Putting Your Money Where Their Mouth Is: Financial Advisors’ Conflicts of Interest and the Limits of Disclosure

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Disclosure: a solution to COIs?

- Financial regulators advocate disclosure
  - SEC (USA), FSA (UK), AMF (France)

- Medicine
  - American Medical Association, MedPAC, Physician Payment Sunshine Act
Why is disclosure so popular?

- Consumers make informed decisions
  - Decreases information gap

- Advisors
  - For regulated, often lesser of evils
  - May limit firms’ and regulators’ liability -- ‘Caveat Emptor’

- Perceived to work!

But does it?
Disclosing a conflict of interest

“Under disclosure rules, I’m required to tell you that I get paid by the fund manager whose investment I’m recommending to you.”
Increased pressure to comply

- Advisor discloses:
  "I personally gain if you do X rather than Y"

- Consumer hears:
  "Please do X because it will benefit me"
Hypotheses: The burden of disclosure

H1: With disclosure, the consumer will trust advice less.

H2: With disclosure, the consumer feels increased pressure to act in the advisor’s disclosed interest.
Lottery studies


- Choosers: pick between two different die roll lotteries, A or B
  - Advisors gave choosers advice on which one was best (A was more attractive)
Lottery studies

- Conflict of Interest: Advisors rewarded if choosers decide to roll inferior die B
  - “Disclosure” condition
  - “No Disclosure” condition

- No-conflict condition
With COI and disclosure, MORE likely to take biased advice

n= 76 advisors, \( p < .01 \)

<table>
<thead>
<tr>
<th>No disclosure</th>
<th>Disclosure</th>
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<td>52%</td>
<td>81%</td>
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Opposing forces act on chooser

All p’s < .01

Strongly disagree (1) to strongly agree (5)

Pleased

Trust

Help advisor

Rejection discomfort

No disclosure

Disclosure
External vs. Personal disclosure

- Conditions:
  - Personal Disclosure from Advisor
  - External Disclosure from third party
External disclosure reduces compliance

% choosers picking inferior die-roll, B

- External Disclosure: 52%
- Personal Disclosure: 84%

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No difference in trust for different sources of disclosure

Trust

Strongly disagree (1) to strongly agree (5)

- External Disclosure
- Personal Disclosure

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Increased pressure to comply

Help advisor

Rejection discomfort

Strongly disagree (1) to strongly agree (5)

External Disclosure

Personal Disclosure
Additional studies

- External Disclosure: Not common knowledge
- Private decisions
- Opportunity to change mind - ‘cooling off’ period

Further research

Disclosure → advisors more reluctant to expose themselves to COIs so that they have “nothing to declare”?

- Disclosure may work best when it changes the behavior of advisors

Conclusions

- Disclosure is popular
- Some benefits
  - Decreases trust

- But distrust happens in a relationship
  - Burden – increased pressure to comply
  - Social component
Thank you!
Research papers


Research papers available at: [www.sunitasah.com/research](http://www.sunitasah.com/research)