Financial Advice Market Review

A response from the International Longevity Centre-UK

Dec 2015

The International Longevity Centre - UK (ILC-UK) is an independent, non-partisan think-tank dedicated to addressing issues of longevity, ageing and population change. It develops ideas, undertakes research and creates a forum for debate.

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International Longevity Centre (ILC-UK) Comments

Key findings

- Approximately 18.2 million people took out a financial product between 2010 and 2012, with nearly 3.1 million investing in risky assets.
- In making decisions about financial products, consumers reported being influenced by a number of sources:
    - 6.1 million people were influenced by "Best buy information, comparison website or shopped around a lot of different sources";
    - Approximately 2 million were influenced by an "Independent Financial Adviser" (IFA);
    - Roughly 3.9 million were influenced by "Information collected from providers or providers websites";
    - About 1.7 million were influenced by friends or family;
    - Most worryingly, 2.7 million people took out a financial product in the last two years without collecting any information at all.
- The general perception that women do not seek financial advice may be incorrect. When women do take out financial products, their choices are as likely to be influenced by an adviser as any men's choice.
    - However, women are also less likely to use best buy websites and shop around, while they are more likely to rely on friends and family they or to avoid collecting any information.
- The demand for independent financial advice is mainly driven by trust.
- Older (age 55+) consumers are significantly more likely to be influenced by IFAs or providers, than best buy information on websites.
- The oldest consumers (aged 75+) are less likely to collect any information than any other age group.
- Advice may only partly benefit those who need it the most: while consumers who report "saving for retirement" as their primary financial need are more likely to seek advice, those who are burdened by debt do not reach out.
- Financially capable consumers are less likely to let their financial choices be influenced by friends and relatives, information received by post, or adverts. Conversely, they are more likely to use best buy information websites and shop around than rely on IFAs and providers.
- Homeowners are more likely to be influenced by IFAs than by their own product provider.

Background

While some financial decisions, such as saving for a short term goal, may be seen as relatively simple, others, such as saving for retirement or using pensions, savings, investments or home equity to provide an income in retirement, are incredibly complex and require a level of financial sophistication that most consumers simply do not have. When faced with such complex choices, consumers need the right help from the financial services industry. And yet for many years, financial advice has been the preserve of the few not the many.

Arguably, the need for financial advice has become even more pronounced in the wake of the recent pension freedoms. Individuals on the verge of retirement have been given more flexibility in how they use their defined contribution pension savings, but as evidence from other countries where similar freedoms are in place has shown, this kind of freedom can lead to worse outcomes. In failing to annuitise some individuals may spend their savings too early facing income shortfalls in later life, while others, who are afraid of using up all their savings, under-consume during retirement. Retirement planning is not easy. Financial guidance may help to avoid the worst outcomes, but generic information online, over the phone or face to face may not be enough.

The ILC-UK has been leading the way in understanding the challenges of retirement planning in the wake of the new pension freedoms. We have used a mixture of research methods to explore what consumers want their pension wealth to deliver, how consumption patterns and daily activities change

over the course of retirement, the risks facing different consumer segments who have DC pension pots and some useful rules of thumb that could help individuals plan for the long-term.

Which consultation questions are we responding to?

The Financial Advice Market Review (FAMR) launched a call for evidence "to improve the availability of advice to people, particularly those who do not have significant wealth or income".

In particular, the FAMR is gathering input on:

- the extent and causes of the advice gap for those people who do not have significant wealth or income
- the regulatory or other barriers firms may face in giving advice and how to overcome them
- how to give firms the regulatory clarity and create the right environment for them to innovate and grow
- the opportunities and challenges presented by new and emerging technologies to provide cost-effective, efficient and user-friendly advice services
- how to encourage a healthy demand side for financial advice, including addressing barriers which put consumers off seeking advice

Our contribution will focus on providing detailed input on a few questions where we can add significant value. We provide some original, hard evidence, gathered from robust analysis of the largest existing dataset on financial wealth in the UK – the Wealth and Assets Survey.

