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Do as i tell you, not as i do: financial advisors and personal financial decision-making

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Abstract

We describe the financial behavior of financial advisors and whether they follow the advice they give clients. We focus on the following areas of comprehensive financial planning as they relate to advisor behavior: (1) cash flow, (2) debt, (3) retirement planning, (4) investments, and (5) estate planning. The primary goal is to investigate whether financial planners practice what they preach. A secondary goal is to identify the characteristics associated with the advisors that best plan their own financial lives. We find that financial advisors generally follow their own advice; as a group they are more likely to be prepared for retirement, have less debt, higher liquidity, covered insurance needs, and have an estate plan in place.

Keywords: Financial advisors; Retirement planning; Investments; Debt; Estate planning

1. Introduction and motivation

The use of financial advisors has been associated with better preparedness for retirement, higher financial confidence, and an increased sense of financial well-being. For example, a 2014 survey conducted by the Insured Retirement Institute claims that baby boomers who use financial advisors are twice as likely to feel confident about their retirement savings as those who do not use an advisor.[1]

A strand of literature suggests that financial advisors provide value to their clients with regard to behavioral biases and investments. Shapira and Venezia (2001) analyze investment patterns of clients of a major Israeli brokerage house and compare investment decisions of those making independent decisions to those managed by professionals. They conclude

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professional training and experience may reduce judgmental biases, and that professionally managed accounts are more diversified and less correlated with the market/more profitable than those of independent accounts. Cici, Kempf, and Sorhage (2017) compare the tax-avoidance behavior of investors who operate under the guidance of financial advisors with investors who do not have financial advisors. They document tangible benefits in the form of useful tax-management advisory services to mutual fund investors, helping those investors engage in tax-avoidance strategies such as tax-loss selling. Financial planners also help clients match self-indicated risk tolerance with ownership of investment assets. Park and Yao (2016) suggest that financial planners provide significant value to households on the consistency of their financial risk attitude and behavior.

Park and Yao (2016) find that financial planners provide significant value to households by matching financial risk attitude to actual savings and investments behavior. In addition, professional financial planners can still benefit from a third-party assessment to provide more objective recommendations on personal financial planning or to de-bias behavioral issues. Common behavioral biases include under-diversification, local and home bias, and the disposition effect.[2] For instance, Seasholes and Zhu (2010) point out that investors who demonstrate local stock bias do not earn superior returns, and. Hoechle et al (2017) find that financial planners help better diversify portfolios and reduce local bias.

At the same time, another strand of literature questions the effectiveness of financial advisors to bring value. This could be explained by the agency problem; the inherent conflict of interest in the advisor-client relationship that makes it hard for the advisor to align her interests with the client. Although advisors should act in the client's best interest, some research questions advisor motivations. For example, Hackethal, Haliassos, and Jappelli (2012) point out that advisors with commission-based incomes prefer to devote time to customers likely to trade on a bigger scale. Mullainathan, Noeth, and Schoar (2012) show that advisors fail to de-bias their clients and often reinforce biases that are in their interests. They also find that advisors encourage return-chasing behavior and push for actively managed funds that have higher fees, even if the client starts with a well-diversified, low-fee portfolio. Hoechle et al. (2017) examine the performance of advised and independent trades by comparing them trade-by-trade with in-person analysis. They conclude financial planners help reduce the behavioral biases to which retail investors are subject, but that advised trades still perform worse than independent trades. Similarly, Chalmers and Reuter (2020) use changes in retirement plans to examine the choice between broker advice and target date funds. They find that brokers recommend higher-commission options and that investors most worried about bear market risk will invest in target date funds when available, with better outcomes than the broker-advised portfolios.

