

At Witt's End

Life Insurance in the Financial Crisis - Don't Trust, And Verify (Fiduciary Responsibility) June 2009

Ronald Reagan was fond of saying "Trust, but verify" in the context of his relationship with the Soviet Union during his presidency. In the world of life insurance, we advocate an even more skeptical approach: **Don't trust, and verify.**

The recent scandals in the financial world have helped shine a light on just how important it is to work with financial professionals that operate in a true fiduciary capacity.

Fiduciaries are legally obligated to act in the best interests of their clients, and fiduciaries cannot have a financial stake in the decisions made by their clients.

Most consumers (and many professionals) are under the mistaken impression that the financial professionals (stock brokers, financial planners, financial advisors, financial representatives, insurance agents, etc.) they work with are fiduciaries.

Q: How do I know if the financial professionals that I am working with are fiduciaries?

A: Attorneys and fee-only professionals such as fee-only investment advisors and fee-only insurance advisors are generally considered to be fiduciaries and are generally subject to strict professional guidelines that dictate their obligations as fiduciaries.

If you have any doubts about the fiduciary status of the financial professionals you are working with, ask them to put it in writing.

Q: How can I benefit by working with an insurance fiduciary?

A: An insurance fiduciary can help a client develop and evaluate options from an unbiased perspective, since the fiduciary's compensation is not dependent on where the insurance is placed, or whether or not any insurance is even purchased. A fiduciary can also ensure that the interests of the client are maximized with respect to policy design, agent compensation levels, and mistake avoidance.

An insurance fiduciary should be able to demonstrate to you in writing why the recommended course of action is superior to the status quo or other options being considered, and this communication should be sufficiently clear that the client is making a decision on the basis of credible information rather than trust.

Life insurance products are some of the most complicated financial products available today. This complexity creates significant consumer confusion, and consumers who are not working with an



insurance fiduciary have no alternative but to rely upon an insurance agent that inevitably has an inherent conflict of interest. Finally, because of the rich and non-transparent compensation in life insurance products, it is difficult or impossible for a consumer to fully grasp the powerful financial incentive behind the advice they are receiving.

A client that pays for the involvement of an insurance fiduciary is essentially buying a very inexpensive insurance policy that protects against making inferior insurance decisions.

Q: Are life insurance agents fiduciaries?

A: It is impossible to serve as a fiduciary when there is an inherent conflict of interest - namely that agents receive compensation that hinges entirely on the decisions their customers make, and agents generally do not have access to the entire universe of insurance products due to contractual limitations or lack of financial incentives.

Agents are agents of the insurance company they are representing in any particular situation, yet many people are under the mistaken impression that an agent represents the customer.

There are numerous situations where a life insurance agent plays a noble role, particularly when insurance is desperately needed but would not have been purchased without the efforts of that life insurance agent.

In addition, some consumers value the relationship with their insurance agent above all else, and these consumers are often willing to have their insurance agent take on roles that would normally be handled by estate planning attorneys and financial advisors. This may especially be true in situations where a consumer is not wealthy enough to employ an estate planning attorney and/or a financial advisor.

Q: Can a life insurance agent help fulfill the obligations of a fiduciary, such as an estate planning attorney or trustee relying on an agent to review existing policies and recommend a course of action?

A: There are several potential stumbling blocks here, but the most critical is that the agent should be prohibited from selling any products to the fiduciary's client. Fiduciaries are opening themselves up to significant liability if they try to satisfy their fiduciary responsibility by relying on advice from someone who has a vested interest in the outcome of the case.

There is too much at stake with life insurance to risk basing decisions solely on trust. With the current state of the life insurance industry and the significant dollars that are involved with life insurance, we believe it is appropriate to extend Ronald Reagan's mantra of "Trust, but verify" to:

Don't trust, and verify.