In particular, we respond to the following questions:

- ***Q3: What comments do you have on consumer demand for professional financial advice?***
- ***Q4: Do you have any comments or evidence on the level of demand for advice from sources other than professional financial advisers?"***

Data and methodology

Data

To answer the above questions, we take advantage of the largest and most comprehensive source of information on income, wealth and assets in Great Britain, the Wealth and Assets Survey (WAS). The WAS is a longitudinal survey, which means that the same individuals are followed over time, and it is representative of all private households in Great Britain. For the purpose of our analyses, we focus on data from the 2010 to 2012 Wave and we keep only individuals aged 16+ who completed the entire interview. We are, therefore, left with a remarkably large sample of **37,601** observations.

Methodology for answering the questions

Demand for professional financial advice: The empirical strategy we adopted to answer **Q3** is not straightforward, since the relevant question was only asked to "savers", i.e. to consumers who had bought at least one financial product[1] in the two years preceding the release of the survey, which makes it a non-random sample. For this reason, we had to use a particular statistical technique to correct for sample selection bias[2].

[1] Products are: Investments; Mortgage; Insurance (Life insurance, payment or income protection insurance, critical illness insurance); A credit card; Loan, other type credit agreement; General insurance; A savings account; A current account.

[2] Heckman J (1979) Sample selection bias as a specification error, *Econometrica*, 47, pp. 153-61. Note: Heckman got the Nobel Prize for this paper.

Demand for sources other than financial advisers: As per **Q4**, we bring evidence on why people choose different sources of financial advice by using another statistical technique, specifically designed to model nominal outcome variables.[3]

Our responses to the questions

Q3: What comments do you have on consumer demand for professional financial advice?

How many people have been influenced by a financial adviser?

When considering the demand for financial advice, we decided to look at consumers whose financial choices have been influenced by an Independent Financial Adviser (IFA) rather than by other sources, as opposed to the potential market size based on assessed needs.

According to our analysis of WAS data, more than half of the consumers in our sample (56.5%) have not "personally taken out a financial product in the last two years".

Among the 43.5% who have taken out a financial product in the last two years, approximately 1 in 10 (11.2%) have been influenced by an Independent Financial Adviser (including relatives who are IFAs).

In terms of overall population, this is **equivalent to approximately 2 million people**.

Table 1: Source of information that most influenced decision about product taken out in the last two years.

	Proportions	Population
Influenced by IFA	11.25%	2,054,297
Influenced by other sources/ no sources	88.75%	16,200,000
Total	100%	18,254,297

Source: own estimates from Wealth and Assets Survey 2010/12. Data weighted using cross sectional weights.
Base: only those who took out a financial product in last two years.

What are the main drivers of consumer demand for financial advice?

We focus on the following socio-demographic factors and estimate their impact on how likely it is that a consumer has both taken out a financial product in the last two years and that this choice was influenced by an IFA (**see Appendix A for full results**).

- Gender
- Age categories
- Income (natural logarithm)
- Proxy for financial ability (how accurately consumers know their balance)[4]
- Impatience (prefer £1,000 today to £1,100 next year)
- Being burdened by debt
- Considering IFAs as the most trustworthy source of advice for retirement
- Being a homeowner
- Risk aversion (only for selected sample)

[3] Multinomial logit: the log odds of the outcomes are modelled as a linear combination of the predictor variables. It is equivalent to estimating the ratio of the probability of choosing one outcome category over the probability of choosing the baseline category, or the "relative risk".

[4] To measure financial ability we use a simple proxy, i.e. how accurately respondents know their balance. The underlying idea is that those who know exactly how much they have as opposed to those who have no idea or only a rough idea are also more financially capable.

