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Advisor compensation: Which clients know and how do they pay?

Somer G. Anderson[a], Martin C. Seay[b,*], Kyoung Tae Kim[c], Derek R. Lawson[d]

[a]*Maryville University, 650 Maryville University Drive, St. Louis, MO, 63141*
[b]*Kansas State University, 318 Justin Hall, Manhattan KS, 66506*
[c]*University of Alabama, 312 Adams Hall, Tuscaloosa AL, 35487*
[d]*Kansas State University, 303 Justin Hall, Manhattan KS, 66506*

Abstract

Using the 2015 National Financial Capability Study Investor Survey, this study uses agency theory to inform an exploration of characteristics associated with knowing how one's financial advisor/broker is compensated. This study further examines how individuals who do know the compensation method choose between financial advisors with different compensation models. Proposed changes in the financial advising regulatory landscape, as well as the pending changes to the CFP Board Standards of Professional Conduct, brings greater emphasis on understanding consumers' advisor compensation preferences. Primary results indicate that clients who place importance on fees, that are more knowledgeable about diversification, and that perform background checks are more likely to know compensation methods. A follow-up analysis reveals distinct differences between individuals that used each model, but also provide some mixed results, indicating that clients may not fully understand the compensation paid to their advisors. Discussion and implications related to these results are provided.

JEL classification: D10; G20; G41

Keywords: Agency theory; Compensation models; Financial advisor; Investor Survey; National Financial Capability Study

* Corresponding author. Tel.: +1-785-532-1486; fax: +1-785-532-5505.
E-mail address: mseay@ksu.edu

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1. Introduction

Given the shift away from defined benefit (DB) plans to defined contribution (DC) plans, U. S. workers have been tasked with an increased responsibility to plan and prepare for their retirement. This task requires individuals to undergo complex financial decisions that involve significant uncertainty, yet individuals often have difficulty making complex decisions under uncertainly (Tversky and Kahneman, 1974). As such, the shift in retirement funding responsibility has helped to ignite the growth of the financial planning profession (Seay, Kim, and Heckman, 2016). A significant body of research exists investigating the relationship between financial literacy, help-seeking behavior (Calcagno and Monticone, 2015; Collins, 2012; Molton, Loibl, Samak, and Collins, 2013), and seeking professional advice (Finke, Huston, and Winchester, 2011; Hanna, 2011; Lachance and Tang, 2012; Seay et al., 2016). However, little research has examined how consumers choose between financial advisors, and more specifically, how consumers choose between advisors with different compensation methods.

The Certified Financial Planner Board of Standards (CFP Board) provides three categories of compensation models under which CFP certificants can operate: (a) commission only, (b) fee-only, and (c) combined commission-and-fee. While advisors compensated by commission are paid based on specific product recommendations, fees are typically charged based on assets under management (AUM), through an annual retainer, or through hourly or project based planning charges. Further, commission-based advisors have historically been held to a suitability standard, simply requiring that a product be suitable for a client given their financial situation. On the other hand, fee advisors, operating in the Registered Investment Advisor (RIA) space, have typically been held to a fiduciary standard that requires recommendations be in the client's best interest. The differences in how compensation has been derived, and more specifically different standards of care, have often been used to differentiate these advisors. Notably, commission-and-fee advisors operate in the hybrid space, operating as a fiduciary when providing advice through an RIA and under the suitability standard when operating through a broker-dealer.

Pending changes in the financial planning regulatory landscape brings greater emphasis on understanding consumers' advisor compensation preferences. While the Department of Labor's (DoL) Conflict of Interest rule (Federal Register, 2017) was vacated by the courts in June of 2018, many financial services firms made structural changes in how their financial professionals engage with clients. Further, much of the spirit of the DOL rule is now found in the Security and Exchange Commission's proposed rule Regulation Best Interest (Reg BI). The current Reg BI proposal would require financial advisors previously held to the suitability standard to act in the best interest of their customers at the time a recommendation is being made, without placing the advisors, or their firms, interests ahead of the client.

Within the nonregulatory space, CFP professionals will be required to act as fiduciaries to their clients when *providing financial advice* beginning October 1, 2019. This is a clear expansion of the previous standard of conduct, which only required CFP professionals to act in a fiduciary capacity when providing financial planning services. Financial advice is defined very broadly, stated as any client communication that "would reasonably be viewed as a suggestion that the Client take or refrain from taking a particular course of action with respect to" an array of financial planning areas including, but not limited to, anytime the CFP

professional has discretion of client assets, development and/or implementation of a financial plan, and investment advice and strategies (CFP Board, 2017, p. 16–17).

In light of these pending changes, most, if not all, CFP professionals will engage in fiduciary work with their clients. Similarly, under the proposed Reg BI the standards of care between all financial professionals, although significantly different, will continue to converge around putting the client's interest first. This change would, in many ways, level the financial planning client services market from a client care perspective, making it imperative to gain an understanding of what factors clients consider when they differentiate between advisors that use differing financial planning compensation models.

Given this backdrop, the current study primarily explores two central research questions. First, what are the characteristics of clients that know their advisors' compensation method? Secondly, of those individuals who did know how their financial advisor was compensated, what are the differences in clients that use commission-only, fee-only, and combined commission-and-fee advisors? For empirical analyses, this study used two linked datasets, the 2015 National Financial Capability Study (NFCS) and its supplementary dataset, the 2015 NFCS Investor Survey. This study provides insights into the client characteristics that are associated with knowledge of financial advisor compensation and the use of a certain type of financial advisor based on their compensation method. Furthermore, it provides financial advisors insights into their clients' characteristics and why they choose to utilize their services.

2. Literature review

The use of professional financial advisors in the United States has been growing steadily over the last several decades. The percentage of U.S. households that reported using a financial advisor grew from 21% in 1998 (Hanna, 2011) to 29% in 2012 (Seay et al., 2016). Previous research has established an understanding of who seeks financial advice and why they do so, and the value that households receive from it. Agency theory provides a lens for informing hypotheses and directional expectations related to an individual knowing or not knowing their financial advisor's compensation method.

2.1. Who seeks financial advice?

The characteristics of financial professionals that consumers are looking for has been examined in previous studies. Bae and Sandager (1997) found that consumers were predominantly interested in using a financial advisor for services related to retirement planning, tax planning, and investment management. Furthermore, Bae and Sandager (1997) found that consumers with both the desire for the personal assurance and confidence that a trusted financial professional can provide and with lower levels of financial knowledge sought a financial professional. The authors also reviewed what was important to consumers in selecting their financial professional, showing that confidentiality, objectivity, competence, honesty, and the ability to communicate were very important factors to prospective clients. Prospective clients found access to the financial professional and compensation transparency

to be less important. Finally, education and certification were found as critical components towards selection of a financial professional, with 92% of clients reporting that a financial professional with the CFP designation is important (Bae and Sandager, 1997).

Much research has also examined the characteristics of consumers that sought financial advice. Individuals that sought financial help from a financial professional typically had higher levels of financial risk tolerance (Grable and Joo, 2001; Hanna, 2011; Joo and Grable, 2001; Marsden, Zick, and Mayer, 2011; Robb, Babiarz, and Woodyard, 2012), financial satisfaction (Grable and Joo, 2001), wealth, educational attainment (Finke et al., 2011; Hanna, 2011; Lachance and Tang, 2012), and income (Hanna, 2011). These individuals were also older (Finke et al., 2011; Grable and Joo, 2001; Marsden et al., 2011) than their counterparts and displayed more positive financial behaviors (e.g., regularly saved, eliminated credit card debt, or planned for big purchases; Grable and Joo, 2001; Joo and Grable, 2001). Another important positive predictor in financial help-seeking is an individual's willingness to trust (Lachance and Tang, 2012; Martin, Finke, and Gibson, 2014). Finally, individuals with more proactive attitudes and women were more likely to seek financial help from a professional (Joo and Grable, 2001).