A 2013 survey from the Society of Actuaries shows that 52% of pre-retirees and 44% of retirees consult with a financial advisor.[3] Alyousif and Kalenkoski (2017) examine five types of financial advice sought by the general population: debt counseling, saving/investment, mortgage/loans, insurance, and tax planning. They find no significant differences across subsamples defined by gender, age, and financial literacy and that income and risk tolerance are positively related to demand for financial advice. They also find that low awareness of financial knowledge, perhaps a proxy for self-confidence, and financial fragility decrease the probability of seeking financial advice.

Overall, financial literacy is found to have a significant impact on portfolio diversification and investment outcomes. A high degree of financial literacy increases the usage of financial planning services, although investors who seek advice may not strictly follow guidance and therefore do not improve their portfolio efficiency. Von Gaudecker (2015) examines portfolio diversification and finds a significant relationship between good investment outcomes and financial literacy and/or reliance on professional financial advice. Compared with those groups, households with below-median financial literacy that trust their own decision-making capabilities underperform those who do not. Calcagno and Monticone (2015) analyze the effect of investors' financial literacy on their decision to seek financial advice. They conclude a high degree of financial literacy increases the likelihood that investors consult with financial advisors. Battacharya et al. (2012) use German brokerage data to examine the efficacy of unbiased investment advice. They find investors who most need financial advice are the least likely to obtain it. In addition, their research suggests that the 5% of investors who do seek advice barely follow the advice and do not significantly improve portfolio efficiency.

Financial planners are a group of individuals with a high degree of financial literacy. According to Nofsinger and Varma (2007), who survey over 100 financial planners to assess their reasoning mode, financial planners are more analytical than the general population with regard to intertemporal choices, risk aversion and preferences, and framing focus. However, many financial planning professionals do not have business plans, retirement plans, or successions plans in place, and Doviak (2016) discusses how advisors struggle to cope with emotional stress using behavioral finance.[4] It is useful to examine whether financial planners handle their personal finances as well as they advise their clients and whether they follow through with execution plans.

This article investigates how advisors make their own financial decisions and whether the advice they give is consistent with their own behavior. We focus on the following areas of comprehensive financial planning as they relate to advisor behavior: (1) cash flow, (2) debt, (3) retirement planning, (4) investments, and (5) estate planning. A secondary goal is to identify characteristics associated with the advisors that plan their own financial lives according to best financial practices.

We examine financial planners' financial decisions with respect to debt and savings, and whether they handle their own personal finances efficiently. In addition, we investigate whether financial planners rely on professional services, such as hiring tax professionals or financial planners. We find that financial planners mostly preach what they practice. As a group, planners are more likely to be prepared for retirement, have less debt, higher liquidity, covered insurance needs, and an estate plan in place. As a result, the general population could benefit financially by hiring planners. These results are consistent with those found by Linnainmaa, Melzer, and Previtero (2021), who examine a sample of financial planners in Canada. They conclude that the personal investments of advisors are similar to client advice, even when the advice may be expensive and inefficient. Dvorak (2015) also finds that advisors' plans are comparable to their clients' plans; they tend to hold identical funds and use the same fund families and fund categories. Outlaw and Outlaw (2017) focus on the investment aspect and compare the advisors' own trading activity with that of their clients. They find that advisors do their best for the clients, as they do for themselves, but sales incentives may influence the quality of advice.

2. Survey design

We collect information from financial advisors via survey in summer 2018.[5] Advisors are recruited through targeted Facebook pages (such as XYPN), NAPFA, and FPA. The responses are anonymous and voluntary, with no renumeration. The survey consists of 33 questions, categorized as follows: demographic information, cash flow questions (budget existence and use, emergency savings and consumer debt), insurance questions (need assessment and implementation), estate planning (existence and household preparedness for emergencies), investments (existence and decision-making in terms of time and investment style), taxes (knowledge and preparation), and an overall assessment of the satisfaction with past financial choices.

We obtained 124 complete responses during the summer of 2018, a response rate of 82%. By design, the sample is biased towards planners who do not exclusively charge commissions. Our sample mirrors the overall gender distribution of financial advisors well. Of the respondents, 68% are male and 83% are married, 34% of the respondents are under 34, and 5% are over 65. 88% consider themselves a comprehensive financial advisor and 63% have earned the Certified Financial Planner (CFP) designation.

