A Review of Advice Models and the Demographic Determinants of Using Financial Advisors and Counselors

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Prepared for presentation at the Financial Literacy Research Consortium
The research reported herein was performed pursuant to a grant from the U.S. Social Security Administration (SSA) funded as part of the Financial Literacy Research Consortium.

The opinions and conclusions expressed are solely those of the author(s) and do not represent the opinions or policy of SSA or any agency of the Federal Government or of the University of Wisconsin System, including Center for Financial Security.
Overview

• What are advice models?
• Who are advice providers? For whom?
• What role does advice play?
• What kinds of advice exist?
• Does advice make a difference?
• Who takes up advice?
Research Approach

• Literature Review
• Developing a Framework
• Synthesis
• Modeling take up of advice
  – Address conflicting evidence
Framework

Financial Capacity Building

- **Information Models**
  - Disclosures
  - Print/Web
  - Interactive Web
  - Workshops
  - One:One
  - Reminders

- **Advice Models**
  - Technical expert (credentialed)
  - Transactional guide (may have sales focus)
  - Counseling (acute problem solving)
  - Coaching

- **Mechanism Models**
  - Defaults
  - Automatic Deposit
  - Product constraints
Technical Experts

• Experts on narrow topic
• Objective advisors – unbiased ‘pure’ advice
• Credentialed
• Costly
Technical Experts

• **Theory: Economics of Information**
  – Stigler (1961): Consumers stop gathering information when marginal benefit of additional search equals the marginal cost

• **Theory: Behavioral De-biasing**
  – Bluethgen et al. (2008): Financial advisors add value to client’s portfolios by identifying and correcting the client’s cognitive mistakes

• **Theory: Psychology / Affective**
  – Engelmann et al. (2009): Financial advice aides client’s decision-making processes and decisions are less taxing to brain if client received advice
Rationale

1. the cost of obtaining financial information may be lower for individuals who work with advisors,

2. advisors can help individuals avoid making cognitive mistakes, and

3. advisors’ services may simply be a less costly substitute when clients’ own time and effort are more valuable than the total costs of using advisor.
Empirical Evidence

Mixed at best

• Endogeneity between clients’ selection into advice and their financial capability

• Horn et al. (2009) - change in German tax laws as natural experiment... financial advice helps clients avoid tax mistakes.

• Hackethal et al. (2010): Clients who use financial advisors had lower returns and were more likely to incur substantial losses; advisors do not lead to better market timing or diversification – used IV

• Hung and Yoong (2010) – voluntary vs. mandatory advice

• Haslem (2010) matched broker accounts to advisor accounts: brokers better

• Several others show no or negative effects (see Jansen et al. 2008; Kramer and Lensink 2009; Kramer 2009).
Transactional Agents

• Focused on a specific transaction
• Many examples
  – Sales, broker, real estate agent, insurance agent, etc..
• Weaker Credentials
• Self-regulation
• Costly?
• Biased...at least potentially
Transactional Agents

• **Theory: Conflict of Interest**
  – But also repeated game / reputation risk
  – Fiduciary duty

• **Empirical Evidence: Weak**
  – Very few ‘fee-only” advisors - compensated in a variety of ways
  – Finke et al. (2009): Clients with financial planners more likely to have appropriate life insurance holdings than clients with insurance brokers
  – Robinson (2007): Fee-only pricing can cause advisors to overbill clients and do minimal work
Financial Counselors

• Acute problem solving
• Basic financial management
• Intervention model
• Strong nonprofit role
• Public subsidies
• Not (generally) compensated by pushing particular financial products
Counselors

• **Theory: Little**
  – Directing, instructing and motivating clients (Kerkmann, 1998)
  – Counselors assist clients when emotional stress is distorting their financial decision-making

• **Empirical Evidence: Some (mostly credit/loans)**
  – Collins (2007): Each additional hour of counseling reduced the probability of foreclosure outcomes
  – Agarwal et al. (2009): Combining educational classes and one-on-one counseling significantly decreased mortgage default rates
  – Endogeniety; Experiments lacking
Financial Coaching

• Performance improvement
• Goal-based
• Client directed
• Coach may not be an expert
• Focus on self-control & monitoring
• Self-actualization
  – Implementation / Adherence
Coaching In General

• **Theory** – mostly recent (and outside U.S.)
  – Biswas-Diener and Dean (2007): Coaching is a subset of positive psychology as it focuses on utilizing personal and social strengths to attain goals and achieve happiness
  – Grant (2008): Coaching is solution or outcome focused and clients must not suffer from serious mental health issues

• **Empirical Evidence: Too new**
  – Tidwell et al. (2004): Coaching for individuals with chronic health care conditions resulted in better adherence to treatment
  – Whittemore et al. (2004): Health coaching for diabetic women resulted in higher treatment satisfaction, higher attendance and lower attrition rates
  – Ariely and Wertenbroch (2002): Coaching can be more effective than self-monitoring and help clients stick to their goals
Summary of Literature

• Seems to be a rationale for technical expert, but few exist in market
  – Not clear what value is in practice; babysitter?
• Most advisors are transactional
  – Fiduciary weak – may undercut value
• Counsel on basic financial management
  – Crisis focused; subsidized
• Coaching – new - adds adherence
  – Self- control and executive attention
Lot we don’t know
Ex: Take Up of Advice
Data / Methods

• Who takes up advice? People with financial literacy deficits or high capacity?

• Data source
  • FINRA National Financial Capability Survey
  • Telephone survey of 1,488 individuals
  • Respondents asked if they sought advice, from what kind of advisor, and how they felt about financial advisors
Who received advice?

Source: Tabulations of FINRA National Financial Capability Survey
Who received advice?

Source: Tabulations of FINRA National Financial Capability Survey
Findings—Take Up of Advisors

<table>
<thead>
<tr>
<th>Factor</th>
<th>Debt Advisor</th>
<th>Investment Advisor</th>
<th>Loan Advisor</th>
<th>Insurance Advisor</th>
<th>Tax Advisor</th>
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<td>Gender</td>
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<tr>
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<tr>
<td>Race</td>
<td>--</td>
<td>Asian ↓</td>
<td>--</td>
<td>African American ↑</td>
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<tr>
<td>Financial Literacy Score</td>
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<tr>
<td>Income Drop</td>
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<td>↑</td>
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</tr>
<tr>
<td>Homeowner</td>
<td>↓</td>
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</table>

Source: Tabulations of FINRA National Financial Capability Survey
SSA FLFC 19-F-10003-5-01, University of Wisconsin
# Attitudes Toward Financial Advisors

<table>
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<tr>
<th>Factor</th>
<th>Trust advisor</th>
<th>Advisor too expensive</th>
<th>Met multiple advisors</th>
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<tr>
<td>Gender</td>
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<tr>
<td>Income</td>
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<td>↓ as income increases</td>
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<td>Education</td>
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*Source: Tabulations of FINRA National Financial Capability Survey*
Conclusions

• Advice models have potential
• Proposed general framework of complements
• Compensation schemes matter
• Little empirical evidence
• Advice going to those with most capability — babysitter model?
  — Context may matter — planning vs. trigger event
Implications / Next steps

• Understanding psychology of advice
• Examine Fiduciary Duty under CFPB/Dodd Act
• Field experiments needed
  – Beyond portfolio measures
• Better understanding of counseling needed
• Coaching has emerging potential to support self control; again need empirical work
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