Do advisors respond to investors' preferences?

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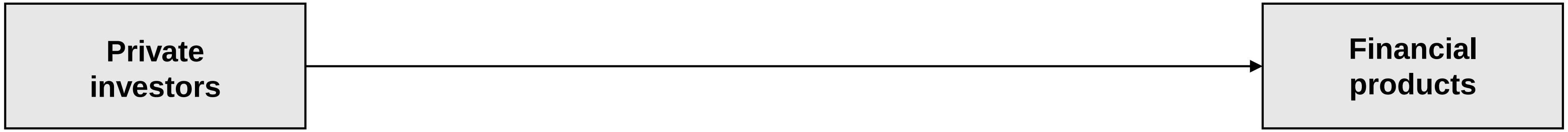
Motivation and literature



- Investor preferences matter as they hold 463,6 trillion in assets (Shorrocks, Davies, and Lluberas 2022)
- Investor preferences are commonly studied ex-post through fund flows or ex-ante through experiments and survey (Hartzmark and Sussman 2019; Heeb et al. 2022)
- **Problem**: Experimental choice sets might not be available in practice, challenges in product accessibility impact fund flow, external factors influence investment decisions

→ **What really happens at the investment stage is unclear**

Motivation and literature

Private investors $\xrightarrow{\text{use}}$ **Advisors** $\xrightarrow{\text{find}}$ **Financial products**

- Many private investors use financial advisors (Inderst 2011, Lusardi and Mitchell 2011, Hackethal et al. 2012, Inderst and Ottaviani 2012, Foerster et al. 2017, Linnainmaa et al. 2021)
- Advisors should help investors to reduce transaction costs and find financial products that suit to their preferences (Inderst 2011, European Commission 2018, Gutsche and Zwergel 2020, Bucher-Koenen et al. 2023)
- We study the investment advisory process and the resulting product recommendations to understand the degree to which investors' expressed preferences align with advisors' product recommendations

Methodology

- We conducted a large field study using a mystery shopping methodology (Blessing and Natter 2019; Finn 2001; Finn and Kayande 1999; Wilson 1998)

- To train our mystery shoppers (i.e., private investors) we developed and pre-tested a multi-day program

- Private investors are equipped with different investor profiles

- We collected data of more than 400 investment consultations between March and August 2023 (n=410)

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Data

- We used an online survey to collect a wide range of information about the investment consultations and advisor's product recommendations

- We collected the mandatory documentation (i.e., suitability declarations)

- We matched the product recommendations with fund-type data from Thomson Reuters Refinitiv Workspace

Do advisors respond to investors’ preferences?

- On average, about 90 percent of the product recommendations correctly addressed the private investors’ risk preference

- Advisors consider sustainability preferences of private investors significantly less in their product recommendations ($p<0.001$)

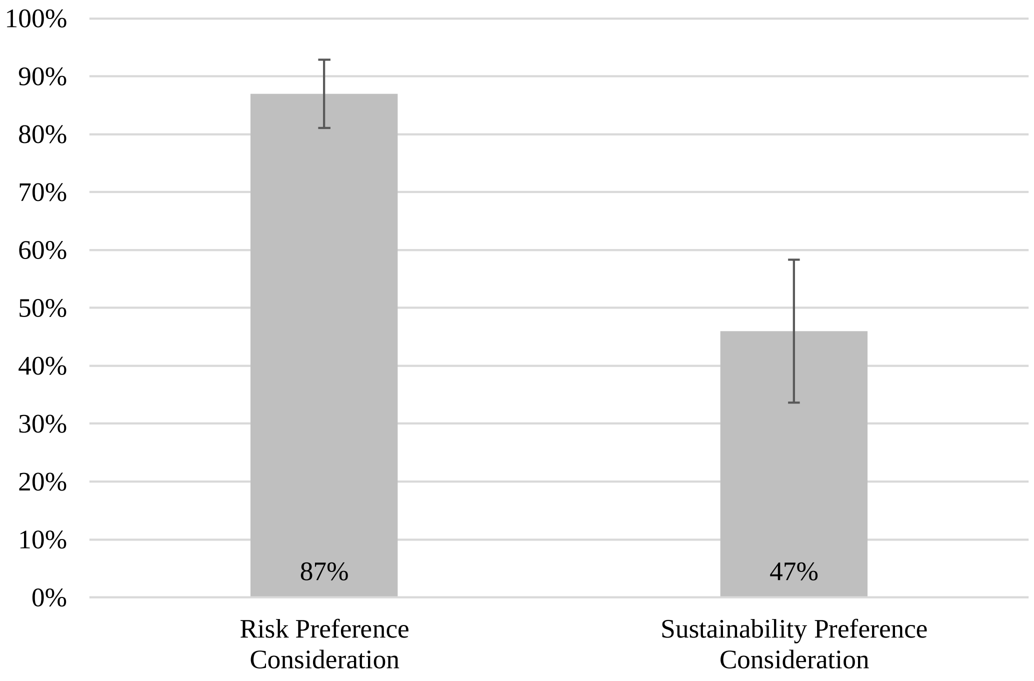

Figure 1: Advisors’ average consideration of private investors’ preferences

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What affects advisors consideration of investors' sustainability preferences?