3. Results

3.1. Descriptive statistics

Table 1 presents descriptive statistics by category. For cash flow, our expectation is that everyone will have a budget, given how consistently this topic is enforced in financial planning. We find that 67% of advisors do have a personal budget, but out of those, despite having a budget in name, 20% do not track or enforce it consistently. Similarly, 67% of U.S. households prepare a monthly budget.[6] Overall, only 47% of planners elevate their own budget to the same level of responsibility they ask their clients to follow.[7]

In terms of liquidity, 9% of the respondents have less than \$3,000 in liquid assets saved for emergencies, 23% have somewhere between \$3,000-\$10,000, and 23% have more than \$50,000. Although liquidity is an important component of financial planning, we do not have an expectation for an optimal level. Still, the 9% that have less than \$3,000 accessible for emergencies is much less than the typical advice of three to six months of liquid assets. By comparison, 45% of U.S. adults have no savings, and 70% have less than \$1,000 in savings.[8]

As a side note, we ask questions about the ability of partners to find the financial records of their spouse. For example, if a spouse were to die, would the second partner be able to access all the accounts, and know who to call for pension plans and insurance, and so forth?

Table 1 Descriptive statistics

Variables	Mean	Standard deviation	Min	Max	*N*
Gender	0.6820	0.4672	0	1	123
Budget	0.8644	0.7151	0	2	118
Age	2.3220	1.2529	1	5	124
MarriageStatus	0.8307	0.37658	0	1	124
AdvisorType	0.8065	0.60723	0	1	124
CFPCode	0.6363	0.4830	0	1	121
LiquidAssets	3.3559	1.3173	0	5	118
Income	3.5213	1.3808	1	5	117

Note. Independent variables are as follows: male is equals 1 and otherwise, 0. Budget is represented by a code where 1 identifies advisors who have a personal budget and review is regularly, 2 represents advisors who have a budget but do not review is regularly and 0, advisors who do not have a formal budget for themselves. Age is represented by a code from 1 to 5 where one is less than 35, two is 36–45, three is 46-64, four is 55-64, and five is over 65. MarriageStatus is equal to 1 if married and 0 otherwise. AdvisorType is equal to 1 if the person is a comprehensive financial planner and 0 otherwise. CFPCode is equal to one if the person is a CFP and 0 otherwise. Liquid assets range between 1 to 5, depending on the amount of available assets. One is less than \$3,000, two is between \$3,000-\$10,000, three is \$10,000-\$20,000, four is \$20,000 to \$50,000, and five is more than \$50,000. Income is a range between one and five where one represents less than \$50,000 per year, two represents \$50,000-\$100,000, three represents \$100,000-\$150,000, four represents \$150,000-\$200,000, and five represents more than \$200,000.

