Financial Advisors: Choosing Between Insurance Agents, Brokers, and Registered Investment Advisors

Find the Right Advisor for You

Investment Advisors: Choosing Between Insurance Agents, Brokers, and Registered Investment Advisors

Thirty years ago, investors relied on stockbrokers for information like a stock quote. With the astounding amount of investment advice available today, the work of financial professionals has changed quite a bit. The old stockbroker model has been destroyed as investors not only seek valuable opinions, but also financial solutions, comprehensive financial planning, and honest advice. As investors look at a crowded field of financial professionals, how can they begin to make a decision to rely on the advice of one professional over another? Investors should begin their search for solutions and advice with an understanding of the similarities and differences between the three types of investment advisors in today's marketplace.

What is an Insurance Agent?

An insurance agent's primary role is to sell insurance products and annuities to clients. Insurance agents are compensated by commissions based on the insurance products they sell. In addition to commissions, agents can receive "trails" – ongoing payouts taken from the often high annual fees of insurance policies. Insurance agents in today's marketplace have a broader selection of products than in prior years, such as proprietary mutual funds, but their ultimate focus is insurance. Insurance products are generally considered very low risk, and also generally provide very low returns.

What is a Broker?

A broker's job is to sell securities to investors and work as a liaison or agent for large brokerage firms. Traditionally, brokers are paid on commission for the securities they help their clients buy or sell. Brokers can offer almost any type of investment opportunity to their clients, but usually try to sell their firms proprietary offerings as opposed to similar securities created by other firms. Many brokerage houses also offer fee-based models, which means they charge a flat fee for service and also receive a commission for specific products. In many cases, brokers have special access to their own firm's products, and sometimes they are encouraged to sell these products for bonuses or additional commissions.

RIAs are not compensated for selling specific products and do not receive commissions.

What is a Registered Investment Advisor (RIA)?

Registered Investment Advisors (RIAs) offer investment advice to clients in return for a fee. These fees are usually assessed on an hourly basis or as a percentage of assets under management. RIAs are not compensated for selling specific products and do not receive commissions.

The most striking difference between insurance agents, brokers, and RIAs is that only RIAs are held to a fiduciary standard. As fiduciaries, RIAs are obligated to put client interests first. This means only making recommendations that are in the best interest of the client. In contrast, insurance agents and brokers are held to a suitability standard. This means that they can recommend any investment to a client so long as it is "suitable" – the recommendation does not necessarily need to be the best choice for the client.

Working with an Insurance Agent for investments and financial planning:

Insurance agents can have a tendency to be product focused rather than solutions oriented. Insurance agents are paid on a commission basis for the products they sell. In many cases, they have strong incentives to sell their own company's insurance policies. Insurance agents can tend to use financial planning as a tool to understand which insurance product they can fit to a client's given situation, without consideration for other investment options.

Unfortunately, insurance agents may find themselves beholden to the old saying, "To a man with a hammer, everything looks like a nail." While insurance is a very important part of financial plans, most insurance products are simply less efficient when it comes to true investment strategies.

Many insurance agents market expensive life insurance products such as whole life or variable life policies. While many of them go about this with good will, most people simply need inexpensive term life insurance and a strong investment plan that is not tied down to an insurance policy. Insurance products tend to be the most expensive financial products in the marketplace. Investors using insurance agents for investments and financial planning may see poor performance from simple insurance products while they pay industry-high fees.

RIAs are different from other financial professionals because of their duty to the Fiduciary Standard.

Working with a Broker for investments and financial planning:

To a certain extent, brokers have similar incentives as insurance agents. Most large brokerage houses encourage their brokers to sell specific offerings, and even brokers who receive most of their compensation through a fee-based structure can receive special commissions for selling particular products.

While insurance agents can be overly focused on insurance policy solutions, brokers can be too focused on playing the market, or finding the "hot picks." Rather than looking at a complete financial plan and an individual investor's risk tolerance, brokers can become so concerned with "beating the market" that they recommend hedge funds, structured notes, and other complicated products that provide commission for themselves and their firm. While their aim to help their clients make money is good, this approach can load up a portfolio with inappropriate risk and complex financial instruments that are difficult, if not impossible, to liquidate in an emergency.

Working with a Registered Investment Advisor for investments and financial planning:

RIAs are different from other financial professionals because of their duty to the Fiduciary Standard. This standard is defined by federal law and requires RIAs to put their client's interests ahead of their own.

Since RIAs are usually independent they do not have proprietary products, complicated corporate bureaucracies, or sales incentives. This means that an RIA is free to focus on his or her clients' plans and goals rather than on a large corporation's bottom line. While an insurance agent might receive a bonus for selling her firm's newest policy riders and a broker might encourage all clients to purchase his firm's new credit card, a RIA does not have these distractions. Because of their fee-based pay structure, a RIAs interests are aligned solidly with their clients'.

Of the three types of financial professionals, RIAs tend to provide their clients with the most comprehensive and dynamic financial plans on the marketplace. Because of the serious responsibility of the fiduciary standard these plans cannot simply be glorified net worth statements or tools to match clients to insurance policies. RIAs rely upon comprehensive financial planning to help them determine which investments and advice are truly in a client's best interest.

In addition to more robust financial planning, RIAs can offer a wider universe of investment opportunities for clients. A RIA can design a custom portfolio suited to each client's specific needs and goals, and does not need to recommend certain investments to ensure a commission. This is a strong contrast to being locked into a limited number of proprietary funds available inside a variable insurance policy, or confined to investment models designed by a brokerage house's strategy team.

Every investor has to determine his or her own goals and investment philosophies. Some tremendously risk-averse individuals might be willing to pay for an insurance-based portfolio. Some individuals might feel a level of comfort investing with a large brokerage house with a familiar logo and a household name. But all investors should be aware of the significant differences between insurance agents, brokers, and RIAs so that they can choose the financial professional that they believe will best serve their goals and needs.

For more information, contact Infinium Investment Advisors at:

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