CFS Research Brief (*FLRC 10-5*)
September 2010

Center for Financial Security
UNIVERSITY OF WISCONSIN-MADISON

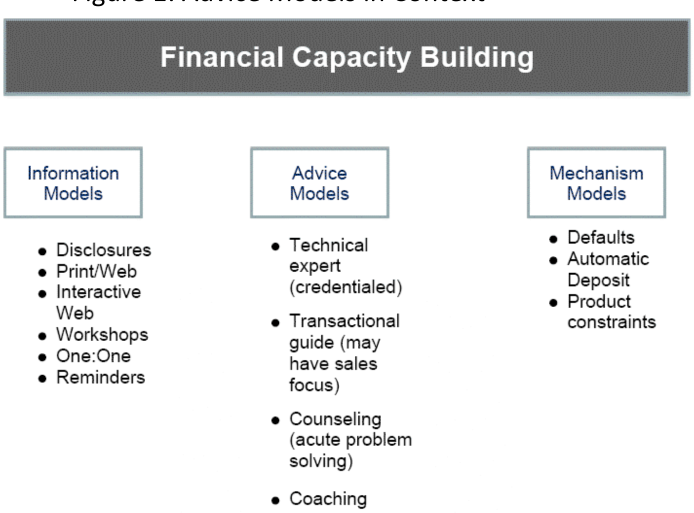
A Review of Financial Advice Models and the Take-up of Financial Advice

By J. Michael Collins

Financial advice may be an important complement to educational interventions for individuals with technical financial issues or acute financial problems. Financial advice may also help clients apply knowledge gained from financial education and adhere to their stated financial goals. This study develops a taxonomy of financial advice models and reviews the literature on financial advice. Empirical research suggests that using a financial advisor has modest or no effects on investment returns, and that financial counseling has weak positive effects on financial behavior. This study also uses data from the 2009 Financial Industry Regulatory Authority Financial Capability Survey to present stylized evidence about the take-up of financial advice. The results indicate that individuals with higher incomes, educational attainment, and financial literacy are among the most likely to receive financial advice.

In this paper, financial advice is defined as third-party services that help consumers make financial decisions. Advice from four types of financial professionals is reviewed: technical experts, transactional agents, counselors, and coaches. These 'advice' models are distinguished from education/information models as well as from more mechanistic models. Financial capacity building requires doses of each in a complementary way.

Figure 1: Advice Models in Context



Technical Experts

Technical experts are defined in this brief as providers of technical financial information, typically for a fee. They have specific expertise on legal and financial aspects of personal financial products and assist when financial information is difficult for a typical consumer to acquire and process.

Older individuals, households with higher net worth, and women are more likely to access financial advice (Bluethgen et al. 2008). The empirical literature provides no evidence that financial advice provides financial benefits that exceed the cost of services (Hackethal et al. 2010). Most studies that find evidence of benefits did not control for selection effects and are likely biased. Further research is needed to better understand the net benefits of using an advisor across various financial decisions.

Transactional Agents

Transactional agents typically assist clients in the buying or selling of a financial product; the agent's compensation is often contingent on a client's choice to buy or sell a specific financial asset. This contingency may create a conflict of interest—agents may be tempted to mislead clients in order to earn a commission. Several theoretical studies highlight the potential for conflict (Demski and Sappington 1987; Krausz and Paroush 2002), while other studies assert the relationship may not be as problematic as predicted (Garicano and Santos 2004). Some financial advisors are bound by the legal obligations of fiduciary duty (the duty to act in the interest of the client), while others are not. Clients are often uncertain about which advisors are subject to fiduciary duty.

Despite the longstanding theoretical debate about the impact of compensation on the objectivity of transactional agents, empirical research is scarce. Further research is needed in this area.

Financial Counseling

In this brief, financial counseling refers to professional advisors working with clients on specific personal financial issues, often in an attempt to remedy a serious financial problem. Financial counselors often lack specific technical training in personal finance. Counseling typically attempts to help clients resolve financial crises or overcome barriers. For example, bankruptcy counseling and credit counseling seek to help clients address acute financial problems. Counseling services are not related to specific financial products and counselors are typically not compensated via commissions or sales-related metrics. The costs of counseling are often subsidized by public or private sources.

Initial descriptive findings across several studies suggest that counseling has significant positive impacts; however, once selection effects are controlled, only weak effects remain. Financial counseling is a rich area for further study.

Financial Coaching

Interest in financial coaching stems from a desire to move beyond promoting financial literacy and to instead focus on helping clients achieve self-defined financial goals. While a financial coach may have financial expertise or training, a good financial coach is, above all, a coach—someone who listens; asks informed questions; and helps clients refine their goals, objectives, and strategies.

Coaching is different than therapy in that it is more goal oriented; it focuses on the future rather than the past (Bluckert 2005); coaches form a collaborative alliance with clients, rather than taking on a healing role; and clients are free of any serious mental health issues (Grant 2008). Although training opportunities for financial coaches have expanded rapidly, a standard credentialing system has yet to emerge.

Because financial coaching is a relatively new phenomenon, there is little empirical evidence about its effectiveness. However, in health care settings coaching has shown promise for improving fitness and treating chronic disease.

