INVESTORS' BEHAVIOR AND PORTFOLIO RISK ADJUSTMENTS: A COMPARISON BETWEEN TWO DIFFERENT CHANNELS OF FINANCIAL ADVICE

Andrea Lippi, Università Cattolica of Sacro Cuore – Piacenza, Italy
Simone Rossi, Università Cattolica of Sacro Cuore – Piacenza, Italy

dx.doi.org/10.18374/IJBR-22-2.10

ABSTRACT

Employing a unique dataset of real-world mutual fund portfolio choices made by more than 3,000 Italian investors over a period of 13 years, this paper aims to test whether the portfolio risk level of investors who have a tied agent as their financial advisor is similar to that of those who have a bank employee as their financial advisor. Despite the theoretical presence of an agency problem between tied agents and investors, our results show that investors who have a tied agent as their financial advisor have lower portfolio risk levels compared with those who have a bank employee as their financial advisor.

Keywords: *financial advice; financial advisory; decision making; mutual funds*

1. INTRODUCTION

Financial advice tends to involve agency problems between advisors and customers (Inderst and Ottaviani, 2009): the former need to sell financial products while at the same time they have to advise the latter on what their best course of action is. In the mutual funds market, conflicts of interest between clients and their brokers have been empirically demonstrated by Bergstresser et al. (2009).

The authors compared the performance of mutual funds sold directly to investors versus those sold through brokers and found that the returns on mutual funds offered through brokers are lower, even before accounting for the distribution fee; moreover, these products do not have a superior aggregate market timing ability, and provide the same return-chasing attitude as observed in direct-channel funds. Not surprisingly, funds with higher distribution fees reveal higher underwriting volumes; it should be noted that financial advisors earn commissions from selling mutual funds and hence they have an incentive to promote such sales. Similarly, Zhao (2003) finds that funds with higher loads tend to receive higher flows.

Italy is a perfect marketplace for testing for the presence of such agency problems in financial advice. In Italy financial advice is provided through two main channels: banks operating through branch employees (henceforth 'bank employees') and banks making use of tied agents (henceforth 'tied agents'), while according to Consob (2019), among retail investors the use of robot advisors and fintech is very limited.

Bank employees receive a monthly salary independent of the type of products sold to investors. Tied agents earn fees related to the type of products proposed and sold to investors; in particular, there is a positive (and high) correlation between the risk level of the products and the level of fees earned. Given this distinction, it is possible to identify an agency problem involving a possible conflict of interest, because with the aim of obtaining personal financial benefit, tied agents could suggest that investors underwrite high risk financial products.

The aim of this paper is to test whether the portfolio risk levels of investors who have a tied agent as their financial advisor are similar compared to those who have a bank employee as their financial advisor. We base our analysis on a unique dataset which accounts for the choices made by over 3,000 Italian investors regarding their mutual fund portfolios from 2004 to 2017. This long time span allows us to examine the behavior of both types of investors 'through-the-cycle', in both favorable and negative macroeconomic conditions.