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Investor Knowledge and Experience with Investment Advisers and Broker-Dealers

Angela Hung

Noreen Clancy

Jeff Dominitz

Background

- ***Brokers*** conduct security transactions on behalf of others
- ***Dealers*** buy and sell securities on behalf of others
- ***Investment advisers (IAs)*** provide advice regarding securities
- **Broker-dealers (BDs) and IAs are subject to different federal regulations**
 - **Securities and Exchange Act of 1934**
 - **Investment Adviser Act of 1940**

Background

- **Trends in the financial services industry have blurred the boundaries between BDs and IAs**
- **SEC attempted to clarify the distinctions with proposed rules in 1999 and 2005**
 - **The 2005 rule was challenged and eventually overturned**
 - **In the past year, these issues have resurfaced with the passage of the Investor Protection Act of 2009**

Key issue for individual investors is difference in legal obligation

- IAs owe fiduciary obligations to their clients: the adviser is required act solely with the client's investment goals and interests in mind
- BDs must follow a suitability standard: the broker-dealer making a recommendation to a retail customer must have grounds for believing that the recommendation is suitable for that customer with respect to his or her portfolio, financial situation, and needs.
- **Do investors understand the differences between BDs and IAs?**

To Analyze Investor Understanding, We Conducted a Survey...

- **RAND's American Life Panel**
 - **Internet panel of more than 2,500 respondents aged 18 and older**
- **Survey was administered 09.26.2007 through 11.06.2007**
 - **654 respondents of varying investment experience**
 - **Respondent age varies from 19 to 89, with average age of 52.**
 - **More than 98 percent of respondents have a high-school degree or GED. Almost 52 percent of respondents have a bachelor's degree.**
 - **49 states (all except Alaska) represented**

...as well as Focus Groups

- **Six focus groups with 10-12 participants each to allow for more in-depth, interactive discussions**
 - **67 participants, Sept and Oct 2007**
 - **3 in Alexandria, VA; 3 in Fort Wayne, IN**
 - **At each location, 2 “experienced” and 1 “inexperienced” groups.**
- **In both the survey and focus groups, we explored:**
 - **Perceptions of differences between IAs and BDs**
 - **Experience with financial service providers**
 - **Level of satisfaction with services received**

Roles and Duties of IAs and BDs

Does the professional do the following?	Investment Advisers (%)	Brokers (%)	Financial Advisors or Financial Consultants (%)	Financial Planners (%)	None of These (%)
Provide advice about securities (e.g., shares of stocks or mutual funds) as part of their regular business	80	63	78	63	3
Execute stock or mutual fund transactions on the client's behalf	29	89	28	23	3
Recommend specific investments	83	51	72	50	2
Provide retirement planning	51	12	80	91	2
Provide general financial planning	42	13	80	88	1
Typically receive commissions on purchases or trades that the client makes	43	96	34	22	1
Are typically paid based on the amount of assets that the client holds	49	40	50	34	12
Are required by law to act in the client's best interest	49	42	59	55	19
Are required by law to disclose any conflicts of interest	62	58	57	51	18

SOURCE: ALP survey, 651 respondents.