	Sustainability Preference Consideration				
	(1)	(2)	(3)	(4)	(5)
Signaling	-0.10				0.07
	(0.43)				(0.35)
Advisor SI Attitude		0.37**			0.28*
		(0.16)			(0.15)
High Asset Manager Concentration			-0.60**		-0.68**
			(0.29)		(0.30)
Wrong Documentation				0.79**	0.97***
				(0.32)	(0.35)
Male Advisor	0.09	0.14	0.23	0.08	0.23
	(0.30)	(0.29)	(0.30)	(0.28)	(0.27)
Advisor Tenure	0.04***	0.04***	0.04***	0.04**	0.03**
	(0.02)	(0.02)	(0.01)	(0.01)	(0.01)
Constant	1.01**	-0.03	1.20**	0.28	-0.31
	(0.55)	(0.57)	(0.49)	(0.46)	(0.61)
Investor Controls	Yes	Yes	Yes	Yes	Yes
Time Control	Yes	Yes	Yes	Yes	Yes
Pseudo-R^2	0.42	0.45	0.55	0.46	0.62
Observations	189	189	171	187	169

Notes: This table presents the results of Tobit regressions where the dependent variable is Documented Sustainability Preference Consideration. Heteroscedasticity robust standard errors clustered at the investor level are reported in parentheses. *p<0.1; **p<0.05; ***p<0.01. All values are rounded to two decimal places.

- A **positive advisor attitude towards sustainable investments** to be associated with a higher percentage of suitable product recommendations
- High **reliance on a product portfolio from a single asset manager** decreases the percentage of suitable product recommendations
- Advisors' **wrongly document** investors' stated sustainability preferences

What affects advisors wrong documentation of investors’ sustainability preferences?

	Wrong Documentation				
	(1)	(2)	(3)	(4)	(5)
Monitoring	0.04				0.08
	(0.07)				(0.07)
Signaling		0.17***			0.17***
		(0.05)			(0.04)
Advisor SI Attitude			0.00		0.02
			(0.03)		(0.03)
High Asset Manager Concentration				0.17***	0.18***
				(0.07)	(0.08)
Male Advisor	0.04	0.05	0.04	0.04	0.05
	(0.06)	(0.06)	(0.06)	(0.06)	(0.06)
Advisor Tenure	0.00	0.00	0.00	0.01**	0.01**
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Investor Controls	Yes	Yes	Yes	Yes	Yes
Time Control	Yes	Yes	Yes	Yes	Yes
Pseudo-R^2	0.36	0.38	0.36	0.49	0.52
Observations	192	192	192	174	174

Notes: This table presents the average marginal effects of binomial logistic regression models where the dependent variable is Wrong Documentation. Heteroscedasticity robust standard errors clustered at the investor level are reported in parentheses. *p<0.1; **p<0.05; ***p<0.01. All values are rounded to two decimal places.

- Sustainability preferences that limit advisors' ability to make an offer are **altered in legal preference documentation**
- Investment advisors working for **banks that primarily sell products from a single asset manager are more likely to wrongly document** investors' sustainability preferences
- Inaccurate documentation persists **even if advisors are monitored**

Discussion

Contribution:

- Literature on pro-social preferences in investment decisions (Riedl and Smeets 2017, Hartzmark and Sussman 2019, Barber et al 2021, Bauer et al. 2021; Heeb et al. 2022; Engler et al. 2024)
  - Increasing focus on measuring individual preferences and the sensitivity to different product characteristics (Bauer, Ruof, and Smeets 2021; Heeb et al. 2022)
  - We show that investors have very little access to products that meet their preferences

- Literature on advisor misconduct, mis-selling, and discriminatory practices in financial advisory services (Bergstresser et al. 2009, Haliassos and Jappelli 2012, Hackethal et al. 2018, Egan et al. 2019, Linnainmaa et al. 2021, Laudi et al. 2023)
  - We show investors' stated sustainability preferences are altered in documentation and suitable products are often not recommended.
  - This is driven by product availability and limiting offers to products from a single in-house asset manager
  - Neither intervention by the investor, nor monitoring investment advisors impacts the results

Implications

For policy maker:

- Regulators should be aware that merely requiring investment advisors to query and document an investor's sustainability preference does not guarantee that preferences are considered in product recommendations.
  - Potential solution: increase product diversification by encouraging banks and financial institutions to offer a broader range of sustainable investment products

For investors:

- Investors with sustainability preferences should carefully consider whether the products recommended by investment advisors really fit their sustainability preferences before investing
  - Potential solution: Increasing their sustainable finance literacy would equip them with the knowledge to detect unsuitable products and enable them to intervene more actively

Thank you for your attention!