The Gamma Factor and the Value of Financial Advice

CLAUDE MONTMARQUETTE

CIRANO and University of Montreal

and

NATHALIE VIENNOT-BRIOT

CIRANO

'If it has a price, it must have value'

Outline

Three basic questions:

- The determinants of having a financial advisor

- Assessing the impact of a financial advisor on the value of assets
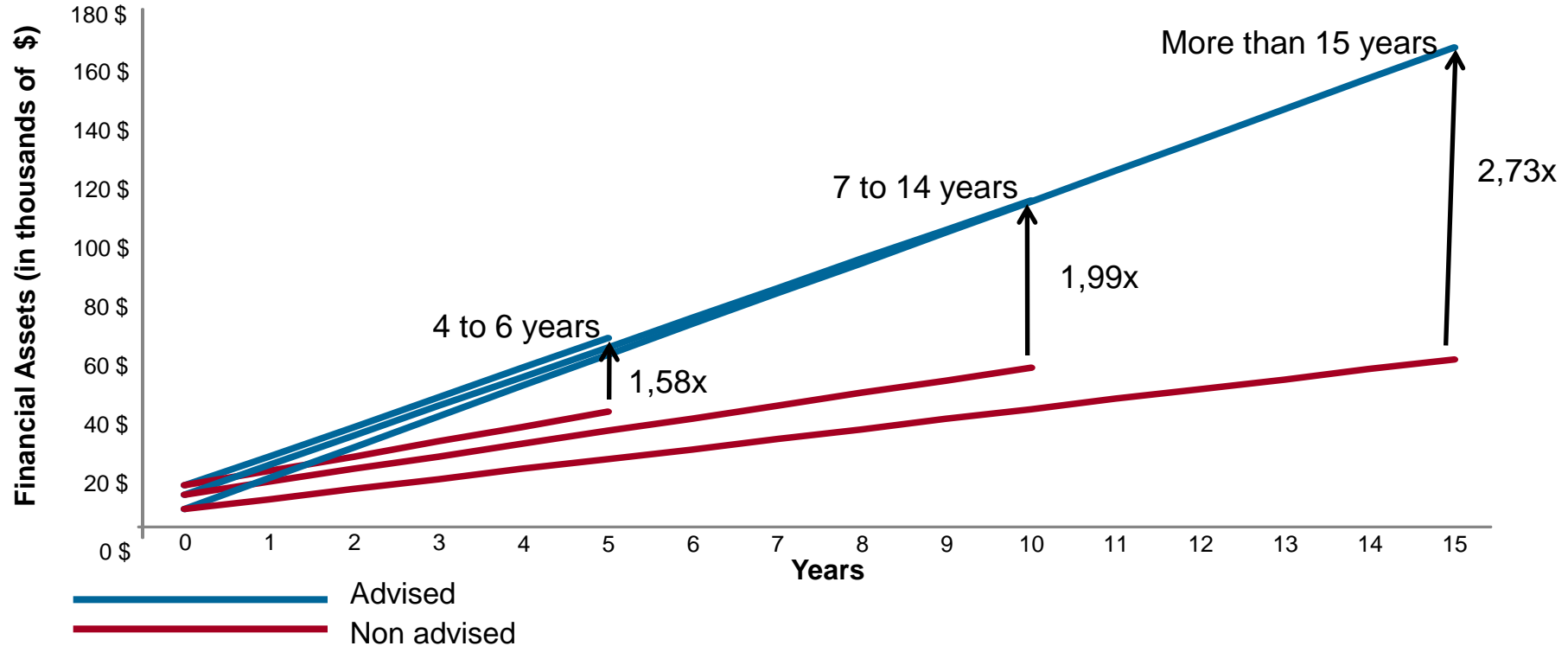
- The gamma factors

Outline

Two issues:

- The causality issue: is wealth attracting advisor or advisor creating wealth

- The survival principle: keeping or dropping the advisor

CIRANO: Measuring the Value of Advice, 2012 Study
Impact of advice on wealth accumulation raises with the duration of advice