After controlling for this range of factors, our results suggest that **age, trust and homeownership are key.**

- Gender does not matter: we find that women are as likely to be influenced by IFAs as men.
- Age has a significant positive impact: consumers aged 55+ are more likely to be influenced by IFAs. The impact is strong and large for consumers aged 55-74, but decreases after age 75 (albeit remaining positive).
- Despite the conventional wisdom, after correcting for sample selection bias, income does not really matter.
- Surprisingly, consumers with higher financial ability, captured by how accurately they say they know their balance, are equally as likely as the less able to report being influenced by an IFA.
- Impatience does not seem to matter.
- Consumers who feel heavily burdened by debt are less likely to be influenced by an IFA when taking out a financial product, but the impact is not statistically significant.
- Unsurprisingly, trust in IFAs is the highest predictor of being influenced by an IFA when choosing to take out a financial product, with the probability almost doubling – from approximately 11% to about 22%. In other words, if we pick at random among consumers who took out a financial product in the last two years, we are likely to find that 1 in were influenced by an IFA. However, if we pick at random among those who indicated IFAs as the most trustworthy source of advice for retirement, then approximately 1 in 4/1 in 5 would have taken out a financial product under the influence of an IFA.
- Homeowners are significantly more likely to be influenced by and IFA when choosing to take out a financial product. In other words, while only 1 in 16 renters (who have taken out a financial product) are likely to be influenced by an IFA, the proportion rises to 1 in 8 for homeowners.

In addition to this original analysis, we offer some relevant facts from the literature on financial advice:

- **Advice does not reach those who need it the most**: investors who are at the highest risk of making investment mistakes (least competent/least financially literate) are less likely to seek help from professional advisers. [5]
- **Overconfidence is an impediment to getting advice:** investors who are more optimistic/confident about their ability are less likely to ask for advice.[5]
- **It's all about trust:** investors trust their advisers as they would trust their doctors and are happy to pay their "money doctors" even when their advice is costly, generic, and occasionally self-serving.[6] The Retail Distribution Review has already raised the required qualifications in the industry; however, current levels of professionalisation may still not be high enough if we consider the level of trust some investors put in their advisers.
- **Making financial advice mandatory may not have good results:** experimental evidence from the US showed that unsolicited advice has no effect on investment behaviour – only those who want advice and ask for it will act accordingly.[7]

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[5] Bachmann and Hens, 2015. Investment Competence and Advice Seeking, Journal of Behavioural and Experimental Finance, 6: 27-41.
Calcagno and Monticone, 2015. Financial literacy and the demand for financial advice, Journal of Banking & Finance 50: 363–380
[6] Gennaioli, Shleifer and Vichny, 2015. Money Doctors, The Journal of Finance, 70:
[7] Hung and Yoong, 2010. Asking for Help. Survey and Experimental Evidence on Financial Advice and Behavior Change. RAND WR-714-1.

Q4: Do you have any comments or evidence on the level of demand for advice from sources other than professional financial advisers?

The WAS contains detailed information on the **different sources of advice**.

- Which ONE source of information or advice did you feel most influenced your decision about which [product] to take out?
    a. Best buy information, comparison website or shopped around a lot of different sources
    b. Independent Financial Adviser (including relatives who are IFAs)
    c. Independent information in newspapers, magazines, radio or TV programmes, etc.
    d. Information collected from providers or providers websites
    e. Information about specific products received in the post, or seen or heard on adverts
    f. Friends or family
    g. No information collected at all

Our preliminary results show that **best buy comparison websites are the most popular choice,** followed by information from providers. Approximately 1 in 7 investors did not collect any information and only about 1 in 10 spoke with an IFA, with the proportion 1.7 percentage points higher among women than men (see Table 2).

Table 2: Main source of information that most influenced decision about which product to take out.

	Male	Female	All
Best buy information comparison website or shopped around a lot of different sources	35.6%	31.0%	33.4%
Information from providers	21.9%	21.1%	21.5%
No information collected	14.0%	15.7%	14.8%
Independent Financial adviser	10.8%	11.7%	11.2%
Friends or family	7.6%	11.5%	9.5%
Information received by post	4.8%	5.4%	5.0%
Independent information in newspapers, magazines, radio or TV	5.2%	3.6%	4.4%
Don't know	0.1%	0.2%	0.1%
No answer	0.0%	0.0%	0.0%
Total	100.0%	100.0%	100.0%
Number of observations	8,407	7,972	16,379

Source: own estimates from Wealth and Assets Survey 2010/12. Data weighted using cross sectional weights.
Base: only those who took out a financial product in last two years.