2.2. The value of financial advice

Some of the best evidence of the value of financial advice based on real client data were provided by Marsden et al. (2011). They found that meeting with a financial advisor encouraged more prudent retirement planning activities. Specifically, individuals were more likely to have established long-term financial goals, calculated financial needs in retirement, higher levels of more supplemental savings, diversified retirement portfolios, saved more regularly, and spent more time learning about financial topics. Measurable long-term impacts of meeting with an advisor were increased confidence in the client's ability to retire and larger emergency fund savings.

Montmarquette and Viennot-Briot (2015) found that having a financial advisor for a minimum of four years had a positive and significant impact on client wellbeing. After controlling for many variables (socio-economic, demographic, and attitudinal variables), individuals using a financial advisor had significantly higher levels of financial assets. This increase in asset levels was not purely because of investment related advice, as evidence suggested that clients receiving financial advice created better savings disciplines.

Blanchett and Kaplan (2013) explored the value of financial advice through the concept of gamma. They evaluated the advantages of using a financial advisor as evidenced through: (1) appropriate asset allocation strategies; (2) creating dynamic withdrawal strategies; (3) understanding the appropriate use of guaranteed income strategies (e.g., annuities); (4) choosing between tax-efficient strategies; and (5) building portfolios that account for risks faced by retirees. Although theoretical and not driven by actual client data, improved financial decision making associated with financial advisors generated increased returns of approximately 1.6% annually within the context of retirement planning for retirees. Grable and Chatterjee (2014) expanded upon this research to introduce Zeta, a function of gamma and alpha (portfolio return beyond expected return within a portfolio), which

focuses on the value of advice in reducing wealth volatility during turbulent markets. They found that clients who met with a financial advisor before the Great Recession experienced significantly less negative returns and wealth volatility, adjusted for the risk taken within the portfolio.

2.3. Understanding compensation method

Previous literature provides little information in regard to which clients would be expected to know how they are paying their financial advisors. In response to this gap, one study, the 2014 Advisor Impact Economics of Loyalty Study conducted by Nielsen, collected information about knowledge of financial professional compensation methods from a sample of 1,229 respondents who worked with a financial professional and possessed investable assets of at least $50,000 (Raskie, Herbison, and Martin, 2017). Descriptive results from that study suggested that 68% of respondents knew how their financial professional was compensated. However, not all respondents that knew the method being used to pay their financial professional indicated that they knew the amount which the professional was being compensated (Raskie et al., 2017). In fact, the results suggested that the more commission that was involved with the compensation method, the less likely it was that the respondent knew how much they were paying their financial professional. Specifically, 82% of respondents who were paying fee-only, 79% who were working with a commission-and-fee professional, and 67% of those who were paying commission-only indicated that they knew how much their professionals were being compensated for their services.

Raskie et al. (2017) used the Nielsen study to investigate the relationship between knowledge of compensation method and knowledge of the financial professional's investment process and found evidence of a link between the two. Compared with those who did not know the compensation method, those who used a fee-only professional had the highest odds of knowing the investment process; with those using fee-and-commission coming in next highest, and those using commission-only having the lowest odds of knowing the investment process. They also investigated the association between compensation method and having an understanding of the investment process and found that client understanding of the investment process used by the financial service professional was affected by the method of compensation. Consumers who knew how their advisor was compensated had a better understanding of the professional's investment process than those who did not. Use of the commission-only method was not found to be a significant predictor of understanding the investment process; however, using the fee-only and commission-and-fee methods were associated with higher levels of understanding as compared with not knowing the compensation method at all.

Although sparse, previous literature (Raskie et al., 2017) suggests that there is a relationship between some individual client characteristics and the likelihood of knowing the compensation method used to pay a financial professional. Agency Theory can provide a lens that can be used to explore this relationship. Clients and financial advisors have an agency relationship where the consumer (client) compensates the agent (financial advisor) to perform services on the consumer's behalf (Jensen and Meckling, 1976; Raskie et al., 2017). Because the financial advisor is presumably more informed about the services that are

delegated by the client, information asymmetry exists between the financial advisor and the client (Jensen and Meckling, 1976). Information asymmetry creates agency costs that can be incurred by both the client and the advisor in the form of monitoring and bonding costs. The client can incur monitoring costs when he or she feels they must observe the behavior of the advisor to make certain the advisor is protecting the client's best interests. The advisor may incur bonding costs, such as obtaining professional designations and licenses, to signal to the client that they have the knowledge and expertise to perform the services in the client's best interests. There should be an inverse relationship between monitoring and bonding costs where the client can reduce monitoring costs when the advisor has signaled an investment in bonding costs. In this vein, clients who are sensitive to agency costs would be expected to understand the method they were using to compensate their financial advisors.

Given the gap in research related to knowledge of how financial professionals are compensated, the primary purpose of the current study is to explore the relationship between client characteristics and knowledge of financial advisor compensation method at the multivariate level. Specifically, the associations between the following client characteristics: (1) client socio-demographic profiles, (2) financial characteristics, (3) financial knowledge, (4) attitudes toward advisor preference, and (5) compensation; and the dependent variable, knowing or not knowing the advisor compensation method, were investigated. Informed by agency theory, the following hypotheses were explored in the primary analysis.

H_1: Financial knowledge will be positively associated with knowing the advisor compensation method.

The financial knowledge block of characteristics explored in this study includes objective knowledge about compound interest, inflation, bonds, mortgages, and diversification. Additionally, this block includes indicators of both subjective financial knowledge and confidence in applying that knowledge. It is expected that there would be less information asymmetry in the relationship between clients with high financial knowledge and their advisors. Therefore, those with higher financial knowledge may better understand the advisor compensation methods that are available and should choose the method that best fits their desired level of agency costs.

H_2: Attitudes about advisor preferences will be positively associated with knowing the advisor compensation method.

Agreement with the importance of using an advisor to free up time, prevent losses, and improve investment performance were the attitudes investigated in the advisor preference block of characteristics. Additionally, this block includes whether or not the client performed a background or registration check, and the degree of importance of an advisor's professional designation. It is expected that clients who had strong advisor preferences would be sensitive to agency costs and would seek to understand the compensation method used by the advisor so they could gauge the level of bonding costs incurred by the advisor and adjust monitoring costs based on those preferences. For instance, agency costs would appear to be very important to a client who went to the trouble to perform a background check on a financial advisor. Therefore, it would be expected that this client would also seek to understand the compensation method they were using to pay their advisor.

H_3: Compensation beliefs will be positively associated with knowing the advisor compensation method.

The compensation beliefs investigated in this study related to agreement with the impact on services received from an advisor who received commission on trading activity or received selling incentives. Additionally, the degree of importance that a respondent placed on advisor fees was also included in this block of characteristics. It is expected that clients who had strong beliefs in this area would be more likely to know how their financial advisors were paid.

2.4. Client preferences in compensation models

Beyond understanding how an advisor is paid, previous literature has provided evidence that there is a relationship between some client characteristics and the compensation method those clients used to pay their advisors (Raskie et al., 2017). However, more research is required to understand how clients choose between compensation models. A first step in understanding how client preferences influence advisor selection was provided by Seay et al. (2017), who analyzed bivariate statistics of clients that used each compensation model. Results indicated that commission-only clients were mostly older (65 and over), relatively financially knowledgeable and confident in their knowledge about finances, and were comfortable with their decision-making as it related to investments. These clients reported placing less importance on professional designations and using a financial advisor to free up time. Similarly, they were not as concerned about fraud, were less prone to believe that commissions influenced advice received, and believed that the fees they paid were reasonable.