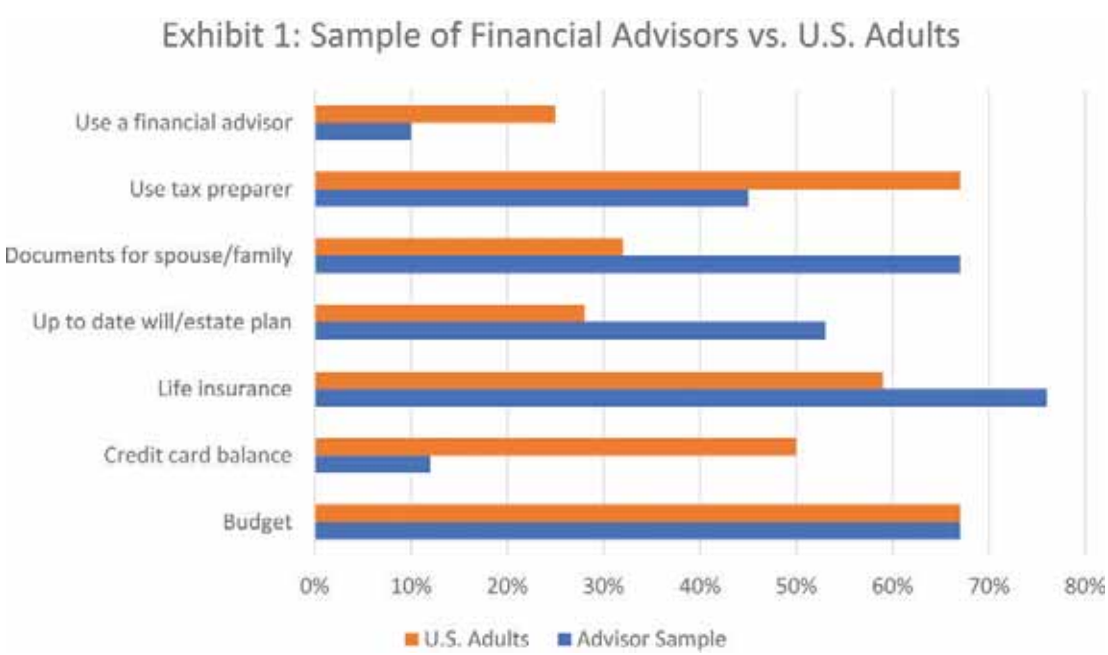
Given that one person in the relationship is a financial advisor, we expect the respondents to be able to easily access the information for their spouse. We find that 67% of advisors have a document in place for their spouse's accounts but 10% do not know what is available or where to access files. On the flip side, 54% of respondents have a document in place for their non-advisor spouse, 21% have no formal document but have shared the accounts and accessibility, and 25% have not prepared the information for their spouse. Across older Americans, 32% have not informed their family where to find legal, medical, and financial documents.[9]

We ask advisors to compare the amount of time and effort they spend on their client portfolios compared with time spent on their own portfolios: 56% of advisors spend the same amount of time on their client portfolios as they do on their own, and only 8% spend significantly more time. Interestingly, 35% stated that they spend significantly less time on their own portfolio.

Because financial advisors sell professional services and experience, we also expect advisors to use such services. Even though advisors have the expertise to manage their own finances, adding a neutral, unbiased third party would be very beneficial for the behavioral aspect of money management. To assess this topic, we ask if they (1) prepare their own taxes and (2) use a financial advisor themselves; 45% of respondents have someone else to do their taxes while 55% prepare their own. Of the advisors who prepare their own taxes, only 33% have a tax qualification like an EA or CPA. By comparison, only 10% of advisors have their own financial advisor. For the general population, 33% file their own taxes and 75% manage their own finances.[10,11]

We also ask advisors if they had made a financial decision in the past that was different from the advice they disperse to their clients; 50% of the respondents answered yes. The most common mistakes are (1) not avoiding debt, and particularly accumulating credit card debt, (2) having investments they would not include in their clients' portfolios, (3) buying a house with a very low-down payment while on a strict budget (house poor), and (4) cashing out a Roth IRA.

Exhibit 1 Summarizes the Differences in Financial Planning Behavior between Our Sample of Financial Advisors and the General Population



Sources: CNBC, debt.com, GOBankingRates, People Press, Wells Fargo

3.2. Multivariate analysis

Table 2 presents the regression results. The dependent variables are as follows: the existence and enforcement of a budget in Model 1, the amount of liquid assets in Model 2, the assessment of insurance needs in Model 3, the amount of credit card debt in Model 4, and the existence of an estate plan in Model 5. Models 6 and 7 break the existence of an estate plan into questions regarding whether the spouse knows about how to access financial