Honing in on those with risky investments

When we focus on a more selected group of consumers, i.e. individuals who have risky investments[8], we see that the proportion of people influenced by IFAs doubles, reaching nearly one in four among women who have investments. By contrast, the proportion of people who rely on best buy information falls (from 35.6% to 24.1% for men and from 31% to 17.9% of women).

The fact that men are more likely than women to use best buy information could be due to two opposing reasons: on the one hand, men are more likely to be financially literate and therefore may feel that they do not need professional advice; on the other, men tend to be overconfident, and overestimate their level of knowledge, and this can also lead to a lower propensity to use advisers.

[8] By investments we mean an equity ISA, PEP, unit trust or investment trust, investment bond, stocks and shares or an endowment policy that was not linked to a mortgage.

Table 3: Main source of information that most influenced decision about which product to take out. (Only consumers who have risky assets)

	Male	Female	All
Independent Financial adviser	22.2%	24.6%	23.3%
Information from providers	21.6%	22.4%	22.0%
Best buy information comparison website or shopped around a lot of different sources	24.1%	17.9%	21.1%
Friends or family	9.1%	14.6%	11.8%
Independent information in newspapers, magazines, radio or TV	13.2%	8.7%	11.1%
No information collected	7.0%	8.3%	7.6%
Information received by post	2.6%	3.3%	3.0%
Don't know	0.1%	0.2%	0.2%
Total	100.0%	100.0%	100.0%
Number of observations	1,791	1,619	3,410

Source: own estimates from Wealth and Assets Survey 2010/12. Data weighted using cross sectional weights.
Base: only those who invested in equity ISA, PEP, unit trust or investment trust, investment bond, stocks and shares or an endowment policy that was not linked to a mortgage in last two years.

What consumer characteristics determine the choice between sources of financial advice?

Best buy information websites appear to be the main source of advice for the majority of people in the UK. However, not all consumers rely on best buy websites when taking out a financial product, and we can identify some individual characteristics that predict different choices.

We focus on the following socio-demographic factors and estimate their impact on the probability of choosing the baseline category, in this case "best buy information", versus the probability of choosing another source (IFAs, providers, friends or family, etc.):

- Gender;
- Age categories;
- Income (natural logarithm);
- Proxy for financial ability (how accurately consumers know their balance);[9]
- Impatience (prefer £1,000 today to £1,100 next year);
- Being burdened by debt;
- Considering IFAs as the most trustworthy source of advice for retirement;
- Being a homeowner;
- Risk aversion;

Our results show that:

1. When choosing between best buy comparison websites, providers information and IFAs, women are more likely to be influenced by IFAs. However (and possibly worryingly), women often responded either "friends or family" or "no information collected" as the source which influenced the choice of a financial product.
2. Consumers aged 55+ are significantly less likely to be influenced by best buy comparison websites, and to a certain extent less likely to be influenced by providers, than IFAs.

[9] To measure financial ability we use a simple proxy, i.e. how accurately respondents know their balance. The underlying idea is that those who know exactly how much they have as opposed to those who have no idea or only a rough idea are also more financially capable.

3. Consumers aged 75+ are the least likely to rely on best buy comparison websites and the most likely to be influenced by information received by post and by friends and family.
4. Consumers with higher income are less likely to be influenced by friends or family, but equally as likely to be influenced by best buy information, IFAs or providers.
5. Consumers with higher financial ability are significantly more likely to consult best buy comparison websites and less likely to consult friends or family.
6. Impatient consumers – those who would rather have £1,000 today than £1,100 next year – are significantly more likely to report that they collected no information at all.
7. Similarly, consumers who feel burdened by debt are more likely to report that they collected no information.

Please see **Appendix B** for a full breakdown of our results.

It is also worth pointing out that, among consumers who felt burdened by debt (approximately 17% of the sample), only about 1 in 8 (or 12.7%) received any advice at all to help them deal with their debts. Among those who sought for advice, 3 in 5 received advice from a free agency, such as Citizens Advice Bureau, money advice centre, debt advice agency, law centre, consumer credit counselling service, and National Debtline.