Note : Financial assets include cash, GICs, term deposits, stocks, bonds, ETFs, mutual funds and other investments.
Source : CIRANO, *An Econometric Analysis of Value of Advice in Canada, 2012*
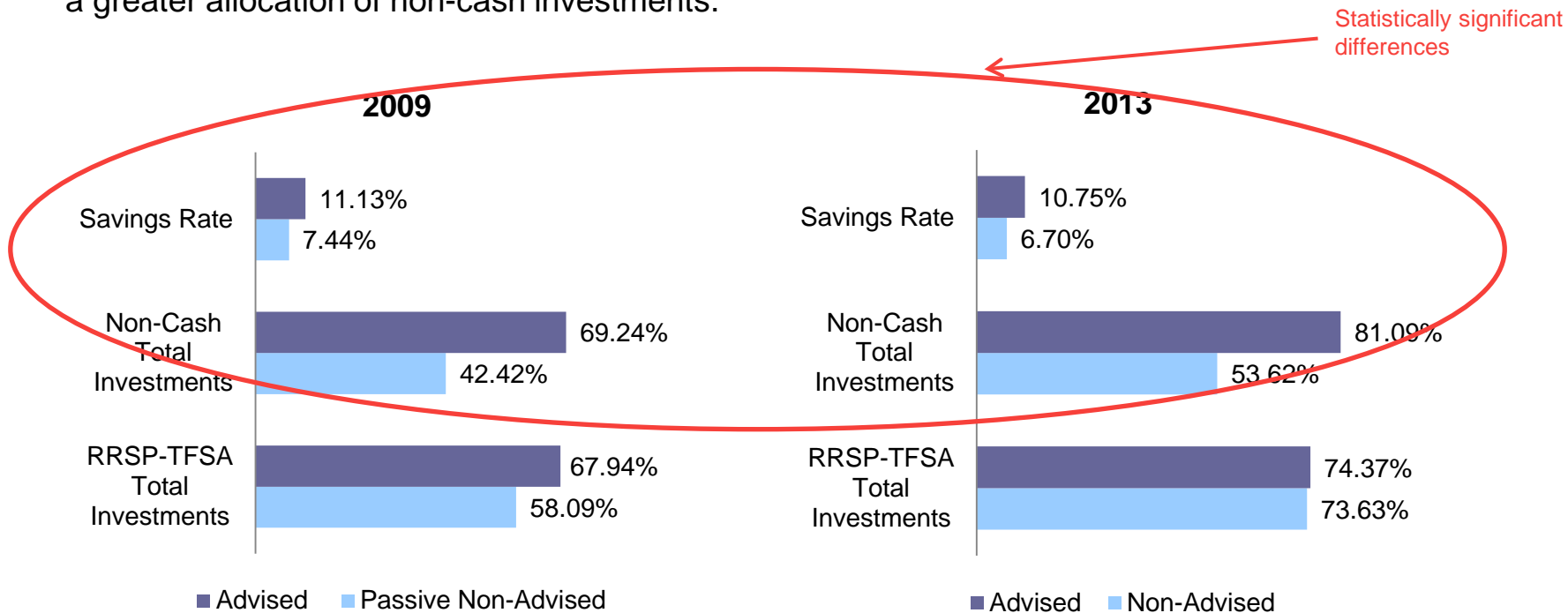
Comparison: 2010 and 2014 Survey Results

- After adjusting for nearly 50 socio-economic and attitudinal differences, investors with advice are found to accumulate 290% more assets after 15 years than comparable non-advised investors.

