d'Astous, Gemmo, and Michaud (2023) - "The Quality of Financial Advice: What Influences Client Recommendations?"

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Summary

Comments

Summing up

Financial advice

Setting

- d'Astous, Gemmo, and Michaud (2023) study the properties & quality of financial product recommendations
  - In the context of Canadian financial planners (FPs)
- Important topic: advice can help mitigate households' behavioral biases (Collins 2012; Gaudecker 2015)
  - Yet prior lit. has documented shortcomings in advice quality
  - Therefore, the picture so far is mixed

This paper

- Novel approach to measuring (potential) biases in recommendations
- Findings are mixed:
  - Recommendations mostly in line with economic theory
  - However, evidence of a familiarity bias on the part of FPs

Methodology to overcome selection bias

Selection bias in observational data

- Each FP has a self-selected client base
- Matching between advisors and clients censors observed outcomes: we don't observe advice in all potential scenarios

Solution

- Randomized survey of Canadian FPs (from across country)
- FPs receive invitations to voluntarily complete a survey by their professional bodies
- In the survey, each FP is presented with 8 randomized scenarios: 4 domains $\times$ 2 sets of randomized features
- FPs make (hypothetical) recommendations

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Measuring familiarity

Familiarity bias

- FPs are more likely to recommend certain products
  - if they own them,
  - or their spouse owns them,
  - or they are licensed to sell them
- Altogether, interpreted as a familiarity bias
- Other forms of familiarity are potentially omitted from the measure:
  - prior ownership & license(s) & spouse (ownership)
  - duration of licensing

Why not ask FPs how familiar they are?

- In a follow-up survey, could you directly elicit FPs' self-reported familiarity with each of the product options (on Likert scales)?
- Then analyze the probability of recommendation[1]

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1. Can run panel logit (or quasi-binomial) regressions, with an indicator for "recommended" as the dependent/outcome variable, and include FP fixed effects to capture any FP-specific biases in over-reporting familiarity.

Role of rational incentives in explaining the bias?

Potential rationalization for making dominated recommendations

- Is it easier for FPs to justify a (sub-optimal) recommendation by pointing to their own ownership?

Example scenarios

1. defending against complaints or lawsuits for mis-selling
2. explaining a recommendation when making it to a client

Could the above scenarios be tested, or further investigated?

- For 2. above, ask FPs whether they would tell the client that they own the product when making the recommendation? And if they expect the client to be more likely to follow such a recommendation?

Underlying drivers of familiarity bias?

Policy solutions

- Can be very different depending on driver(s) of familiarity bias

Some potential drivers

- Hartzmark, Hirshman, and Imas (2021) show that owning a product leads to faster learning via more attention
  - Could check by testing FPs on their knowledge of products
  - Is this ruled out by the results on dominated products & paying down debt?
- Form of self-serving bias, in which they attribute value to what they own, in order to attribute greater ability/esteem to themselves
  - Is this supported by the results on dominated products & paying down debt?

Affinity/similarity between FP and client

- In the MNL analysis, the value of recommendations for the FP splits out characteristics of the client $W_{i,j}$ and the FP F_i:

$$\overline{V}_{i,j,k} = X_i\,\beta_k + Z_{i,j}\,\gamma_k + W_{i,j}\,\delta_k + F_i\,\alpha_k \qquad (1)$$

- Eqn. (1) does not capture affinity/similarity. (An interaction could.)
- In the MNL setup, one way to capture such an effect could be via distance between characteristics $\Rightarrow$ could you augment Eqn. (1) to include a vector $D_{i,j}$ of distances/dis-similarities between chars.

$$\overline{V}_{i,j,k} = X_i\,\beta_k + Z_{i,j}\,\gamma_k + W_{i,j}\,\delta_k + F_i\,\alpha_k + D_{i,j}\,\rho_k \qquad (2)$$

  in which elementwise distances between matched characteristics m could be parameterised as (for example)

$$D_{i,j}^{(m)} = \left(F_i^{(m)} - W_{i,j}^{(m)}\right)^2 \qquad (3)$$

- Or even replace Eqn. (1) entirely with

$$\overline{V}_{i,j,k} = X_i\,\beta_k + Z_{i,j}\,\gamma_k + D_{i,j}\,\rho_k \qquad (4)$$

Other points on exposition

- It seems "artefactual field experiment" is not standard terminology?
  - Especially the word "artefactual" - I'm not familiar with it, and the dictionary definition is uninformative: `https://www.collinsdictionary.com/dictionary/english/artefactual`
  - Consider explicitly defining, or replacing with a synonym; I have seen "vignette experiment" and "vignette study" used
- Page 11: I suggest rewriting *"One implication of this result is that the sign of a coefficient in a multinomial logit does not give the sign of the effect of a change in a covariate on the probability."* to more directly state that this is why you are focussing on partial effects rather than coefficient values.
- Page 11: non-zero coefficients on FP characteristics do not necessarily imply a bias. For example, older planners are more experienced, and so maybe a non-zero coefficient on age (which is correlated with experience) is fine? I suggest weakening/rewriting language of this type: *"To test for the various biases we postulate, we compute a Wald test statistic on groups of coefficients related to a particular variable. For example, to test whether there are biases associated with a variable F_i, we need to test $\alpha_2 = \alpha_3 = \alpha_4 = 0$."*
- Can you include a short Discussion section in which you write about how many and which Canadian investors (in the general population) are likely to be harmed by the familiarity biases you find? This would give a sense of its seriousness.

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Conclusion

Very interesting paper

- The question is clearly important in Household Finance
- This paper takes a clever & fruitful approach
- My comments focus on:
  - Exploring the mechanism further
  - Further analyses the authors have the opportunity to do

Good luck!

References

Collins, J Michael. 2012. “Financial advice: A substitute for financial literacy?” *Financial Services Review* 21 (4): 307.

d'Astous, Philippe, Irina Gemmo, and Pierre-Carl Michaud. 2023. “The Quality of Financial Advice: What Influences Client Recommendations?”

Gaudecker, Hans-Martin von. 2015. “How does household portfolio diversification vary with financial literacy and financial advice?” *Journal of Finance* 70 (2): 489–507.

Hartzmark, Samuel M, Samuel D Hirshman, and Alex Imas. 2021. “Ownership, learning, and beliefs.” *Quarterly Journal of Economics* 136 (3): 1665–1717.