Commission-and-fee clients were relatively younger (specifically, age 18–34), more racially diverse and were full-time workers (Seay et al., 2017). They reported the highest levels of concern about fraud and were the most likely group of clients to perform a background check on their advisor, yet they believed the fees they paid were reasonable. These clients had the lowest financial knowledge but reported the highest subjective knowledge of all client groups. They were confident in their investment decision-making, were the most optimistic about the future prospects of the financial markets, and used an advisor to free up time.

Lastly, fee-only clients were the largest group of clients, had high incomes, were financially knowledgeable but were not confident in their investment decision-making and also reported the lowest subjective financial knowledge of all client groups (Seay et al., 2017). Fee-only clients were interested in working with an advisor with a professional designation, wanted to delegate decisions to their advisor, and utilized an advisor to free up their time. Finally, fee-only clients had strong beliefs about commissions influencing advice received.

Given the basis for compensation model preference provided by Seay et al. (2017), a secondary analysis within the current study explored the association between client characteristics and the use of either a commission-only, fee-only, or combined commission-and-fee financial advisor for those individuals who did report knowing the compensation model used to pay their financial advisor. Given the heterogeneity of services provided within each

compensation method, it is difficult to make consistent a priori hypotheses related to characteristics associated with the use of each method. Consequently, this secondary analysis is purely exploratory in nature, and there are no directional expectations for which clients might be using which method.

3. Method

3.1. Data and sample selection

This study utilized data from the 2015 NFCS, a nationally representative survey of American adults administered between June and October 2015, and the follow-up 2015 NFCS Investor Survey that was administered in July 2015 to a subset of respondents who had indicated ownership of nonretirement investments. The larger 2015 NFCS state-by-state data were collected from an online survey of 27,564 adults in the United States, with approximately 500 observations per state plus the District of Columbia. The 2015 study included an oversampling for large states, resulting in 1,000 respondents each from California, Illinois, New York, and Texas. Respondents were recruited from established online panels and selected using a nonprobability quota sampling methodology with criteria based on income, gender, ethnicity, age, and education level.

To explore the associations between client attributes and financial advisor compensation models, the analytic sample was drawn from the 2,000 individuals who indicated owning nonretirement investments and completed the 2015 NFCS Investor Survey. From this subset, the sample was then limited to 955 respondents who indicated having a specific broker or advisor. Observations with missing data for any variables in the regression model were listwise deleted, leaving an analytic sample of 750 for the primary analysis. Of this 750, 142 respondents indicated that they did not know the compensation method used to pay their advisor; while 608 did know the compensation method. The secondary analysis used only the sample of 608 individuals who knew their compensation method. To obtain further details on this dataset, see Mottola and Kieffer (2017).

3.2. Measurement of variables

The dependent variable, compensation method, was based on the following question from the 2015 NFCS Investor Survey: "Which of the following types of fees do you pay for your nonretirement investment accounts" with the response choices of: (a) a commission on trades, (b) a percentage of the total value of assets managed, and (c) a fixed monthly or annual fee. No information related to hourly planning fees was collected. Responses were organized into four mutually exclusive categories: *commission-only* ($n = 143$) if the respondent selected only option a; *fee-only* ($n = 291$) if the respondent selected option b and/or c but not option a, *commission-and-fee* ($n = 174$) if the respondent selected option a along with another option, and *do not know* ($n = 142$) if the respondent indicated that they did not know the compensation method. For the primary analysis, we created a binary indicator of knowing compensation method and coded it as 1 if the compensation method was located in the

commission-only, fee-only, or commission-and-fee categories and 0 if the compensation method was located in the do not know category. The secondary analysis, "compensation method" was coded as 0 for commission-only, 1 for fee-only, and 2 for commission-and-fee.

Independent variables were organized into five blocks of client characteristics: (a) socio-demographic, (2) financial, (3) basic financial knowledge, (4) advisor preference, and (5) compensation beliefs. These variables and their measurements are discussed below. Additional measurement information is provided in the Appendix.

3.2.1. Socio-demographic characteristics

The NFCS includes a variety of demographic and socio-economic variables. However, because of sample size limitations, some groups were condensed to ensure appropriate cell sizes for the multinomial logit analysis. Socio-demographic variables included in the analysis include age, gender, race, education, marital status, and employment status.

3.2.2. Financial characteristics

The 2015 NFCS and 2015 NFCS Investor Survey include both objective and subjective assessments of an individual's financial situation. Objective assessments include income and approximate value of all investments in nonretirement accounts. Subjective measures include respondents' self-reported risk tolerance measured on a 10-point Likert-type scale, with higher scores indicating greater willingness to take risks.

3.2.3. Financial knowledge

The 2015 NFCS asked five questions about the fundamental concepts of personal finance drawn from a 5-question scale created and used by Lusardi and Mitchell (2009, 2011). For the purposes of this analysis, binary variables were created to signify whether the respondent correctly answered each question related to compound interest, inflation, bonds, mortgages, and diversification. Additionally, respondents were asked to assess their subjective financial knowledge and confidence in financial ability according to a 7-point Likert-type scale, with higher scores indicating greater self-assessed financial knowledge and confidence in financial ability.

3.2.4. Advisor preference characteristics

The NFCS 2015 Investor Survey provided several measures related to financial advisor use and preference. Respondents were asked to assess the importance of each of the following reasons for using a financial advisor: to free up my time, to help avoid losses, and to improve investment performance. For this analysis, responses were coded as binary variables with very important = 1, otherwise coded as 0. Respondents were also asked about the importance of financial advisor designations (very important = 1, otherwise = 0) and performance of background checks (yes = 1, otherwise = 0).

3.2.5. Advisor compensation characteristics

The 2015 NFCS Investor Survey asked a question that measured the respondents' attitudes toward sales-based compensation structures. Responses were coded as categorical variables

with the following levels: would not affect at all, would affect somewhat, and would affect a great deal. Additionally, the survey contained a question that measured respondents' agreement with fee importance when opening nonretirement investment accounts, assessed on a 10-point Likert-type scale.

3.3. Empirical models

A binary logit was used to analyze the effect of the selected predictor variables on the likelihood of knowing advisor compensation method. The model for the probabilities of clients knowing the compensation method is:

$$Prob\ (Y_i = j|X_i) = P_{ij} = \frac{exp(x'_i\beta_j)}{1 + \sum_{k=1}^{J} exp(x'_i\beta_k)},\ j = 0,\ 1.$$

We estimate probabilities for being in the *J+1* type for clients with characteristics, X_i for the group indicator J, 0 = do not know compensation method and 1 = know compensation method.

To analyze the effect of the selected predictor variables on the likelihood of utilizing the three compensation methods, a multinomial logit model was used. The model for the probabilities of clients using each compensation is:

$$Prob\ (Y_i = j|X_i) = P_{ij} = \frac{exp(x'_i\beta_j)}{1 + \sum_{k=1}^{J} exp(x'_i\beta_k)},\ j = 0,\ 1,\ 2.$$

We estimate probabilities for being in the *J+1* type for clients with characteristics, X_i. For the group indicator J, 0 = commission-only, 1 = fee-only, and 2 = commission-and-fee.

Multicollinearity among the predictor variables was tested using variance inflation factor (VIF) scores. Although the NFCS provides weighting information for the full sample, weights are not provided for the subset represented by the NFCS investor survey. Consequently, results were not weighted for the purpose of this research.

