



Life Insurance: The Missing Fiduciary Standards of Full Disclosure

Joseph W. Maczuga, LIC, CFIS

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While the spotlight of fiduciary standards is focused on investment activity (and that of asset management), only a small number of advisors are connecting the dots to challenge a dual set of compromising standards. The challenge is to our profession and the debate that seems to be so narrowly focused as to miss the larger picture of consumer enlightenment and choice. If full disclosure and client interest forms 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. 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:

- (1) Obligation to act for another under circumstances which require total trust, good faith and honesty;
- (2) Must avoid self-dealing or conflicts of interest;
- (3) The best interest of the client must be primary;
- (4) the requirement of absolute candor.

To fulfill even these basic conditions, full disclosure and client education is mandated. However, neither of these exist when discussing life insurance. I am amazed at how many advisors 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 of today's life insurance venue.

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 PUA's. 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 principals of the policy? There are no requirement to divulge the underlying cost assumptions. A variable life insurance policy must illustrate a -0- 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 that 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



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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 advisor 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 to be hidden... that of cost manipulation. By providing full disclosure, the principals of fiduciary focus began to take form. The client can see where every dollar is going due to the ledger that "unbundles" the premium for stated allocation. The advisor 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 will have to wait until the problem occurs to find out that assumptions were faulty. The Financial Planners Association clearly states that you cannot be a financial planner and not have fiduciary responsibility. Obviously, half a fiduciary is better than none.

Joseph W. Maczuga is the Executive Director of Fee Advisors Network.



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20 North Wacker Drive, Suite 2900, Chicago, Illinois 60606

Telephone: 312-621-4400 | Fax: 312-621-0268