- By examining results for respondents who participated in both the 2010 and 2014 samples researchers were also able to report that households who dropped their advisors between 2010 and 2014 lost a significant percentage of their asset values while those who continued to be advised gained in asset values.
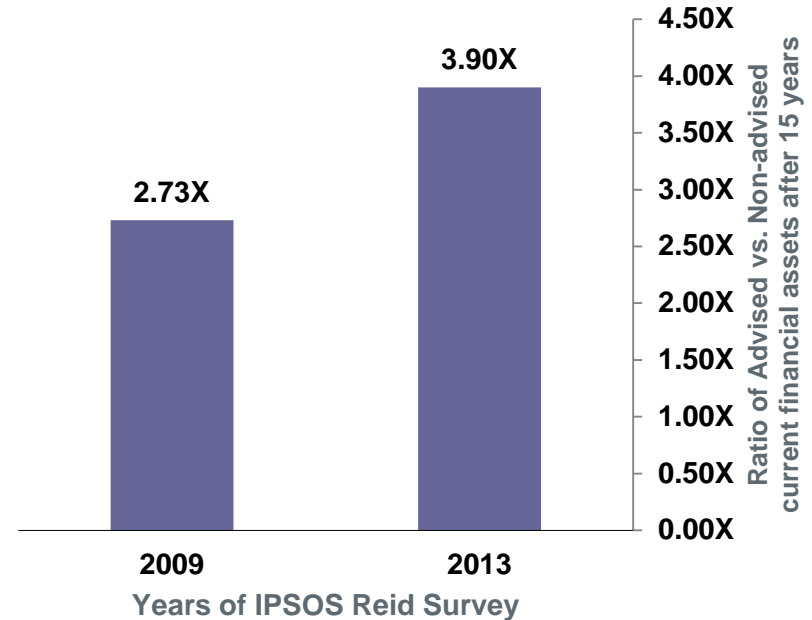
Comparison: 2010 and 2014 Survey Results

The difference in financial assets is explained by higher household savings rates and a greater allocation of non-cash investments.

Statistically significant differences

2009

Savings Rate	11.13% / 7.44%
Non-Cash Total Investments	69.24% / 42.42%
RRSP-TFSA Total Investments	67.94% / 58.09%

■ Advised ■ Passive Non-Advised

2013

Savings Rate	10.75% / 6.70%
Non-Cash Total Investments	81.09% / 53.62%
RRSP-TFSA Total Investments	74.37% / 73.63%

■ Advised ■ Non-Advised

2013 vs 2009

Causality issue: In 2013, we introduce a distinction between households choosing their advisor relatively to households being approached by a financial advisor. We estimate that only 14.71% of households are in that last category. The 2013 analysis concerns households who chose their own advisor

Survival principle: For a sample of 282 households, we have their complete financial information for 2009 and 2013. Some households have dropped their advisor others have finally used the services of an advisor: Evaluating the consequences on their value of assets

Literature Review

- Hermansson and Song (2016) for new references. Discussion on alpha and gamma effects: ….authors found positive value added from financial advice when focusing more on portfolio diversification and help to improve saving discipline than return…

- Hung and Yoong (2010). Policy makers recommending mandatory financial counseling is not a remedy to bad financial behavior; 2) As recipients of advice must be prepared to take profit of counsel.

Descriptive Statistics on the Value of Financial Assets by Category of Respondents

	2009		2013	
	Advised	Non-Advised	Advised not approached	Non-Advised
Observations	1785	1825	487	1097
Median ($)	101000	24000	135000	25000
Mean ($)	193772	93384	273091	79634
Standard Deviation	281874	264005	427866	173901

The mean value of the assets of an household with an advisor is 243% (2013) more than the mean value of assets of households without an advisor. 108% (2009)

Descriptive Statistics on the Value of Financial Assets by Category of Respondents

- In 2013, 30.7% of households have an advisor in our final sample (34.2% including all advisors, a value almost identical with the full sample)

- In 2009, 49% of households had an advisor in our final sample.

$$\mathbf{Pr}\left(FA=1\right)=\mathbf{Pr}\left(x\beta+\eta\right)$$

The Determinants of Having a Financial Advisor (Probit models)

SAMPLE	2009	2013
	FA	FANS
Assets Needed (ln)	(-)	
60000<= income before taxes <90000	(+)	
Income before taxes >=90000	(+)	(+)
savings>0 & savings<=3000	(+)	(-)
savings>3000 & savings<=10000	(+)	
savings>10000	(+)	(+)
Individual has life insurance		(+)
Financial literacy	(+)	
Post-secondary diploma	(+)	(+)
45<= age<54	(+)	(+)
54<=age<65	(+)	(+)
age>=65		(+)