4. Results

4.1. Descriptive results

Tables 1 through 5 display the descriptive statistics of financial planning clients overall and by compensation model.

4.1.1. Socio-demographic characteristics

Table 1 contains the descriptive statistics for socio-demographic characteristics. The majority of the overall sample respondents were age 55 or older (60%); however, the ages of the respondents using the commission-and-fee compensation method were more evenly split between under 55 (52%) and over 55 (48%). Overall, the sample respondents

Table 1 Socio-demographic characteristics, 2015 National Financial Capability Study (NFCS) investor survey

Compensation model						
	Full sample (N = 750)	Do not know compensation (N = 142)	Know compensation (N = 608)	Commission only (N = 143)	Fee only (N = 291)	Commission-and-fee (N = 174)
Age						
18 to 34	11.20%	11.97%	11.02%	6.29%	9.97%	16.67%
35 to 44	12.00%	9.15%	12.66%	12.59%	11.68%	14.37%
45 to 54	16.80%	14.79%	17.27%	17.48%	15.12%	20.69%
55 to 64	25.07%	25.35%	25.00%	23.08%	25.09%	26.44%
65 and older	34.93%	38.73%	34.05%	40.56%	38.14%	21.84%
Gender						
Male	54.13%	38.03%	57.89%	61.54%	52.58%	63.79%
Female	45.87%	61.97%	42.11%	38.46%	47.42%	36.21%
Race						
White	82.80%	78.17%	83.88%	89.51%	83.85%	79.31%
Non-White	17.20%	21.83%	16.12%	10.49%	16.15%	20.69%
Education						
High school or less	8.00%	14.79%	6.41%	5.59%	6.87%	6.32%
Some college	24.40%	26.76%	23.85%	20.28%	24.05%	26.44%
College	67.60%	58.45%	69.74%	74.13%	69.07%	67.24%
Marital status						
Married	70.67%	68.31%	71.22%	70.63%	72.85%	68.97%
Not married	29.33%	31.69%	28.78%	29.37%	27.15%	31.03%
Employment status						
Full-time	39.07%	28.87%	41.45%	34.27%	34.71%	58.62%
Self-employed	10.00%	6.34%	10.86%	13.29%	10.31%	9.77%
Retired	33.87%	36.62%	33.22%	36.36%	38.83%	21.26%
Other	17.07%	28.17%	14.47%	16.08%	16.15%	10.34%

were male (54%), White (83%), had at least some college education (92%), and married (71%). There were some demographic differences noted between the respondents who did not know their compensation and the rest of the sample groups. There were more women (62%), there was more diversity (22% non-White), and more of these respondents indicated that they had no college education (15%). Most of the overall sample respondents were either employed full-time (39%) or retired (34%); however, the majority of the respondents using the commission-and-fee compensation method were employed full-time (59%). Respondents that knew their compensation method also had a higher rate of being employed full time (41%) than respondents who did not know their compensation method (29%).

4.1.2. Financial characteristics

Table 2 displays the descriptive statistics for financial characteristics. Most participants reported a household income of $50,000 or more (85%) and a total nonretirement account value of less than $500,000 (75%). Participants in the sample reported relatively high risk tolerance (M = 6.19 out of 10); however, respondents using the commission-and-fee method had the highest risk tolerance (M = 6.78 out of 10) compared with respondents using the

Table 2 Financial characteristics, 2015 National Financial Capability Study (NFCS) investor survey

Compensation model						
	Full sample (N = 750)	Do not know compensation (N = 142)	Know compensation (N = 608)	Commission only (N = 143)	Fee only (N = 291)	Commission-and-fee (N = 174)
Household income						
Less than $35,000	7.60%	11.27%	6.74%	11.19%	6.87%	2.87%
$35,000 to $49,999	7.07%	9.86%	6.41%	6.29%	6.53%	6.32%
$50,000 to $74,999	24.27%	28.87%	23.19%	24.48%	22.34%	23.56%
$75,000 to $99,999	21.07%	20.42%	21.22%	20.28%	19.93%	24.14%
$100,000 or more	40.00%	29.58%	42.43%	37.76%	44.33%	43.10%
Total value of non-retirement accounts						
$0 to $49,999	20.93%	27.46%	19.41%	24.48%	19.24%	15.52%
$50,000 to $99,999	13.07%	12.17%	12.17%	10.49%	11.68%	14.37%
$100,000 to $249,999	20.53%	19.90%	19.90%	16.08%	20.62%	21.84%
$250,000 to $499,999	20.13%	21.22%	21.22%	19.58%	21.65%	21.84%
$500,000 to $999,999	13.73%	9.15%	14.80%	13.99%	15.46%	14.37%
$1,000,000 or more	11.60%	7.75%	12.50%	15.38%	11.34%	12.07%
Risk tolerance Mean (SD)	6.19 (2.05)	5.56 (2.14)	6.34 (2.01)	6.24 (2.01)	6.12 (0.20)	6.78 (2.00)

commission-only or fee-only methods (M = 6.24 and 6.12, respectively). Moreover, respondents who did not know their compensation had the lowest risk tolerance (M = 5.56).

4.1.3. Financial knowledge characteristics

Descriptive statistics for basic financial knowledge characteristics are located in Table 3. Most respondents in the sample correctly answered objective financial knowledge questions related to compound interest (91%), inflation (83%), bonds (55%), mortgages (91%), and diversification (79%); however, respondents using the commission-and-fee method had a

Table 3 Basic Financial Knowledge, 2015 National Financial Capability Study (NFCS) investor survey

Compensation model						
	Full sample (N = 750)	Do not know compensation (N = 142)	Know compensation (N = 608)	Commission only (N = 143)	Fee only (N = 291)	Commission-and-fee (N = 174)
Financial knowledge (correct %)						
Compound interest	91.07%	85.21%	92.43%	90.91%	93.81%	91.38%
Inflation	83.33%	82.39%	83.55%	90.91%	84.19%	76.44%
Bond	55.20%	41.55%	58.39%	66.43%	55.67%	56.32%
Mortgage	91.07%	86.62%	92.11%	95.10%	91.41%	90.80%
Diversification	79.33%	64.79%	82.73%	84.62%	85.22%	77.01%
Subjective financial knowledge, mean (SD)	5.83 (0.86)	5.51 (0.99)	6.00 (0.81)	5.96 (0.79)	5.87 (0.83)	5.90 (0.82)
Confidence in financial ability, mean (SD)	6.45 (0.92)	6.25 (1.19)	6.50 (0.84)	6.47 (0.92)	6.59 (0.71)	6.39 (0.94)

Table 4 Advisor preference, 2015 National Financial Capability Study (NFCS) investor survey

Compensation model	Full sample (N = 750)	Do not know compensation (N = 142)	Know compensation (N = 608)	Commission only (N = 143)	Fee only (N = 291)	Commission-and-fee (N = 174)
Use advisor to free up time						
Very important	29.60%	34.51%	28.45%	19.58%	30.93%	31.61%
Not very important	70.40%	65.49%	71.55%	80.42%	69.07%	68.39%
Use advisor to prevent losses						
Very important	79.47%	81.69%	78.95%	80.42%	81.44%	73.56%
Not very important	20.53%	18.31%	21.05%	19.58%	18.56%	26.44%
Use advisor to improve investment performance						
Very important	84.40%	84.51%	84.38%	81.12%	86.94%	82.76%
Not very important	15.60%	15.49%	15.63%	18.88%	13.06%	17.24%
Performed advisor background/ registration check	25.07%	7.75%	29.11%	23.08%	26.46%	38.51%
Importance of professional designation						
Very important	59.20%	62.68%	58.39%	49.65%	62.20%	59.20%
Not very important	40.80%	37.32%	41.61%	50.35%	37.80%	40.80%

lower percentage of correct answers on each question compared with respondents using the other two compensation methods. Further, respondents who did not know their compensation also had a lower percentage of correct answers on each question compared with those who did know their compensation. In terms of self-assessed financial knowledge measures, respondents rated themselves at the higher-end of the subjective financial knowledge and confidence in financial ability scales (M = 5.83 and M = 6.45 out of 7, respectively). However, those paying commission-and-fee reported lower confidence in financial ability (M = 6.39) than those using the other two methods. Those who did not know their compensation reported the lowest subjective financial knowledge (M = 5.51) and confidence of all groups (M = 6.25).