Who needs financial advice (but isn't getting it)?

In light of our results, we would like to emphasise the following issues:

IFAs are influential, but not as much as best buy websites

Independent financial advisers are an influential source of information for a large number of consumers - approximately 2 million people. However, the influence of best buy comparison websites is three times as large, with over 6.1 million people referring to them when taking out a financial product. The good news is that those people shop around, and may therefore get better deals. The bad news is that information on best buy websites tends to be generic and may not be appropriate for consumers with complex needs.

Financial ability or overconfidence?

Consumers who are most financially able, i.e. those who report that they know exactly how much they have in their bank account, are also more likely to choose DIY financial solutions, by surfing best buy websites or shopping around. For these consumers, technological innovations, such as robo-advice, may be the best solution.

Targeting women and older consumers

The number of people not collecting any information or relying on friends and family before taking out a financial product is large – about 4.4 million. Among them, older consumers (aged 75 plus) tend to be over-represented. Older consumers are also more likely to be influenced by product related information received by post or by adverts, which makes them particularly vulnerable to scams.

Independent Financial Advice may only partly be used by those who need it the most.

Saving for retirement and managing debt are particularly complex financial tasks, for which consumers may need professional help. However, while consumers who aim to save for retirement may be more aware of the complexity of their needs and reach out to financial advisers, those who are burdened by debt try to manage on their own and do not reach out. Indeed, despite the broad availability of free debt counselling, only 1 in 8 consumers burdened by debt seek any advice at all.

Appendix A: Drivers of consumer demand for IFAs

VARIABLES	(1) Influenced by IFA	(2) Selection: taken out financial product in last 2 yrs
Female	0.008	-0.205***
	(0.008)	(0.015)
Age group (35-54= baseline)		
16 to 34	0.004	0.026
	(0.008)	(0.023)
55 to 74	0.030***	0.025
	(0.006)	(0.018)
75 and over	0.017*	-0.097***
	(0.010)	(0.025)
Log Income	0.005	0.105***
	(0.004)	(0.005)
Proxy for financial ability		
How accurately know balance: I have a rough idea	0.012	0.363***
	(0.016)	(0.031)
How accurately know balance: I know exactly	0.013	0.420***
	(0.017)	(0.031)
Impatient	-0.011	-0.130***
	(0.007)	(0.017)
Burdened by debt	-0.011	0.103***
	(0.007)	(0.019)
Trust in IFA	0.112***	0.169***
	(0.007)	(0.016)
Homeowner	0.055***	0.322***
	(0.012)	(0.018)
Risk aversion (risk neutral= baseline)		
Take risks to get good return = Agree Strongly		0.128***
		(0.030)
Take risks to get good return = Agree		0.199***
		(0.019)
Take risks to get good return = Disagree		0.278***
		(0.023)
Take risks to get good return = Disagree strongly		0.074
		(0.048)
Constant	-0.052	-1.586***
	(0.080)	(0.061)
Observations	30,648	30,648
Censored observations	14,838	14,838
Uncensored observation	15,810	15,810
Wald (χ^2)	425.9	425.9
λ		0.025
		(0.043)