Table 2 Financial planning

Variables	Model 1 coefficient p-Value	Model 2 coefficient p-Value	Model 3 coefficient p-Value	Model 4 coefficient p-Value	Model 5 coefficient p-Value	Model 6 coefficient p-Value	Model 7 coefficient p-Value
Gender	−0.002	−0.294	−0.315	−0.038	0.192	−0.322	−0.062
	(0.991)	(0.332)	(0.103)	(0.842)	(0.404)	(0.112)	(0.720)
Age	−0.127	0.184	0.034	0.063	0.318	0.001	0.026
	(0.052)*	(0.064)*	(0.687)	(0.374)	(0.000)***	(0.990)	(0.758)
MarriageStatus	−0.256	0.515	−0.344	−0.384	0.095		
	(0.292)	(0.415)	(0.401)	(0.247)	(0.840)		
AdvisorType	−0.342	−0.011	−0.305	−0.192	−0.583	−0.868	−0.582
	(0.260)	(0.978)	(0.316)	(0.375)	(0.115)	(0.001)***	(0.029)**
CFPCode	0.020	0.432	−0.661	0.459	0.088	0.203	−0.265
	(0.918)	(0.230)	(0.005)***	(0.047)**	(0.711)	(0.014)**	(0.169)
LiquidAssets	−0.105		0.092	−0.473	0.147	0.203	0.119
	(0.169)		(0.163)	(0.000)***	(0.116)	(0.303)	(0.169)
Income	0.057	0.304	−0.029	−0.006	−0.017	0.231	0.004
	(0.382)	(0.029)**	(0.665)	(0.929)	(0.848)	(0.785)	(0.952)
Constant	1.904	1.431	2.376	2.328	1.330	1.673	1.853
	(0.000)***	(0.131)	(0.000)***	(0.000)***	(0.079)*	(0.010)***	(0.003)***
Observations	79	79	79	78	79	72	72
Prob > F	0.0489**	0.0010***	0.0066***	0.0000***	0.0002***	0.0023***	0.0363**
R^2	0.1278	0.2345	0.2268	0.4127	0.2698	0.2071	0.1194

Note. The dependent variables are as follows: The existence and enforcement of a budget in model 1, the amount of liquid assets in Model 2, the assessment of insurance needs in Model 3, the amount of credit card debt in Model 4, and the existence of an estate plan in Model 5. Models 6 and 7 break the existence of an estate plan into the questions whether the spouse knows about how to access financial information in case of the advisor's death, and whether the advisor knows how to access the spouse's financial information in case of his or her death.

Independent variables are as follows: male is equals 1 and otherwise, 0. Age is represented by a code from 1 to 5 where one is less than 35, two is 36-45, three is 46-64, four is 55-64, and five is over 65. MarriageStatus is equal to 1 if married and 0 otherwise. AdvisorType is equal to 1 if the person is a comprehensive financial planner and 0 otherwise. CFPCode is equal to one if the person is a CFP and 0 otherwise. Liquid assets range between 1 to 5, depending on the amount of available assets. One is less than \$3,000, two is between \$3,000-\$10,000, three is \$10,000-\$20,000, four is \$20,000 to \$50,000, and five is more than \$50,000. Income is a range between one and five where one represents less than \$50,000 per year, two represents \$50,000-\$100,000, three represents \$100,000-\$150,000, four represents \$150,000-\$200,000, and five represents more than \$200,000.

Table 3 Professional services

Variables	Model 1 coefficient *p*-Value	Model 2 coefficient *p*-Value	Model 3 coefficient *p*-Value
TaxPerson		−2.501	−0.141
		(0.001)***	(0.012)**
Gender	0.168	0.351	−0.143
	(0.147)	(0.488)	(0.514)
Age	0.013	−0.129	−0.003
	(0.785)	(0.559)	(0.886)
MarriageStatus	0.054	−0.338	−0.344
	(0.792)	(0.640)	(0.674)
AdvisorType	0.213	0.067	0.126
	(0.149)	(0.902)	(0.240)
CFPCode	−0.221	0.604	−0.007
	(0.070)*	(0.311)	(0.911)
LiquidAssets	0.089	−0.547	0.001
	(0.039)**	(0.006)***	(0.939)
Income	−0.014	0.263	−0.006
	(0.768)	(0.195)	(0.767)
Constant	1.264	6.852	0.674
	(0.006)***	(0.002)***	(0.733)
Observations	114	111	111
Prob > F	0.0101**	0.0001***	0.3786
R^2/Pseudo	0.1286	0.2185	0.971

