

The Fiduciary Role of the Fee-Only Advisor in Risk Management

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Many advisors think of risk management as representing a client's exposure to market volatility or the Beta factor of a portfolio. However, risk comes in many other forms, too. As a fiduciary advisor, it is your duty, both ethically and legally, to advise your clients about many forms of risk and risk management.

This article considers the risk management options that are available through life insurance to help clients manage their ability to earn income from an asset, avoid erosion of their estate due to taxation, and transfer wealth to their heirs.

Comprehensive financial planning engages both asset management and risk management. Life insurance is properly part of the consideration of fiduciary responsibility that an advisor has to his or her clients. Yet the complexities of life insurance policies, plus the high commissions and occasional abuses that clients have encountered, have led many Fee-Only advisors to decide to have as little to do with insurance decisions as possible. They want to help a client identify a general level of insurance, and then leave all the decision-making to the client and a no-load insurance provider.

While this strategy is practical from an advisor's viewpoint, it is not necessarily what is best for a client. It might not even rise to the level of fiduciary responsibility to which a NAPFA member is held.

Developing life insurance needs through software programs does not fulfill the fiduciary requirement. Referring a client to commissioned planners does not fulfill the full disclosure requirement. Comparing illustrations without using due diligence in checking an insurer's cost assumptions and other components integrated into that illustration does not fulfill the fiduciary requirement. Referring a client to a no-load insurance provider, in itself, does not fulfill full fiduciary duty.

Instead, let's consider how an advisor can help clients integrate life insurance into their financial plans, and what role the Fee-Only advisor can play in the selection process.

First, be assured that you do not have to be an expert on life insurance. However, you do have to have a basic understanding of policy structure, design, and purpose. In addition, you need to look at the various situations in which life insurance may provide an answer for your client's needs.

The advisor should know the difference between a premium-dependent policy structure and a cash-value dependent policy structure; how these differences affect premium design and the shifting of risk from company to client; and the advantages and disadvantages of either structure. In addition, the advisor should know when a policy structure gets compromised (which is the case with a participating whole life policy that has term riders, or a universal life policy that has a no-lapse guarantee rider) and the impact of such a compromise.

Advisors also must be able to differentiate which structure of policy requires annual or more frequent monitoring for on-track performance, and which policy structure does not; which policy is best suited for a death benefit objective, and which is best suited for asset accumulation; and which policy structures are the most flexible for future cash flow, and which may be too sensitive for such a strategy.

No-Commission Insurance Products

The introduction of the no-load life insurance policy by Ameritas some 20-plus years ago was a major breakthrough. No-load, or advisor–designed, insurance policies provide a number of great advantages to both the client and the advisor. These products are available in term, universal life, variable life, and survivorship policies. They also are available as variable and fixed annuities.

No-load life insurance policies (particularly universal and variable universal life) have strong merits. First, the product and its illustration provide full disclosure and transparency (a very important element that is missing in a commission policy). This presents a format that is consistent with the fiduciary process. Second, the client has a policy with cost efficiencies and capital efficiencies. Third, the policy has a much wider range of flexibility and control than its commission counterpart. Fourth, the full disclosure page in the illustration allows the advisor to determine cost ratios, percentages, and needed financial data for premium design. Fifth, the policy provides maximum liquidity from the first policy year. Sixth, the policy statements are fully disclosed so that the advisor can monitor the annual cost/capital functionality to that which was initially illustrated. Seventh, of course, a Fee-Only advisor can participate with a client in the life insurance planning activity through the fee-engagement venue.

However, there are going to be situations when an advisor-designed product may not fit or resolve the client’s stated goals. For example, if the death benefit is the driving objective for policy design, and the client wants the premium and death benefit to be established as a guarantee, a commission product may be the only product offering available to fulfill this objective. You need to be able to recognize this situation and pronounce that it is acceptable.

You also need to assure yourself and your client that you have done your fiduciary duty by checking the options. Were multiple products reviewed and compared, regardless of compensation structure? Did each product presentation contain the same features? Is the product with the lowest premium reserved too thinly to maintain its guarantee? Did the proposing advisor focus on the best interest for the client, keeping him/her out of harm’s way, or was there some other motivating factor? Did you present the comparison of the no-load universal life policy with the commission product so that the client understood the cost (loss of cash value accumulation, flexibility, and control) of the no-lapse guarantee? Was the client educated on the workings of the policy structure under consideration—both the advantages and disadvantages?

Remember, the method of compensation is not the line of demarcation for determining product value or fiduciary foolery.