The Acquisition of Financial Advice

A sample of 1,488 individuals was drawn from the 2009 Financial Industry Regulatory Authority Financial Capability Survey to assess the predictors of obtaining financial advice. Respondents reported whether or not they had asked for each of five types of advice from a financial professional in the past five years. The survey also inquired about attitudes toward financial advice.

Fifty-seven percent of survey respondents reported receiving some type of financial advice within the last five years. The acquisition of each form of financial advice varied across demographic characteristics. Overall, these findings suggest that the use of financial advice is more likely among individuals with higher incomes and higher educational attainment. Minority group members were less likely to seek some forms of advising. Controlling for other factors, age did not have strong effects. A recent drop in income was associated with a higher rate of acquisition of some services. Gender was statistically significant in several models, consistent with prior studies showing men may be more prone to overconfidence bias (Odean 1999).

Consumers with lower levels of functional financial literacy are among the least likely to obtain advice. While advice may be hypothesized to be most valuable to people with lower education levels, the results do not support such a hypothesis. The findings indicate that higher income individuals consume more advice and imply that financial advice is a complement to financial capacity.

Figure 2: Summary of Take Up of Financial Advice

Factor	Debt Advisor	Investment Advisor	Loan Advisor	Insurance Advisor	Tax Advisor
Gender	--	**Male ↓**	**Male ↓**	**Male ↓**	--
Income	↑	↑	↑	↑	↑
Education	--	↑	--	↑	--
Race	--	**Asian ↓**	--	**African American ↑**	**Hispanic ↓**
Financial Literacy Score	--	↑	--	↑	↑
Income Drop	↑	↑	--	↑	↑
Homeowner	↓	--	↑	--	--

Source: Tabulations of FINRANational Financial Capability Survey

20

Implications for Vulnerable Populations

Populations seemingly most at risk to financial mis-steps are among the least likely to obtain financial advice. Financial counseling, which often focuses on recovering from a crisis situation, may prove more applicable to this population than other forms of advice, which focus on investment and higher order financial planning needs.

Conclusions

If expanding access to advice is a policy goal, more efforts may be needed to increase the availability of low-cost, objective, and high-quality advice for households with low levels of educational attainment and low incomes. There is a high correlation between advice seeking and financial literacy. As such, the demand for financial advice may increase if financial literacy levels increase across the population.

Overall, more research is needed to better define, quantify, and measure the impact of each of the advice models presented. More robust evidence on the costs and benefits of various forms of financial advice can help inform policy decisions and guide consumers regarding the value of professional advice.

References

Bluckert, Peter (2005). 'The Similarities and Differences between Coaching and Therapy', *Industrial and Commercial Training,* 37(2):91-96.

Bluethgen, Ralph, et al. (2008). 'Financial Advice and Individual Investors' Portfolios', *European Business School Working Paper*.

Demski, Joel S. and Sappington, David E. M. (1987). 'Delegated Expertise', *Journal of Accounting Research,* 25(1):68-89.

Garicano, Luis and Santos, Tano (2004). 'Referrals', *The American Economic Review,* 94(3):499-525.

Grant, Anthony M. (2008). ' Past, Present and Future: The Evolution of Professional Coaching and Coaching Psychology', in Stephen Palmer and Alison Whybrow, *Handbook of Coaching Psychology: A Guide for Practitioners.* London: Routledge.

Hackethal, Andreas, Haliassos, Michael, and Jappelli, Tullio 'Financial Advisors: A Case of Babysitters?', *SSRN Working Paper Series* <http://ssrn.com/abstract=1360440>, accessed August 10, 2010.

Krausz, Miriam and Paroush, Jacob (2002). 'Financial Advising in the Presence of Conflict of Interests', *Journal of Economics and Business,* 54(1):55-71.

Odean, Terrance (1999). 'Do Investors Trade Too Much?', *The American Economic Review,* 89(5):1279-98.

Acknowledgments

J. Michael Collins is faculty director of the Center for Financial Security at the University of Wisconsin-Madison. Collin O'Rourke, John Rehbeck and Stephanie Chase provided invaluable research support and writing for this study.

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, any agency of the Federal Government, or the Center for Financial Security at the University of Wisconsin-Madison.

The Financial Literacy Research Consortium

The Financial Literacy Research Consortium (FLRC) consists of three multidisciplinary research centers nationally supported by the Social Security Administration. The goal of this research is to develop innovative programs to help Americans plan for a secure retirement. The Center for Financial Security is one of three FLRC centers and focused on saving and credit management strategies at all stages of the life cycle, especially helping low and moderate income populations successfully plan and save for retirement and other life events, including the use of Social Security's programs.

The Center for Financial Security

The Center for Financial Security at the University of Wisconsin-Madison conducts applied research, develops programs and evaluates strategies that help policymakers and practitioners to engage vulnerable populations in efforts which build financial capacity. The CFS engages researchers and graduate students through inter-disciplinary partnerships with the goal of identifying the role of products, policies, advice and information on overcoming personal financial challenges.

For More Information:

Center for Financial Security
University of Wisconsin-Madison
Sterling Hall Mailroom B605
475 N Charter St.
Madison, WI 53706
(608) 262-6766
http://www.cfs.wisc.edu/