Note. The dependent variables are as follows: In Model 1, the dependent variable is the amount of time spent on advisor investments compared with client investments. Model 2 explores the tax preparation strategies of advisors and Model 3 explores which advisors have their own financial advisors (where 1 equals having an outside advisor and 0, otherwise).

Independent variables are as follows: TaxPerson equals to one if the advisor is also a CFP or EA and 0 otherwise, Gender is represented by male that equals 1 and otherwise, 0. Age is represented by a code from 1 to 5 where one is less than 35, two is 36-45, three is 46-64, four is 55-64, and five is over 65. MarriageStatus is equal to 1 if married and 0 otherwise. AdvisorType is equal to 1 if the person is a comprehensive financial planner and 0 otherwise. CFPCode is equal to one if the person is a CFP and 0 otherwise. Liquid assets range between 1 to 5, depending on the amount of available assets. One is less than \$3,000, two is between \$3,000-\$10,000, three is \$10,000-\$20,000, four is \$20,000 to \$50,000, and five is more than \$50,000. Income is a range between one and five where one represents less than \$50,000 per year, two represents \$50,000-\$100,000, three represents \$100,000-\$150,000, four represents \$150,000-\$200,000, and five represents more than \$200,000.

information in case of the advisor's death, and whether the advisor knows how to access the spouse's financial information in case of his or her death.

Overall, we find a direct relationship between age and preparedness for retirement. Older advisors are more likely to have higher liquid assets and have an estate plan in place. They are also less likely to follow a budget, which is understandable given the higher resources and experience. Both age and liquidity are associated with higher income.

It is notable that having a CFP designation is less likely to be associated with having assessed the advisor's own insurance needs. This could have two explanations. It is possible that advisors who work in insurance are more likely to buy insurance and those advisors are less likely to have a CFP designation. Or, it is possible that the CFP designees are younger and do not have the same need for life insurance. This is a point that requires further analysis and investigation.

We are not surprised to find a very strong positive association between age and having an estate plan, but it is surprising to see the relationships when we break the plan into Models 6 and 7. In case of the advisor's death, the spouses who are prepared to take over the financial affairs seamlessly are those who have married a CFP who considers themselves a comprehensive financial planner. This result carries over to the opposite scenario, the untimely death of the non-advisor spouse and the ability of the advisor to be able to access the deceased spouse's accounts. This result is particularly encouraging as it shows that getting comprehensive financial planning could lead to efficiency benefits beyond finances. Advisors who look at the big picture are more likely to have conversations with their clients about such scenarios, and as a result, leave the clients better prepared to deal with unforeseen events.

Table 3 presents the results of more specific questions. In Model 1, the dependent variable is the amount of time spent on advisor investments compared with client investments. Model 2 explores the tax preparation strategies of advisors, and Model 3 explores which advisors have their own financial advisors.

We find that advisors who do not have tax certifications are less likely to do their own taxes. Although these results can be explained, they are still surprising as many advisors do have more tax expertise than the average adult. Additionally, advisors who have more liquid assets are less likely to prepare their own taxes. This might imply that the value of time an advisor puts on his or her own time is more than the time spent on preparing the tax return.

We are not able to draw any conclusions about the use of financial advisors because (1) a small subsample of the advisors uses a third party for their own financial planning, and (2) with a F value of 0.3786, the overall model is not significant. Only 9.64% of respondents identified as having a financial advisor, a number that we suspect is higher than the actual industry representation. Univariate analysis shows that those advisors also tend to have their estate plan in place, have a significant amount of liquid assets, and tend to budget consistently. About half of them are fee-only advisors, and about half have a CFP designation. Their income ranges widely, from less than $50,000 per year to over $200,000.