4.1.4. Advisor preference characteristics

Table 4 contains descriptive statistics related to advisor preference characteristics. Most respondents found it very important to use their advisor to help them prevent losses (79%) and improve investment performance (84%). Only 30% of respondents found it very important to use an advisor to help them free up time, while 35% of those who did not know their compensation and only 20% of respondents using the commission-only method found this factor to be very important. Concerning advisor selection, 59% of the respondents felt that it was very important for their financial advisor to have possession of a professional designation; but 63% of those who did not know their compensation method and only 50% of respondents using the commission-only method found professional designations to be very important. Only 25% of the overall sample respondents reported that they had performed a background, registration, or license check on a financial advisor; however, 39% of respondents using the commission-and-fee method and only 8% of those who did not know their compensation had done so.

Table 5 Compensation beliefs, 2015 National Financial Capability Study (NFCS) investor survey

Compensation model						
	Full sample (N = 750)	Do not know compensation (N = 142)	Know compensation (N = 608)	Commission only (N = 143)	Fee only (N = 291)	Commission-and-fee (N = 174)
Commission on trading activity impacts advice received						
Would not affect at all	21.60%	16.90%	22.70%	32.17%	19.24%	20.69%
Would affect somewhat	42.40%	47.89%	41.12%	41.26%	39.18%	44.25%
Would affect a great deal	36.00%	35.21%	36.18%	26.57%	41.58%	35.06%
Selling incentive impacts advice received						
Would not affect at all	14.13%	11.97%	14.64%	16.08%	15.12%	12.64%
Would affect somewhat	38.53%	46.48%	36.68%	36.36%	34.71%	40.23%
Would affect a great deal	47.33%	41.55%	48.68%	47.55%	50.17%	47.13%
Fee importance, mean (SD)	7.89 (1.93)	7.15 (2.33)	8.07 (1.78)	8.06 (1.62)	7.99 (1.88)	8.20 (1.72)

4.1.5. Advisor compensation characteristics

In regard to the dependent variables, the majority of the sample (81%) indicated that they knew the compensation method. Of those that did know their compensation method, almost half of the respondents reported paying compensation on a fee-only basis (48%), with the rest of the sample reporting compensation based on commission only (23%) or both commission and fees (29%). Table 5 displays descriptive statistics related to advisor compensation characteristics. Respondents overwhelmingly felt that advisor compensation based on sales factors such as commissions on trading activity and selling incentives would at least somewhat affect advice received. In terms of fee importance, respondents felt that fees and pricing structure related to nonretirement accounts were important factors when opening an account (M = 7.9 out of 10), but those who did not know their compensation method found it to be less important (M = 7.2).

4.2 Regression results—primary analysis

To analyze the effect of the selected predictor variables on the likelihood of knowing the compensation method, a binary logit model was used. Results from the binary logistic regression analysis are presented in Table 6. In regard to model fit, Pseudo R^2 was 0.195. Variance inflation factors ranged from 1.1 to 4.3, indicating that multicollinearity among the predictor variables is not a concern in this analysis. Holding all else equal, variables from each block of characteristics except for the financial characteristics block were found to be significant predictors of knowing the compensation method ($p < 0.05$).

Hypothesis one expected a positive relationship between financial knowledge and knowing the advisor compensation method; however, knowledge of diversification was the only variable in the financial knowledge block that was significantly associated with knowing the compensation method. Specifically, those answering the question correctly had 2.5 times higher odds of knowing the compensation method than those who answered the question

Table 6 Binary logistic regression results estimating probability of knowing compensation method ($N = 750$)

Characteristic	*B*	SE *B*	Odds ratio	*p* value
Intercept	−.3281	1.210		0.007**
Socio-demographic characteristics				
Age (ref group: 65 and older)				
18 to 34	0.114	0.472	1.121	0.809
35 to 44	0.450	0.470	1.569	0.338
45 to 54	0.412	0.401	1.510	0.304
55 to 64	0.175	0.300	1.192	0.559
Gender (ref group: Female)				
Male	0.570	0.227	1.767	0.012*
Race (ref group: Non-White)				
White	0.421	0.289	1.524	0.145
Education (ref group: College)				
High school or less	−0.780	0.351	0.459	0.027*
Some college	−0.002	0.261	0.999	0.996
Marital status (ref group: Not married)				
Married	−0.182	0.254	0.834	0.474
Employment status (ref group: Full-time)				
Self-employed	0.280	0.445	1.322	0.531
Retired	−0.196	0.345	0.822	0.576
Other	−0.623	0.312	0.534	0.044*
Financial characteristics				
Household income (ref group: $100,000 or more)				
Less than $35,000	−0.452	0.482	0.637	0.349
$35,000 to $49,999	−0.561	0.447	0.571	0.210
$50,000 to $74,999	−0.234	0.305	0.790	0.439
$75,000 to $99,999	−0.210	0.312	0.811	0.503
Total value of non-retirement accounts (ref group: $1,000,000 or more)				
$0 to $49,999	0.145	0.504	1.156	0.774
$50,000 to $99,999	−0.378	0.494	0.685	0.444
$100,000 to $249,999	−0.029	0.456	0.971	0.949
$250,000 to $499,999	0.334	0.463	1.399	0.467
$500,000 to $999,999	0.192	0.486	1.211	0.694
Risk tolerance	0.033	0.058	1.034	0.563
Basic financial knowledge				
Compound interest	0.603	0.352	1.827	0.087
Inflation	−0.158	0.326	0.854	0.628
Bond	0.274	0.233	1.316	0.239
Mortgage	0.147	0.374	1.158	0.695
Diversification	0.934	0.273	2.545	0.001**
Subjective financial knowledge	0.210	0.139	1.234	0.131
Confidence in financial ability	0.058	0.118	1.060	0.622
Advisor preference				
Very important to use advisor to free up time	−0.279	0.244	0.756	0.251
Very important to use advisor to prevent losses	−0.050	0.313	0.951	0.874
Very important to use advisor to improve investment performance	0.106	0.333	1.111	0.751
Performed advisor background/registration check	1.392	0.372	4.021	0.000**
Professional designation very important	−0.286	0.231	0.751	0.214
Compensation beliefs				
Commission on trading activity impacts advice received (ref group: Would not affect at all)				
Would affect somewhat	−0.232	0.376	0.793	0.537
Would affect a great deal	−0.385	0.416	0.680	0.355
Selling incentive impacts advice received (ref group: Would not affect at all)				
Would affect somewhat	−0.486	0.443	0.615	0.273
Would affect a great deal	−0.231	0.469	0.793	0.621
Fee importance	0.243	0.056	1.275	<.0001***
Pseudo R^2	0.195			

†$p < .10$, *$p < .05$, **$p < .01$, ***$p < .001$.

incorrectly. Answering questions correctly that were related to compound interest, inflation, bonds, and mortgages was not associated with knowledge of the compensation method. Regarding the subjective financial knowledge variables, self-assessed financial knowledge and confidence in financial ability, neither client characteristic was associated with knowing the compensation method.