2. Assessing the impact of a financial advisor on the value of assets

$$\ln A_i = y_i\theta + \alpha_0 FA_i + \alpha_1 FA * 4\,to\,6\,years + \alpha_2 FA * 7\,to\,14\,years$$
$$+ \alpha_3 FA * 15\,years\,or\,more + \varepsilon_i$$

$$\ln A_j = y_j\theta + \varepsilon_j$$

Determinants of the (logarithm) Value of Assets (Instrumented linear least squares)

| SAMPLE	2009	2013
	FA	FANS
The household has a Financial advisor (IV**)**	-0.123	0.468***
Financial Advisor X 4 to 6 years	0.456***	0.837***
Financial Advisor X 7 to 14 years	0.687***	0.504**
Financial Advisor X 15 or more years	1.006***	0.894***
35000<= income before taxes <60000	(+)	
60000<= income before taxes <90000	(+)	(+)
Income before taxes >=90000	(+)	(+)
Wages (2010) , Wages and salaries & Self-employment income (2013)		(-)
Fully retired	(+)	
Financial literacy	(+)	(+)
Male	(+)	(+)
45<= age<54	(+)	(+)
54<=age<65	(+)	(+)

Value of Advice

For identical households, those with an advisor for 4 years or less will have 69% more assets (no effect in 2009).

290% more with an advisor for 15 years or more (173% in 2009).

From the descriptive statistics, the mean value of the assets of an household with an advisor is 243% (2013) more than the mean value of assets of households without an advisor.

Savings Discipline and Asset Allocation (mean values)
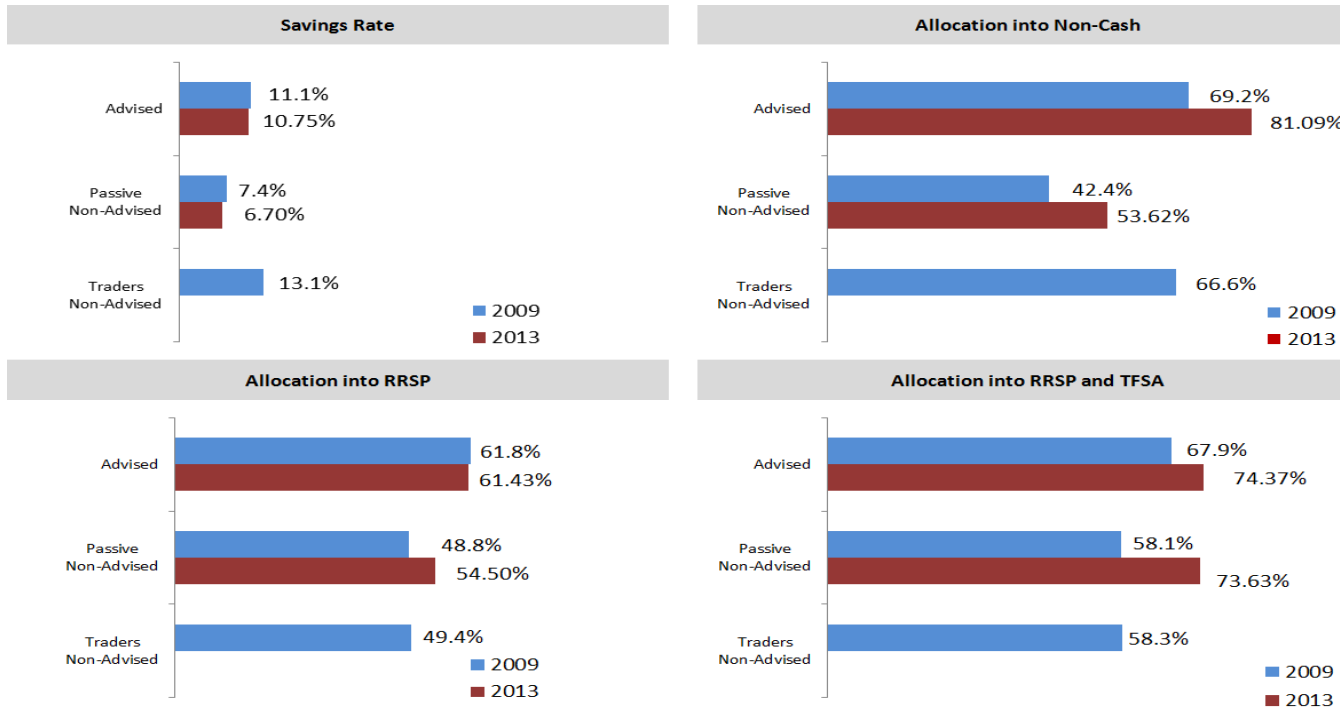
$$\ln(A) = \gamma_0 + \gamma_1 E(savings \ rate) +$$