3.3. Additional questions

One of our goals is to gather more information about the type of financial decisions in which advisors' actions diverge from what they tell their clients. As a result, we asked if respondents had ever made personal decisions contrary to advice they give their clients. From the 116 advisors who answered this question, 50% answered yes. We categorized the answers along investment issues, debt issues, and liquidity issues. 51% of the answers referred to investment decisions, 12% can be categorized as a debt issue, 17% revolve around a liquidity issue, and 20% can be categorized as "other."

On the investment side, most of the answers involve higher portfolio risk compared with their clients, with as much as 100% in equity and speculative, bitcoin-type investments.

Many advisors pick individual stocks for themselves while investing their clients' assets only in funds. On the liquidity side, the answers oscillate between not having enough and having too much liquidity compared with client advice. The debt responses involve carrying too much credit card debt as well as cashing Roth IRAs and taking 401k loans to pay off debt. Finally, in the "other" category, the answers range from not buying disability insurance to inadequate college planning for children.

When it comes to debt and liquidity, the most common answers were buying houses with low down payments or on a stretched income, buying expensive "dream" cars, taking on credit card debt, inadequate emergency funds, financing children even at the detriment of their own lives, and avoiding debt even when it makes sense to increase debt. Even though advisors are trained to be able to avoid these mistakes, many still commit them. Clients may ask "why hire an advisor if the person won't follow his or her own advice?" Ross (2013) argues investment advisors should acknowledge their fallibility and uncertainties regarding financial markets to their clients.

3.4. Implications and conclusion

Although very few survey respondents choose to retain a financial advisor, we still strongly believe in the value of financial advice and our recommendation is that the advisors themselves should have their own advisors. There is an enormous psychological component when it comes to dealing with financial choices and having a third party who can offer an independent assessment is invaluable.

Overall, we find that advisors do largely follow their own advice when dealing with their personal finances. Although exceptions exist, as a group they are more likely to be prepared for retirement, have less debt, higher liquidity, covered insurance needs, and an estate plan in place. We suggest that the general population should consider hiring a third-party independent advisor to organize and improve finances.

Our results also point out that the agency problem does not explain advice and behavior of financial advisors. Planners tend to do what they recommend to their clients, and generally follow their own advice. Although much discussion in the financial literature is focused on agency problems and the tensions that exist between conflicts of interest, we do not find support in our analysis. Further study focused on different dimensions of advisor characteristics such as fees, sophistication, and fiduciary status may shed more light on this topic.

Notes

1 https://www.myirionline.org/docs/default-source/research/state-of-the-insured-retirement-industry-20149AACCE1232CA.pdf?sfvrsn=8620a8c1_2

2 See Goetzmann and Kumar (2008), French and Poterba (1991), Grinblatt and Keloharju (2001), and Odean (1998).

3 https://www.prnewswire.com/news-releases/society-of-actuaries-release-new-survey-report-on-retirement-risks-235014281.html

4 See *Journal of Financial Planning*, 28(12), p. 10 (2015) "Succession: Why Aren't Planners Planning?" and *Journal of Financial Planning*, 27(2), p. 10 (2014) "Planners Fail to Plan."
5 Survey is available upon request.
6 Debt.com 2019 budgeting survey.
7 It is important to note that due to omitted variable bias we do not directly compare advisors to the general population; the numbers are presented to put our results in context.
8 GOBankingRates 2019 survey.
9 https://www08.wellsfargomedia.com/assets/pdf/commercial/retirement-employee-benefits/perspectives/ElderNeedsWhitePaper-IRT_WP_ADA.pdf
10 https://www.people-press.org/2013/04/11/a-third-of-americans-say-they-like-doing-their-income-taxes/
11 CNBC and Acorns 2019 "Invest in You" Savings Survey.

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