Attitudes about advisor preferences were expected to be positively related to knowing the compensation method in hypothesis two. Only one variable in this block of characteristics was significantly related to knowing the compensation method. Specifically, those who had performed an advisor background or registration check on their financial advisor had four times higher odds of knowing the compensation method compared with those who did not perform these checks. Clients who indicated that it was very important to use a financial advisor to free up time, prevent losses, and improve investment performance and those who found professional designations to be very important did not have significantly different odds of knowing the compensation method than those who did not find these variables to be very important.

In Hypothesis 3, it was expected that compensation beliefs would be positively associated with knowing the advisor compensation method. One item in the compensation beliefs block was associated with knowing the compensation method. Specifically, an increase in the belief that fees were important when opening nonretirement investment accounts was associated with 28% higher odds of knowing the compensation method. Believing that commission on trading activity or selling incentives would impact advice received was not significantly associated with knowledge of the compensation method.

Several variables in the socio-demographic block of characteristics were associated with knowing the compensation method. Men had 1.8 times higher odds of knowing the compensation method in comparison to women. Education was also a significant predictor of knowing the compensation method. Compared with having a college education, those with an education of high school or less had lower odds of knowing the compensation method; however, there was no significant difference between completing a college education and only having some college. In terms of employment status, there were no significant differences between clients who classified themselves as full-time versus those who considered themselves self-employed or retired. However, clients with an employment classification of "other" had significantly lower odds of knowing the compensation method. Age, race, marital status, household income, the total value of nonretirement accounts, and risk tolerance were not found to be significant predictors of knowing the compensation method.

4.3. Regression results—secondary analysis

As a follow-up analysis, a multinomial logit model was used to analyze the effect of the selected predictor variables on the likelihood of utilizing the three compensation methods using only the sample of respondents who reported knowing the compensation method used to pay their advisor. Results from the multivariate logistic regression analysis are presented in Table 7. In regard to model fit, Pseudo R^2 was 0.12. Holding all else equal, variables from all five blocks of client characteristics were found to be significant predictors of compen-

Table 7 Multinomial logistic regression results estimating probability of using compensation model ($N = 608$)

Compensation model	Fee-only vs. commission-only				Commission-and-fee vs. commission-only				Commission-and-fee vs. fee-only			
	B	SE *B*	Odds ratio	*p* value	*B*	SE *B*	Odds ratio	*p* value	*B*	SE *B*	Odds ratio	*p* value
Intercept	1.504	1.497		0.315	2.400	1.631		0.141	0.896	1.364		0.511
Socio-demographic characteristics												
Age (ref group: 65 and older)												
18 to 34	0.775	0.542	2.170	0.153	1.228	0.588	3.413	0.037*	0.453	0.459	1.573	0.324
35 to 44	(0.120)	0.454	0.887	0.791	0.015	0.504	1.015	0.976	0.135	0.436	1.145	0.756
45 to 54	(0.078)	0.403	0.925	0.846	0.088	0.449	1.092	0.844	0.167	0.390	1.181	0.669
55 to 64	0.151	0.314	1.163	0.630	0.397	0.364	1.487	0.276	0.246	0.312	1.278	0.431
Gender (ref group: Female)												
Male	(0.400)	0.239	0.670	0.093†	0.034	0.268	1.035	0.899	0.434	0.220	1.544	0.049*
Race (ref group: Non-White)												
White	(0.559)	0.362	0.572	0.123	(0.702)	0.382	0.496	0.066†	(0.143)	0.281	0.867	0.610
Education (ref group: College)												
High school or less	0.268	0.490	1.307	0.585	0.416	0.546	1.516	0.446	0.149	0.447	1.160	0.739
Some college	0.318	0.293	1.374	0.277	0.649	0.324	1.913	0.045*	0.331	0.260	1.392	0.203
Marital status (ref group: Not married)												
Married	(0.192)	0.277	0.825	0.487	(0.398)	0.303	0.672	0.189	(0.206)	0.249	0.814	0.409
Employment status (ref group: Full-time)												
Self-employed	(0.267)	0.394	0.766	0.498	(0.761)	0.429	0.467	0.076†	(0.494)	0.370	0.610	0.182
Retired	0.404	0.366	1.497	0.270	(0.575)	0.413	0.563	0.164	(0.978)	0.351	0.376	0.005**
Other	0.003	0.358	1.003	0.993	(0.760)	0.413	0.468	0.066†	(0.763)	0.345	0.467	0.027*
Financial characteristics												
Household income (ref group: $100,000 or more)												
Less than $35,000	(1.241)	0.519	0.289	0.017*	(1.926)	0.693	0.146	0.005**	(0.685)	0.629	0.504	0.276
$35,000 to $49,999	(0.878)	0.531	0.416	0.098†	(0.644)	0.595	0.525	0.279	0.234	0.491	1.263	0.634
$50,000 to $74,999	(0.894)	0.328	0.409	0.006**	(0.607)	0.365	0.545	0.096†	0.287	0.300	1.333	0.338
$75,000 to $99,999	(0.651)	0.325	0.522	0.045*	(0.336)	0.355	0.715	0.344	0.315	0.288	1.371	0.274
Total value of non-retirement accounts (ref group: $1,000,000 or more)												
$0 to $49,999	0.282	0.469	1.326	0.548	(0.702)	0.543	0.496	0.196	(0.984)	0.477	0.374	0.039*
$50,000 to $99,999	0.465	0.491	1.592	0.343	0.052	0.544	1.053	0.924	(0.413)	0.460	0.661	0.369
$100,000 to $249,999	0.787	0.446	2.196	0.078†	0.529	0.496	1.697	0.286	(0.258)	0.416	0.773	0.535
$250,000 to $499,999	0.586	0.413	1.797	0.156	0.394	0.461	1.483	0.393	(0.192)	0.397	0.825	0.628
$500,000 to $999,999	0.703	0.429	2.019	0.101	0.445	0.477	1.560	0.351	(0.258)	0.413	0.773	0.532
Risk tolerance	0.010	0.061	1.010	0.871	0.076	0.071	1.079	0.281	0.066	0.059	1.068	0.266

(continued on next page)

Table 7 (Continued)