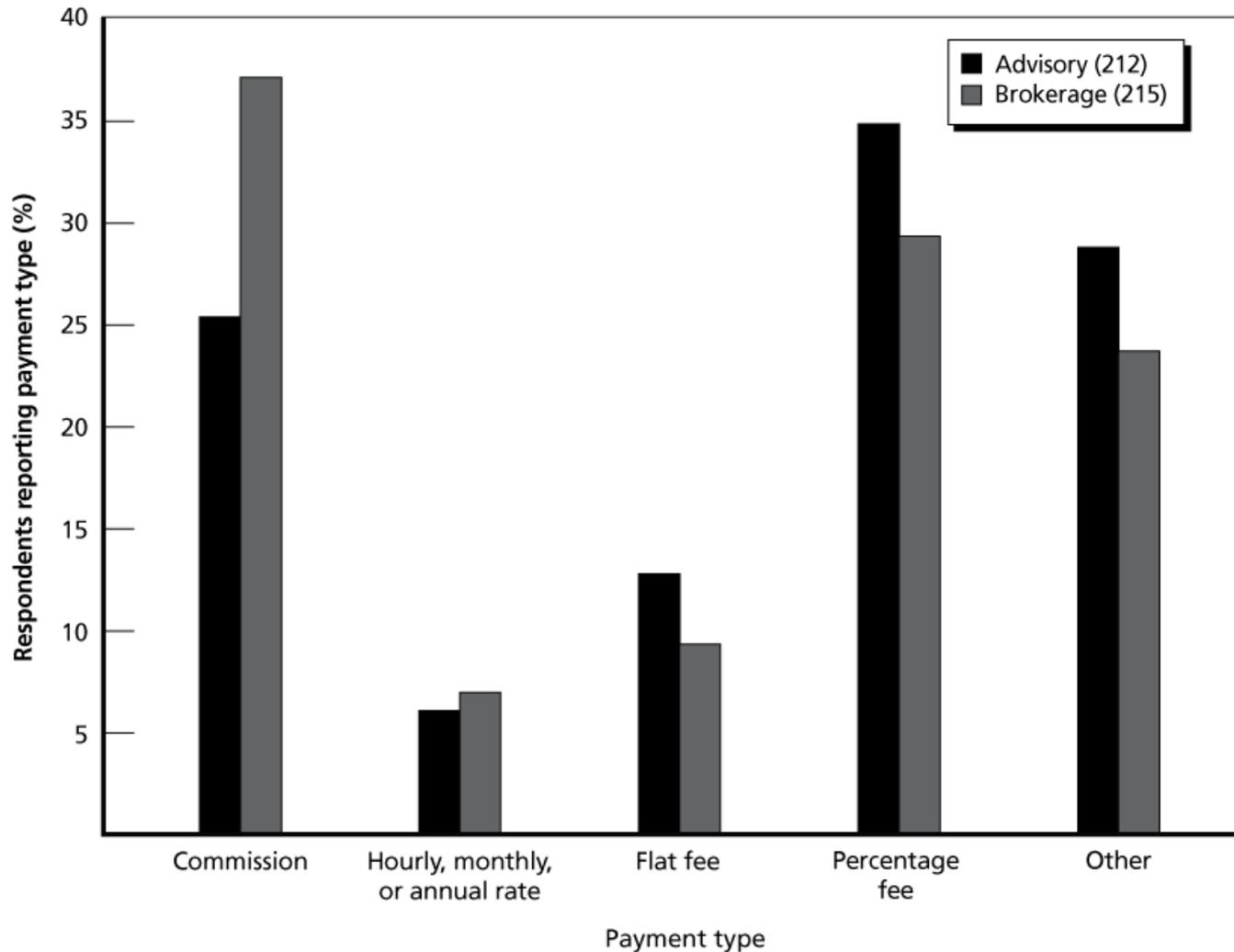
Interchangeable titles compound the confusion

Title	All Individual Professionals	Provide Advisory Services Only	Provide Brokerage Services Only	Provide Both Types of Services
Advisor	11	1	1	9
Banker	21	2	8	11
Broker, stockbroker, or registered representative	38	0	8	30
CFP	21	3	3	15
Financial adviser or financial advisor	78	7	11	60
Financial consultant	25	2	0	23
Financial planner	44	6	1	37
Investment adviser or investment advisor	22	3	3	16
President or vice president	20	0	2	18

SOURCE: ALP survey.

NOTE: Four hundred forty-nine titles were reported. Entries indicate the number of times that the title was reported.

Responses indicate confusion about the methods of payment or the type of firm with which their individual professional is associated



Individuals are equally likely to seek services from a BD or IA

	Investment Adviser	Broker
	Mean (%)	Mean (%)
Percent chance of seeking <i>services</i> from [investment adviser/broker] in the next five years	37.1	36.6
Percent chance of seeking <i>investment advice</i> from [investment adviser/broker] in the next five years	51.9	47.7
I would trust investment advice from [investment adviser/broker] (1 = strongly disagree, 5 = strongly agree)	3.4	3.1

SOURCE: ALP survey.

- **From focus group discussion:**
 - **Compensation structures, disclosure requirements, and legal duties make IAs appealing**
 - **Account minimums, industry certification, and costs make brokers appealing**

Still, Investors Expressed High Levels of Satisfaction with Their Financial Professionals

- **They tend to have long-term relationships with them**
- **Most commonly cited reasons for satisfaction: professional's attentiveness, accessibility, and level of trust**
- **We have no evidence on how levels of satisfaction vary with actual financial returns and costs**

Conclusions

- **Investors do not operate with a clear understanding of their financial professionals**
 - **the different functions**
 - **legal obligations**
 - **fiduciary responsibilities**
- **However, investors feel like they need assistance in making important financial decisions**