

New fiduciary language challenges risk management issues

By Joseph W. Maczuga

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Debate over new fiduciary language from the CFP Board and the FPA has focused on the risk management aspects of life insurance, though some of the conclusions have gone unchallenged, and others reflect industry biases.

The Certified Financial Planners Board of Standards Inc. is located in Washington, and the Financial Planning Association is based in Denver.

The new language represents a major change in our profession, and an open dialogue about it is necessary. It brings fiduciary process and responsibility out of the shadows.

It forces us to challenge some of our conclusions about the product and ways we do business, to determine if they have merit.

While the debate has gone on for decades, there are still those who view the source of compensation as the sole issue of fiduciary conflict. That is an erroneous conclusion. There is nothing in the regulatory statutes or case history that makes that claim.

However, the commission environment has led to unhappy clients, resulting in class action litigation and regulatory fines for activity that was not in the client's best interests. It is almost impossible to provide fiduciary standards in the risk management component of financial planning if the practice is commission-based. External influence and production pressure make any recommendation suspect.

Fee-only advisers, meanwhile, fail to meet their fiduciary responsibilities. Due to their non-commission bias, they totally ignore their risk management responsibility to clients. Many advertise financial planning and insurance planning on their websites, but proficiency is minimal at best.

Fee-only advisers need to recognize that insurance can offer productive planning strategies that benefit the client, and then find a trusted, unbiased person who can educate them and assist with clients.

Also, we must recognize that educational material provided for life insurance and annuities is biased in its presentation. For instance, when was the last time you ordered educational material from an insurance industry source that discussed fee engagement insurance planning or provided insight as to the liquidity advantages of no-load policies?

The industry has not provided a clear and concise definition of policy styles within the two primary classifications of premium-dependent policies and cash-value-dependent policies.

That has led advisers into an area of unrecognized legal jeopardy, according to several studies. Further, it has opened opportunities for abuse and created a difficult environment for fiduciaries, for whom litigation concerns are justified.

Premium-dependent-policy styles are premium price-fixed (whole life, term), meaning that the insurance company has assumed the risk as well as the fiduciary responsibility for pricing the risk.

Cash-value-dependent policy styles (universal and variable life), on the other hand, have no required premium and have shifted the risk to the policy owner and the full fiduciary responsibility for the continuation of the policy to the adviser.

It is up to the adviser to determine the appropriate premium deposits necessary for managing the assumed risk. This can be achieved if the adviser is aware of the pricing assumptions used by the issuing company. Unfortunately, illustration software is neither transparent nor fully disclosed and forthright about pricing assumptions.

The problem is that the conclusions carried over from the old premium-dependent policy styles (term and whole life) created an environment in which clients were neglected. Because few understood that premiums did not represent a pricing structure for cash-value-dependent policies, the results were poor policy review when universal life and variable life were sold to clients.

Cash-value-policy styles mandate annual reviews (quarterly for variable universal life), though there are few examples of this practice being implemented.

CORRECTING THE PROBLEM

How do we employ unbiased objectivity and open architecture? How do we engage in the facilitation of the financial planning process from a different perspective to that which is most common in the industry? How can the adviser substantiate the recommendation?

This is where compensation does become an issue, challenging the integrity of a recommendation and leading to several questions. Could the goal be met without insurance? How can we be sure that the insurance is necessary? Is it the right policy style? Does the policy structure best fit the objective? What product represents best execution?

A fiduciary process should provide the required open architecture of full disclosure and transparency for a client-centric focus, creating a filter to protect the client from external forces.

We must find areas of deficiency, compromise or contradiction. We need to seek the full horizon of potential resolutions without regard to product implementation. We should select those variables or products that would best fit that particular client, and solve them.

Some guiding benchmarks to this approach are:

- Each client has a need, and that need must be defined in a succinct manner.
- Every need reflects financial, physical, emotional, mental or spiritual motivations related to the client, his or her family or philanthropic concerns.
- There might be circumstances that require insurance.
- There are circumstances in which insurance is not necessary.
- Compensation should never be the goal, nor should it be an obstacle.

If we want to alter the process so there is a more prudent approach under fiduciary standards of full disclosure and transparency, there are systems that perform historical market-cycle back-testing for fiduciary disclosure and due diligence, as well as other functions.

The full-disclosure-and-transparency model for fiduciary compliance is void of motivation to move product — keeping the focus on the client.

There are occasions when a commission policy works best — not for the agent but for the client. There are times when a no-load policy works best, and there are times when no policy is necessary. Regardless, the process has to be handled correctly.

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