$$\gamma_2 E(non \ cash \ r) + \gamma_3 E(fiscal \ r) + \mu$$

$$\frac{\Delta ln(A)}{\Delta E(SR)} = \gamma_1 \qquad \frac{\Delta E(SR)}{\Delta FA}$$

- Having an advisor increases the probability of reporting a positive saving rate and the level of the saving rate
    - In 2013, our estimates and computations indicate that the effect of having a financial advisor on the expected savings rate, holding everything else constant, translates into a 20.04 percentage point increase in the expected savings rate. This result is a significant effect.
        - (In 2013, 35% of participants declare a zero saving rate against 13% in 2009).

Savings rate (2009) / Savings rate (2013)
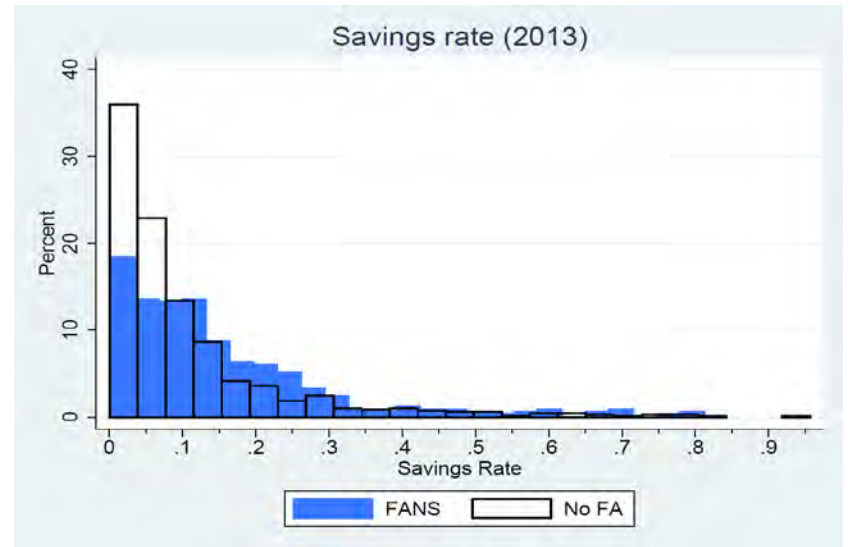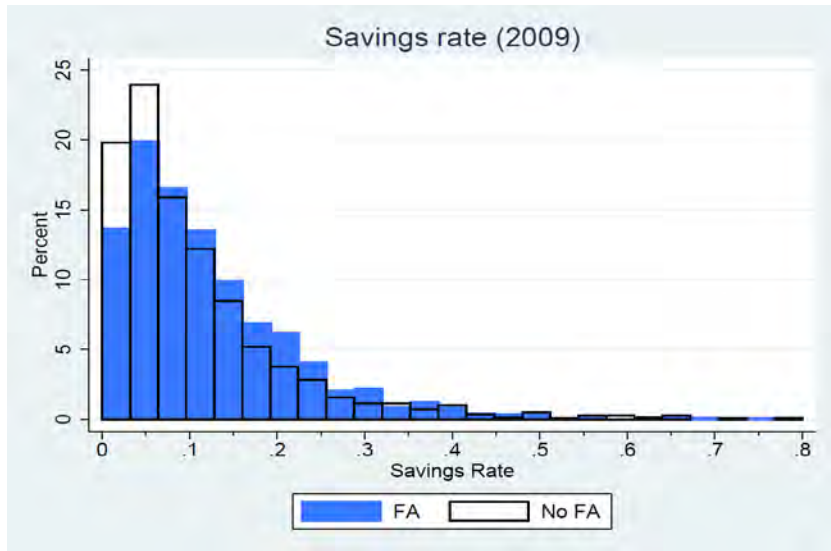
- Repeating the exercise for the expected non-cash ratio and the expected (RRSP+TSA) ratios indicates that having a financial advisor decreases the values of these ratios by 0 and -5.38 percentage points respectively.