Compensation model	Fee-only vs. commission-only				Commission-and-fee vs. commission-only				Commission-and-fee vs. fee-only			
	B	SE *B*	Odds ratio	*p* value	*B*	SE *B*	Odds ratio	*p* value	*B*	SE *B*	Odds ratio	*p* value
Basic financial knowledge												
Compound interest	1.002	0.452	2.723	0.027*	0.847	0.498	2.332	0.089†	(0.155)	0.425	0.857	0.716
Inflation	(1.034)	0.401	0.356	0.010*	(1.151)	0.421	0.316	0.006**	(0.117)	0.303	0.890	0.699
Bond	(0.392)	0.247	0.676	0.113	(0.177)	0.274	0.838	0.518	0.215	0.223	1.239	0.335
Mortgage	(0.347)	0.495	0.707	0.484	0.015	0.542	1.015	0.978	0.362	0.390	1.436	0.353
Diversification	0.307	0.347	1.359	0.377	(0.145)	0.369	0.865	0.692	(0.452)	0.295	0.636	0.126
Subjective financial knowledge	(0.227)	0.160	0.758	0.083†	(0.210)	0.176	0.810	0.233	0.067	0.148	1.069	0.652
Confidence in financial ability	0.307	0.153	1.359	0.045*	0.018	0.152	1.018	0.904	(0.286)	0.140	0.749	0.039*
Advisor preference												
Very important to use advisor to free up time	0.618	0.282	1.855	0.029*	0.654	0.310	1.923	0.035*	0.036	0.241	1.037	0.881
Very important to use advisor to prevent losses	(0.361)	0.325	0.697	0.266	(0.811)	0.345	0.444	0.019*	(0.450)	0.282	0.638	0.111
Very important to use advisor to improve investment performance	0.253	0.346	1.287	0.466	(0.023)	0.373	0.978	0.952	(0.275)	0.324	0.759	0.396
Performed advisor background/ registration check	0.181	0.283	1.199	0.521	0.306	0.303	1.358	0.313	0.125	0.246	1.133	0.612
Professional designation very important	0.485	0.247	1.625	0.050*	0.356	0.279	1.428	0.201	(0.129)	0.234	0.879	0.581
Compensation beliefs												
Commission on trading activity impacts advice received (ref group: Would not affect at all)												
Would affect somewhat	1.014	0.361	2.756	0.005**	0.732	0.391	2.080	0.061†	(0.282)	0.371	0.755	0.448
Would affect a great deal	1.850	0.404	6.359	<.0001***	1.178	0.438	3.248	0.007**	(0.672)	0.405	0.511	0.097†
Selling incentive impacts advice received (ref group: Would not affect at all)												
Would affect somewhat	(0.806)	0.428	0.447	0.059†	(0.153)	0.480	0.858	0.751	0.654	0.431	1.923	0.130
Would affect a great deal	(1.155)	0.447	0.315	0.010*	(0.474)	0.500	0.622	0.343	0.680	0.454	1.974	0.134
Fee importance	(0.114)	0.069	0.892	0.098†	(0.035)	0.080	0.965	0.659	0.079	0.067	1.082	0.235
Pseudo R^2	0.120											

†$p < .10$, *$p < .05$, **$p < .01$, ***$p < .001$.

sation method ($p < 0.05$). Significant results from each multinomial logit model are detailed below.

4.3.1. Fee-only compared with commission-only compensation method

Elements of financial knowledge were found to be associated with using the fee-only versus the commission-only compensation method, although there were confounding results. First, those who correctly answered the compound interest question had 2.7 times higher odds of using the fee-only than the commission-only method, and a one-unit increase in self-assessed confidence in financial ability was associated with a 36% increase in the odds of using the fee-only method. However, those who correctly answered the inflation question had lower odds of using the fee-only than the commission-only method. These divergent results were surprising, and remained present in a variety of different model specifications.

Advisor preference and compensation beliefs were also associated with advisor compensation method. As related to advisor preferences, those who found it very important to use an advisor to free up time and those who found a professional designation to be very important had 86% and 63% higher odds, respectively, of using the fee-only method than the commission-only method. However, confounding results were found related to compensation beliefs. While respondents who believed commissions affect advice received were more likely to use a fee-only advisor, respondents who believed selling incentives impacted advice received were less likely to use a fee-only advisor as compared with a commission-only advisor.

Lastly, household income was found to be associated with advisor choice, as higher income households were more likely to use a fee-only advisor. When compared with households with income of $100,000 or more, those making less than $35,000, between $50,000 and $74,999, and between $75,000 and $99,999 had lower odds of using the fee-only compensation method. None of the variables in the socio-demographics block of characteristics were significant predictors of compensation method in this model ($p < 0.05$).

4.3.2. Commission-and-fee compared with commission-only compensation method

One element of financial knowledge was associated with compensation method in this model. Respondents who correctly answered the inflation question were less likely to use the commission-and-fee method than the commission-only method. Two characteristics related to advisor preference were significant in this model. Respondents who found it very important to use an advisor to free up time had 92% higher odds of using the commission-and-fee method; and those who found it very important to use an advisor to prevent losses had lower odds of using the commission-and-fee method. Related to compensation beliefs, compared with respondents who felt that advisors receipt of commission on trading activity would not impact advice received, those who thought advice would be a great deal impacted had higher odds of using the commission-and-fee method compared with the commission-only method.

In terms of socio-demographic and financial characteristics, age, education, and household income were associated with compensation method in this model. Compared with those aged 65 and older, respondents in the youngest age group of 18 to 34 had 3.4 times higher odds

of using the commission-and-fee method compared with the commission-only method. Compared to those with a college degree, respondents with only some college had 91% higher odds of using the commission-and-fee than the commission-only method. Households making less than $35,000 annually had lower odds of using the commission-and-fee than the commission-only method.

4.3.3. Commission-and-fee compared with fee-only compensation method

One characteristic of financial knowledge was associated with compensation method in this model. A one-unit increase in self-assessed confidence in financial ability was associated with a decrease in the odds of using the commission-and-fee method compared with the fee-only method. In terms of financial characteristics, the total value of nonretirement accounts was also a significant predictor of compensation method in this model. Compared with respondents who reported having $1,000,000 or more in nonretirement accounts, those who reported having between $0 and $49,999 were less likely to use the commission-and-fee method than the fee-only method. Two elements of socio-demographic characteristics, employment status and gender, were found to be associated with compensation method in this model. Compared with respondents who were working full-time, those who identified as being retired or other had lower odds of using the commission-and-fee compensation method than the fee-only method. Compared to females, male respondents had higher odds of using the commission-and-fee compensation method than the fee-only method.

5. Discussion

The primary purpose of this paper was to investigate the characteristics of individuals that are associated with knowing the compensation method used to pay their financial advisor. Of those respondents who did know how their financial advisors were compensated, a secondary analysis explored the characteristics between clients who used the commission-only, fee-only, and combined commission-and-fee methods to pay their advisors. Using data from the 2015 NFCS Investor Study, this study is one of the first attempts to explore whether clients knew how they paid their advisors, and how clients make choices between compensation models at the multivariate level. Although significant variation was found between clients who knew and did not know how their advisors were compensated, and between compensation models for those who did know how their advisor was paid, some results were somewhat contradictory in nature.

Given that this study represents the first use of the NFCS Investor survey to evaluate advisor compensation methods at the multivariate level, an evaluation of the sample quality in relation to previous research is important. Sample descriptive results were largely consistent with previous research that suggested clients who seek financial help from financial professionals are older, have higher levels of income, are better educated, and have higher risk tolerance (Finke et al., 2011; Grable and Joo, 2001; Hanna, 2011; Marsden et al., 2011). However, most of the clients in this sample were male, despite previous research indicating women were more likely to seek financial help from a professional (Joo and Grable, 2001). Similarly, incongruences were found with Bae and Sandager's (1997) suggestion that

consumers sought a financial professional because they had lower levels of financial knowledge, as respondents in this sample were very knowledgeable about compound interest, inflation, mortgages, and diversification. However, this pattern is consistent with more recent research indicating that financial knowledge, specifically understanding diversification and mortgages, is positively related with the use of a financial advisor (Calcagno and Monticone, 2015; Seay et al., 2016).

Regarding subjective financial knowledge, previous research found that clients were most likely to pay for financial advice if they believed themselves to be less financially knowledgeable (Finke et al., 2011). However, clients in the sample assessed their own financial knowledge very highly on average. In support of Bae and Sandager's (1997) suggestion that certification was a critical component when clients were selecting a financial professional, most of the financial planning clients in this sample found certification to be very important. Regarding advisor compensation, previous research that found compensation transparency to be less important to prospective clients (Bae and Sandager, 1997) was not supported as the clients in this sample found fees and pricing structure to be important factors when opening nonretirement accounts. Overall, it appears that the NFCS Investor Survey provides a reasonable sample of individuals that use financial advisors, but it likely is not perfectly generalizable.