Find Trusted Resource

Find a trusted resource. Yes, it’s easier said than done. Many advisors may lean towards an insurance professional who has experience and knowledge regarding life insurance products and the advanced planning strategies in which they may be employed. However, if the advisor does not incorporate a broad horizon of no-load, as well as commission products, he is not following a fiduciary.

In many cases, an advisor’s “fiduciary process” is assembling a number of proposals and illustrations to compare premium and future cash values. I would argue that this is inadequate. Have those illustrations been scrubbed to expose all hidden caveats and undisclosed costs? Are the assumed costs of insurance credible?

On the other hand, turning over a client to a no-load product provider to get an illustration or to design a policy without your input and informed guidance might be abandoning your fiduciary duty. Is the policy designed to leverage capital? Are the assumptions credible? Is the product software available so you have the availability of looking at different design strategies?

A no-load policy presents a masterful planning tool because of its flexibility and wide range of concept applications. Do you really want to be completely divorced from that part of your client relationship?

Treat Risk Management Like Asset Management

It has been my experience that RIAs and Fee-Only advisors are knowledgeable and experienced in most aspects of comprehensive financial planning, as well as asset management techniques. However, risk management/life insurance has been brushed aside. I implore you to apply the same energy and practice standards to risk management as you do to asset management.

Fee-Only advisors need to overcome the negative perception of life insurance as a product that is transactional, better for the agent than the client. Given the fairly low exposure that most advisors have to life insurance, it's not surprising that this side of the financial planning equation is misunderstood. If you were to accept the fact that, with some commitment, you could learn the important fundamental information that is not usually presented in the mainstream institutions, what would prevent you from doing so? This would allow you to integrate insurance planning and guidance into your practice in a venue that places your client first by employing a higher standard.

There is also a defensive reason for becoming engaged in the life insurance process. Because life insurance generates fee income and assets under management for advisors who have taken the initiative, you may be ceding turf to others. The fact that not enough advisors are stepping up to this responsibility leaves the consumer (and your client) in the unfortunate situation of placing his or her risk management needs into the hands of someone not as concerned as you, or as competent as you can be.

Regulatory Confusion

Our evolving industry may place us where we feel that we have to serve two masters who are at odds. A state or federal RIA must answer to a particular regulating body which has laid out your fiduciary responsibility and other practice standards. Is there a potential conflict with state insurance department restrictions on your life insurance activities? This may seem like a complex situation, but there are some guiding principles.

Become familiar with the state regulations about charging fees for insurance planning and see how they conflict with your RIA fiduciary obligation. Prepare your life insurance client presentation so that it conforms with your ADV and RIA practice operational statement. History shows that if there are regulations from separate entities that are in conflict with each other, the governing body is usually favored. As an RIA, your fiduciary obligation supersedes. If you are uncomfortable, work with a qualified and licensed professional who can assist you and provide a "firewall" of protection.

States have archaic regulations which are eons behind the changing landscape of the insurance profession. I work with many advisors across the country who have not felt in jeopardy regarding this issue. But each advisor must seek his or her level of comfort.

I am associated with a number of RIAs and Fee-Only advisors who have successfully equipped themselves to offer risk management/life insurance services to their clients. This effort has expanded their practices and strengthened their bonds with their clients.

Closing Summary

In my consulting work with wealth management firms, I find that over 85 percent of the in-force policies are underperforming, will eventually self-destruct, or have nothing in common with what the client thought had been purchased. Illustrated proposals are just as dangerous. This fact should embarrass us, because we are allowing, by default, the client/consumer to seek guidance elsewhere.

Today's fiduciary climate mandates that all of us reassess our practice approach and methodology; Fee-Only advisors are not immune. There is no denying that NAPFA has been a leader in the creation of awareness in fiduciary concerns.

But When I spoke at a NAPFA conference a few years ago, I looked at a sample financial plan in one of the lobby areas. The section under life insurance had a ledger of all policies, total death benefit, total premiums, and total cash value. Very disappointing.

Because of my respect for this organization, I agreed to write this article—straight on—as my experience dictates. And I suspect, as with many of my published articles, some advisors will be offended by my statements. I hope others will be stirred and motivated to provide more for their clients.

My advice is to become acquainted with a no-load product provider. Consider the company's history and product menu. Is software and educational material provided? Is there a fully trained staff to support you? Are you allowed to get involved and assist in policy design?

Become familiar with what the products can do. Then find an independent, trusted resource who can accommodate you in a fiduciary way, not just a source to facilitate an application.

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