- One can infer that for two identical individuals, the one with a financial advisor will have 188 % more financial assets, or 2.88 x the level of financial assets of the non-advised respondent.

- How does the assets value of households that had no financial advisor in 2009 nor in 2013 compares with households who had no financial advisor in 2009 but reported having one in 2013?

- How does the assets value of households that had a financial adviser in both 2009 and 2013 compares with the assets value of households reporting a financial advisor in 2009 but declared not to have one in 2013?

Regressions in the differences in assets value between 2009 and 2013

SAMPLE	All	No advisor in 2009	Advisor in 2009
No more FA	-0.653***		-0.603***
	(0.201)		(0.215)
At last FA	0.133	0.048	
	(0.267)	(0.302)	
Difference between income	4.78e-06	4.15e-06	1.67e-06
	(6.62e-06)	(1.03e-05)	(9.22e-06)
Difference between squared income	7.14e-12	2.10e-11	1.42e-11
	(2.71e-11)	(4.58e-11)	(3.62e-11)
No more wages	0.275	0.007	0.388
	(0.269)	(0.537)	(0.312)
At last wages	-0.389	-0.661	-0.152
	(0.532)	(0.758)	(0.793)
No more working pension	0.624**	0.714	0.563
	(0.273)	(0.461)	(0.355)
At last working pension	0.248	0.171	0.329
	(0.239)	(0.326)	(0.387)

Regressions in the differences in assets value between 2009 and 2013

SAMPLE	All	No advisor in 2009	Advisor in 2009
No more Full time	0.126	0.087	0.207
	(0.148)	(0.230)	(0.207)
At last Full time	-0.824**	-1.260**	-0.318
	(0.413)	(0.597)	(0.629)
No more Fully retired	-1.072	-0.855	
	(0.865)	(1.050)	
At last Fully retired	-0.017	0.416	-0.094
	(0.407)	(0.820)	(0.483)
No more Financial literacy	-0.299	-0.379	-0.258
	(0.224)	(0.353)	(0.311)
At last Financial literacy	0.080	0.129	-0.015
	(0.179)	(0.255)	(0.270)
Change in the composition of the household	0.044	0.017	0.036
	(0.163)	(0.257)	(0.225)
Moved to another province	-0.790*	-0.898*	
	(0.451)	(0.501)	
Constant	0.088	0.186	-0.027
	(0.142)	(0.216)	(0.199)

Comparing…

- The robust results indicate that households who kept their advisor have seen their assets values increase by 26% while the households who dropped their advisor have suffered a loss of 34.2%.

Conclusion

- The determinants of having a financial advisor:
  - Income; financial literacy

- Assessing the impact of a financial advisor on the value of assets:
  - Advice matters; a robust result

- The gamma factors:
  - Discipline and increased saving rate are the key factors associated with valuable financial advice

Conclusion

- **The causality issue:**
  - Not a concern in 2013; validation of our 2013 assumption about the direction of causality

- **The survival principle:**
  - Time is needed to have an impact; dropping her advisor can be costly

Further Research

- More useful to low income households?

- The role of financial literacy.

- 'Asset mix', and its impact on performance, as an additional determinant of the value of advice.

Further Research

- Why some households have dropped their advisor?

- Paying for advice. How and how much?