Standard errors in parentheses
**** p<0.01, ** p<0.05, * p<0.1*

Appendix B: Drivers of consumer choice between sources of financial advice

Baseline outcome = Best buy info	**IFAs**	**Media**	**Providers**	**Post/ adverts**	**Friends and family**	**No info collected**
Female	0.254***	-0.083	0.139***	0.226***	0.629***	0.230***
	(0.055)	(0.077)	(0.046)	(0.078)	(0.065)	(0.052)
Age group (35-54=baseline)						
16 to 34	0.007	-0.884***	-0.119*	-0.264*	0.585***	-0.177**
	(0.090)	(0.192)	(0.070)	(0.138)	(0.090)	(0.083)
55 to 74	0.530***	0.922***	0.277***	0.678***	0.399***	0.404***
	(0.064)	(0.092)	(0.053)	(0.095)	(0.079)	(0.062)
75 and over	1.124***	1.638***	0.906***	1.636***	1.542***	1.601***
	(0.106)	(0.130)	(0.090)	(0.131)	(0.110)	(0.091)
Log income	0.019	0.015	0.014	-0.087***	-0.076***	-0.036**
	(0.024)	(0.035)	(0.017)	(0.022)	(0.018)	(0.017)
Financial ability						
How accurately know balance = I have a rough idea	-0.200	0.163	-0.185	-0.411**	-0.945***	-0.453***
	(0.141)	(0.217)	(0.116)	(0.179)	(0.128)	(0.121)
How accurately know balance = I know exactly	-0.243*	0.264	-0.206*	-0.474***	-1.154***	-0.554***
	(0.141)	(0.217)	(0.117)	(0.179)	(0.130)	(0.121)
Impatient	-0.035	-0.261***	0.015	0.160*	0.073	0.203***
	(0.059)	(0.080)	(0.051)	(0.092)	(0.073)	(0.061)
Burdened by debt	-0.081	-0.071	0.117**	0.078	-0.079	0.125*
	(0.071)	(0.106)	(0.056)	(0.100)	(0.080)	(0.064)
Trust in IFA	0.935***	-0.059	0.008	-0.107	-0.281***	-0.101*
	(0.057)	(0.078)	(0.046)	(0.082)	(0.066)	(0.054)
Homeowner	0.325***	0.062	-0.215***	-0.592***	-0.541***	-0.636***
	(0.089)	(0.117)	(0.061)	(0.095)	(0.077)	(0.065)
Risk aversion						
Take risks to get good return = Agree Strongly	0.209**	0.146	-0.233**	-0.391**	-0.330**	-0.220**
	(0.107)	(0.146)	(0.093)	(0.175)	(0.134)	(0.108)
Take risks to get good return = Agree	0.124*	0.032	-0.043	-0.054	-0.123	-0.097
	(0.074)	(0.103)	(0.060)	(0.101)	(0.081)	(0.068)
Take risks to get good return = Disagree	0.021	-0.007	-0.010	0.076	-0.024	0.041
	(0.090)	(0.123)	(0.071)	(0.117)	(0.094)	(0.079)
Take risks to get good return = Disagree strongly	0.242	0.129	0.071	0.324	0.257	0.450***
	(0.212)	(0.276)	(0.168)	(0.253)	(0.209)	(0.170)
Constant	-2.154***	-2.471***	-0.399*	-0.700**	0.235	0.046
	(0.296)	(0.427)	(0.220)	(0.305)	(0.246)	(0.227)
Observations	15,810					
Pseudo R^2	0.034					

Robust standard errors in parentheses
**** p<0.01, ** p<0.05, * p<0.1*

About the International Longevity Centre – UK (ILC-UK)

The International Longevity Centre – UK (ILC-UK) is an independent, research led, think-tank dedicated to addressing issues of longevity, ageing and demographic change. We develop ideas, undertake research and create a forum for action and debate.

The ILC-UK was established in 2000 to explore and address the new longevity revolution and its impact on the life-course and society. It provides the visionary approach needed for individual and societal planning to ensure a progressive, economically viable and socially inclusive tomorrow for all.

Based in Westminster, much of our work is directed at the highest levels of government and the civil service, in London, local government and Brussels. We have a reputation as a respected think-tank which works, often with key partner organisations, to inform important decision-making processes. We are aided in this work by our Chief Executive, Baroness Sally Greengross, former director-general of Age Concern and now a cross-bench peer.

Our policy and research remit is broad, and covers everything from pensions and financial planning, to health and social care, housing design, and age discrimination. We work primarily with central government, but also actively build relationships with local government, the private sector and relevant professional and academic associations.

Partners Programme

International Longevity Centre - UK

The ILC-UK Partners Programme

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If you are interested in finding out more about our Partnership programme or becoming a Partner, please David Sinclair at davidsinclair@ilcuk.org.uk