial advisor, you may want to consider bringing an insurance agent or broker specializing in UHNW clients onto your team.

The Wharton study concludes that there are "potential open opportunities for wealth managers to bring to bear the direct treatment of total balance sheet asset management including risk management of those assets." Advisors can build trust and strengthen their relationships with UHNW clients by incorporating a deeper understanding of risk into their services. This path can increase your clients' risk-adjusted investment returns — as well as enhance their emotional security, happiness, and client satisfaction.

# Learn more and reach out

To learn more about risk management for UHNW families and individuals, visit:

- chubb.com/wharton
- chubb.com/individuals-families

**Or contact an independent agent or broker specializing in insurance for UHNW clients.**

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