

# The missing fiduciary standard: Full disclosure of risk

By Joseph W. Maczuga

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While the spotlight of fiduciary standards is focused on investment activity and asset management, only a small number of advisers are connecting the dots to challenge some compromising standards. Debate seems to be so narrowly focused as to miss the larger picture of consumer enlightenment and choice.

If full disclosure and client interest form the starting point of fiduciary function, why is this premise limited to only one of the two primary functions in the financial planning process? The last time I looked, comprehensive financial planning involved both asset management and risk management.

### Questionable argument

Is it possible to argue that while fiduciary construct should be applied to the asset management side of the function, such professional guidelines do not have to apply on the risk management side?

When reviewing the definition of a fiduciary, the following is made clear:

- There is an obligation to act for another under circumstances that require total trust, good faith and honesty.
- Self-dealing and conflicts of interest must be avoided.
- The best interests of the client must be primary.
- Absolute candor is required.

To fulfill even these basic conditions, full disclosure and client education is mandated. Neither of these exists when discussing life insurance. I am amazed at how many advisers agree that life insurance is a vital part of risk management in the financial planning function but then view it as a neglected orphan that needs to be cleaned up and made presentable. There are a number of negative conditions that exist in the new-paradigm products in today's life insurance arena.

First is the lack of regulatory guidance as to mandatory disclosure of illustrated proposal components.

A participating whole-life policy is free to illustrate highly leveraged rider-to-base-policy concepts (which require the future assumed dividends for continuance). Yet there is no requirement to divulge any information on the price structure of the term components of the rider, or pro-rata relationship of term and paid-up additions.

A universal-life policy can be illustrated in 25 variations using the same policy from the same company. Each version can be tweaked to offer a lower annual premium or higher future-cash-value projection. What does this say about the financial principles of the policy? There is no requirement to divulge the underlying cost assumptions.

A variable-life policy must illustrate a zero market return as an effort to show the "worst" scenario. Wouldn't the worst scenario be a negative-return year?

There are no guidelines requiring a Monte Carlo simulation of market history to test the proposed premium's ability to maintain the policy. In fact, most illustrated level annual premiums have a greater probability of failure than of success.

Second is the lack of actuarial standards and accountability when developing current cost assumptions. Although there is sufficient evidence that questionable assumptions are integrated for the purpose of marketing a better "illustration," this self-regulating profession has very little interest in protecting the integrity of the policy due to marketing pressure.

Third is the acceptance by the consumer and adviser community that what you see illustrated is what you are going to get. Of course, we all accept the caveat that future results may be more or less than those illustrated on the basis of assumed returns, but the lack of full disclosure allows the real risk - that of cost manipulation - to be hidden.

By providing full disclosure, the principles of fiduciary focus begin to take form. The client can see where every dollar is going, due to the ledger that "unbundles" the premium for the stated allocation.

The adviser can ascertain the amount of premium needed to support the cost components of the policy, which have been clearly defined and identified. This approach also allows for an examination of the cost assumptions employed.

The problem is that only a no-load, fee-based policy offers such full disclosure. Since most life insurance is sold in a transactional,

commission-generating environment, full disclosure will not be provided to the majority of consumers, who have to wait until the problem occurs to find out that assumptions were faulty.

As the Financial Planning Association in Denver clearly states, you cannot be a financial planner and not have fiduciary responsibility. Obviously, half a fiduciary is better than none.

Joseph W. Maczuga is executive director of the Fee Advisors Network in Troy, Mich.