Moving to the primary analysis, some evidence was generated to support all three hypotheses related to financial knowledge, advisor preference, and compensation beliefs blocks. Hypothesis 1 proposed that higher financial knowledge would be associated with knowing the compensation method. This hypothesis was supported for those who correctly answered the diversification question, but it was not supported for the other objective financial knowledge questions nor the two subjective questions related to confidence and ability. This limited result indicates that one's level of financial knowledge may not inform the level of agency costs that a client is willing to incur in the client/financial advisor relationship, or that it may be a domain specific relationship. Specifically, diversification, as compared with the other knowledge questions, may be measuring a higher level of investment sophistication that is more closely tied to scrutiny of investment professionals.

Hypothesis 2 proposed that clients with strong advisor preferences would be more likely to know the compensation method used to pay their advisors. This hypothesis was supported for those who had performed a background or registration check on an advisor. This finding suggests that clients who are sensitive to agency costs will seek to understand how their advisors are being paid. However, there was no significant relationship found between the level of importance placed on professional designations and knowing the compensation method; which indicates that either these designations are not functioning as a signal of an investment in bonding costs or that professional designations are not a strong enough signal of knowledge and expertise to motivate clients to adjust their monitoring costs. Preferences about advisor use (to free up time, to prevent losses, and to improve investment performance) were not associated with knowing the compensation method, indicating that clients who outsourced financial decisions for these specific reasons were not taking agency costs into account when choosing their financial advisor.

Finally, Hypothesis 3 posited that strong beliefs about compensation would be associated with knowing the compensation method used to pay the advisor. Results did provide evidence of a positive relationship between finding fees to be important and knowing how

the advisor was compensated, suggesting that clients who were sensitive to agency costs would be more likely to gain an understanding of how their advisors were being compensated. However, there were no relationships revealed between beliefs about commissions and sales incentives and knowing compensation method.

Lastly, a follow-up exploratory analysis was conducted to determine characteristics associated with each advisor compensation model among those that were aware. Instead of a clear picture, results related to financial knowledge were confounding. Clients who correctly answered the compound interest question were less likely to use a commission-only advisor as compared with the other methods; but those who answered the inflation question correctly preferred the commission-only method above commission-and-fee. In terms of self-assessed financial knowledge, the more knowledgeable that a client felt about finances, the less likely they were to use the fee-only method as compared with the commission only method. However, this pattern did not align with confidence in financial ability, as higher confidence was associated with a preference for the fee-only method as compared with the commission-and-fee method. Taken together, it is hard to get a clear understanding of how knowledge informs compensation model choice. It should be noted that these results may be due to the wide variation in services that are provided by different advisors operating within each compensation model. This could be an indication that there is something going on beyond compensation model, potentially quality of the financial advisor, which is driving the advisor choice and confounding the analysis. However, these results could also indicate that there is confusion in the market about what each of these fee-models entails.

More consistent patterns were found around advisor use preferences. Respondents who found it very important to use an advisor to free up time overwhelmingly preferred either method over the commission-only method. Alternatively, clients who found it very important to use an advisor to prevent losses preferred the commission-only method, but only when compared with the commission-and-fee method. Regarding professional designations, clients who thought it was very important that a financial advisor have a professional designation preferred the fee-only to the commission-only method; but there was no significant preference between the commission-and-fee and fee-only methods. These preferences seem to reveal client beliefs that service level is related to compensation structure. The results echo the patterns revealed in Seay et al. (2017), and may indicate that advisors using a fee-only advisor are looking to outsource financial decision making, while those using commission based advisors are looking more for a partner to facilitate their financial decisions, as opposed to offload on to.

5.1. Limitations

Several limitations exist in this study. First, the primary analysis was limited to 750 clients who reported owning nonretirement investments, with the follow-up analysis further limited to 608 individuals who knew the type of compensation model they were using to pay their financial advisor. This sample restriction limits the type of client that is analyzed, and results may not be generalizable to the entire population of financial planning clients in the United States. Additionally, the analyses were based on self-reported survey data and perhaps respondents were confused about the compensation method they were using for their financial advisor. It is also

possible that respondents were confused about the difference between commissions and incentives, given the confounding results in that area. Finally, the NFCS 2015 Investor Survey did not collect information about compensation based on hourly fees, so either clients who use this type of compensation structure are missing from this analysis or those who use an hourly fee model chose one of the three models available to them in the survey.

6. Conclusion

Using data from the 2015 NFCS Investor Survey, this study explored the associations between client socio-demographic characteristics, financial and financial knowledge characteristics, advisor preferences, and compensation beliefs and the likelihood of knowing the compensation method they used to pay their financial advisor/broker. A secondary analysis explored the relationship between these client characteristics and the use of either a commission-only, fee-only, or commission-and-fee compensation model for their financial advisor. Primary results revealed patterns between client characteristics and knowledge of how their advisors were compensated. Specifically, clients with knowledge about diversification; those who took the time and initiative to perform a background or registration check on their advisor/broker, and those who found fees to be important had higher odds of knowing how their financial advisors were being compensated. These results indicate that clients with a higher level of investment sophistication and those who are sensitive to agency costs will seek to understand how their financial advisors are compensated. In understanding this relationship, it is important to point out that 19% of respondents did not know how their advisor was paid. This is consistent with previous literature, and highlights the limited information that many clients gather, or retain, in assessing the use of a financial advisor.

For clients who did know the compensation method, results revealed some relationships between client characteristics and preferred compensation models. However, the results also provided evidence of some misunderstanding related to advisor compensation. Overall, there are clear differences in the services clients are expecting based on the type of compensation method used, and given clear regulatory trends leveling the standard of care between financial services professionals, it is important to continue to gain an understanding of what services are important to which clients, and how clients will be able to differentiate between financial advisors in the future.

Appendix 1 Description of key variables in the 2015 National Financial Capability Study (NFCS)

Variable	Description
Compensation method	"Which of the following types of fees do you pay for your non-retirement investment account(s)?"
Non-retirement account value	"Not including retirement accounts, have any investments in stocks, bonds, mutual funds, or other securities?"
Objective financial knowledge	
Compound Interest	"Suppose you had $100 in a savings account and the interest rate was 2% per year. After 5 years, how much do you think you would have in the account if you left the money to grow?"
Inflation	"Imagine that the interest rate on your savings account was 1% per year and inflation was 2% per year. After 1 year, how much would you be able to buy with the money in this account?"
Bonds	"If interest rates rise, what will typically happen to bond prices?"
Mortgage	"A 15-year mortgage typically requires higher monthly payments than a 30-year mortgage, but the total interest paid over the life of the loan will be less."
Diversification	"Buying a single company's stock usually provides a safer return than a stock mutual fund."
Subjective financial knowledge	"On a scale from 1 to 7, where 1 means very low and 7 means very high, how would you assess your overall financial knowledge?"
Confidence in financial ability	"I am good at dealing with day-to-day financial matters, such as checking accounts, credit and debit cards, and tracking expenses."
Reason for advisor use	"Below are some reasons that people might use a financial adviser. How important is each of the following to you, personally?"
Importance of designation	"If you were looking for a financial adviser, how important would the person's professional designations or certifications be in your decision to work with that person?"
Performed advisor registration/ background check	"Have you ever checked with a state or federal regulator regarding the background, registration, or license of a financial professional?"
Sales based compensation impacts advice received	"How much do you think each of the following would affect the advice that a financial adviser gives to you?"
Fee importance	"How important to you were the fees and pricing structure when opening your non-retirement investment accounts?"

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