DISCUSSION

Financial Literacy and the Demand for Financial Advice

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Financial Innovation and Market Dynamics: the Role of Securities Regulation

Milan, February 10 2012
Summary - 1 -

- The paper aims at assessing:
  - whether the quality of financial advice and the investors’ financial knowledge may be regarded as substitutes
  - the impact of financial knowledge on the demand for financial advice

- Theoretical model
  - An informed non-independent advisor interacts with investors having access to information with a varying degree of precision depending on their financial knowledge
  - Investors choose whether to invest on their own, delegate or ask for advice
  - Advisor chooses his communication strategy depending on the investor’s type
Central predictions of the theoretical model:
- Advisors provide empty advice to the least informed individuals, who either invest autonomously or delegate.
- Advice is demanded only by informed investors and advisors provide meaningful information to them.

Implications:
- Financial literacy and advice are not substitutes.
- Advice benefits only informed investors.

Empirical analysis:
- Based on the 2007 Unicredit Customer Survey (UCS).
- Higher financial literacy increases the probability of consulting the advisor while maintaining the final decision over investments.
The theoretical model - comments

- Illiterate investors never ask for advice - either invest by themselves or delegate - and always buy the risky asset: but the empirical evidence shows that illiterate investors may not even buy the risky asset at all.

- Literate investors solicit advise. But the model does not deal with their decision to disregard the advice once received, which is instead the finding of the empirical estimation. What about modelling this behaviour as a two stage decision process (like in Bucker-Koenen and Koenen, 2011)?
The empirical model - comments

- **Methodology**
  - Different measures for financial literacy are used (maybe could try also with a measure using only diversification and risk assessment?); self-assessed financial knowledge is correctly used as a self-confidence index
  - Endogeneity is controlled for with an IV model
  - A concern: the estimation refers only to investors holding risky assets. May this raise a selection bias problem? What about a two stage estimation?

- **The data set used is not very representative of Italian investors:**
  - high percentage of investors holding risky assets
  - as the authors point out, the UCS sample include individuals who are older, more educated, more likely to live in the North of Italy and with a higher family income than the Bank of Italy’s SHIW. This might explain why age, region, income are not significant
  - Only one wave considered (2007 UCS), but survey data shows that market upturns and downturns may impact on the demand for advice, trust, etc.
Policy implications - 1 -

- The regulator should:
  - raise financial literacy (demand-side measure)
  - reduce agency conflicts between advisors and investors (supply-side measure)
- Raising financial literacy may prove very difficult, as shown also by empirical evidence
- As for conflicts of interest the regulator can:
  - impose disclosure
  - spur the development of unbiased and professionally sound financial advice
Policy implications - 2 -

- Dealing with conflicts of interest: how can it work?
  - Disclosure: experimental evidence shows that it may be neglected by investors or may induce a sub-optimal contrarian effect (EC 2010)
  - Spurring independent advice works as long as it raises the quality (and the clients’ perception of the quality) of the advice and the propensity of investors to ask for and to follow advice
  - In fact people may not demand advice or may not follow it once received (Bhattacharya et al. 2011). Moreover they may not be willing to pay up-front fees for advice. Why? Because of bounded rationality, procrastination and inertia, overconfidence, social interaction, financial illiteracy, loss aversion …
  - Need to complement with demand-side remedies
The Italian case

- The evidence for Italian households seems to claim for both supply-side and demand-side remedies.
- On the basis of the GfK Eurisko Survey data, the fraction of households receiving advise (MiFID consultancy service) is around 10%.
The Italian case

- The figure is higher for more educated people
The Italian case

- Among those obtaining advice, the percentage of households who solicited it (rather than receiving an investment proposal by the intermediary) is low.
The Italian case

- Households receiving advise hold more diversified portfolios (higher fraction of risky assets)
The Italian case

- The percentage of households mistrusting the advisor has overall declined …

% of households that consider the consultant is in conflict of interest divided by type of consultancy service received

- MIFID consultancy service
- generic consultancy
- passive consultancy
The Italian case

- … but the percentage of households judging poorly the quality of the advice received has increased sharply
The Italian case

- When asked about the willingness to pay for advice by method of payment, the majority of the households are quite confused.