Trust and financial advice

Vanguard Research

September 2017

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- Advised investors predominantly trust their current financial advisors: Eight in ten give their advisors a high trust rating. However, nearly one-quarter have had an experience that undermined trust in their current or previous advisor.
- Trust in a financial advisory relationship can be divided into three components—functional, emotional, and ethical. Emotional trust has the greatest impact on overall trust, followed by ethical and functional trust.
- Advocating for a client and acting in the client's best interest are the top two drivers of an advisor's trustworthiness. Numerous other attributes are identified as having a significant impact on trust.
- While emotional trust has the largest influence in building trust, a failure in any of the components can compromise trust. Portfolio underperformance, neglecting the relationship, and poor investment choices are some reasons for the breakdown in trust.
- Gaining investors' trust is associated with greater client loyalty and favorable business outcomes for the financial advisor.
- Financial advisors can employ a variety of approaches to manage trust proactively—which can involve standards of ethical and fiduciary conduct, the pricing and quality of products and services, types of compensation arrangements, and a focus on elements of emotional, ethical, and functional trust embedded in their marketing and client experience.

Acknowledgment: We would like to thank Catherine Clinton of Vanguard's Center for Analytics and Insights for her help with the survey logistics.

Introduction

A large majority of investing households in the United States work with a financial advisor or investment professional.[1] By hiring an advisor, investors are taking a leap of faith that the advisor will provide proper guidance and oversight of their finances. The cornerstone of that relationship is the bond of trust between the advisor and client.

Recent history has highlighted the question of trust. For example, trust in financial institutions and markets was likely impaired by the Great Financial Crisis of 2008–2009. The recent debate in a number of countries over the regulation of financial advice was motivated by evidence that investments were sold to investors based on misleading advice and of advisors not acting in their client's best interest. Therefore, trust is an important policy and research question within the financial system, and in the provision of advice to households.

The objective of this paper is to better understand trust in a financial advisory setting by answering the following questions:

1. What are the various components of trust?
2. What attributes are key drivers of trust in an advisory relationship?
3. How is trust undermined?
4. How does the level of trust affect business outcomes for financial advisors?

Trust and financial services

Trust is a key determinant of seeking a financial service professional for advice (Burke and Hung, 2015). Trust requires the acceptance of vulnerability; clients take a risk in depending on someone who is expected to deliver positive outcomes (Rousseau et al., 1998). In the financial services industry, this vulnerability manifests itself not only in the risk of being let down as a person, but also in potential loss of assets. Trustworthiness is established through benevolence or concern about the consumer's interest; integrity; expertise; shared values; and effective communication (Ennew and Sekhon, 2007).

Early in the relationship, trust is based on a calculus or the use of "proof sources." This is where credentials, past performance, and referrals are important. It is followed by relational trust, which develops over time through repeated and reciprocated interactions (Rousseau et al., 1998). In spite of the original motivation for the advisory relationship—improving the investor's financial outcomes—the personal aspect of trust tends to permeate the relationship. There is evidence that investor satisfaction in the advisory relationship tends to come from personal attention rather than from actual financial returns (Hung et al., 2008). Barnett White (2005) also shows that when decisions are emotionally difficult, consumers are more likely to take the advice of benevolent providers rather than the experts.

The importance of trust (or lack of it) has been documented in the financial services industry. For example, lack of trust has been linked to limited stock market participation (Guiso et al., 2008) and decreased 401(k) participation (Agnew et al., 2007). On the other hand, investors who are too trusting can overlook practices that advance advisor self-interest (Gennaioli et al., 2015; Mullainathan et al., 2012).

1 Sixty-six percent of investors with $100,000 or more in investable assets work with a financial advisor or investment professional (Market Strategies International, 2016).

As the role of technology in the financial services industry continues to expand, the nature and role of trust may evolve with it. For example, Botsman and Rogers (2010) see the rising importance of reputation capital—the use of one's reputation as a trust currency—which will be facilitated by technology. In our increasingly online world, product or service reviews are becoming more common, and are usually delivered in real time, to a broader audience. People rely on these reviews more and more when making a purchase decision—part of a movement described as collaborative consumption. This may bring about a scenario where the establishment of trust is based not on personal experience but on the experience of strangers (Botsman, 2016). While this scenario is evident in retail examples like Airbnb and Uber, it raises the question of how the scenario will play out in the financial services industry and, in particular, in the marketplace for personal advice.

Methodology

We designed a two-phase research process.[2] The first phase was qualitative. It involved conducting 18 in-depth interviews of 45 minutes each with advised investors in the United States who were between the ages of 30 and 75. The aim was to gain insight into how trust is built between financial advisors and clients. In particular, we were interested in the way the investors described their trust in their advisors and the factors they associated with it. Phase one was conducted in November 2015.

In the second phase of the research, we conducted a survey of advised investors who had at least $100,000 in investable assets. We wanted to quantify various aspects of the advisor-client relationship as well as investors' experience with building trust (or having it broken). Insights from the qualitative phase were used to design questions that would measure the various factors that are associated with trust, often using the words of the investors themselves. Investors were sourced from an online research panel and 3,955 completed the survey.[3] The data were collected in April 2016.

Measuring trust

In this study, trust is based on the investor's rating of how much trust the investor has in his or her current financial advisor. It is measured on an 11-point scale, ranging from 0 to 10, with 10 being the highest trust rating. A rating of 8 to 10 on this scale is considered high trust, 5 to 7 is medium trust, and 0 through 4 is low trust.

Overall, 81% of the investors surveyed were in the high-trust category (**Figure 1, see page 4**). This is consistent with the fact that these investors are with their current advisors and therefore maintain a trusting relationship with them. However, the level of trust varies by certain demographic characteristics.

Trust is positively related with investor age and tenure with a financial advisor. Seventy-two percent of investors under the age of 50 give their advisors a high trust rating compared with 86% of those age 65 or older. Similarly, high trust in their advisor is found among 65% of investors with less than a year of tenure with their current advisor, but among 89% of those with tenure of 15 years or more. Investors who are more knowledgeable about investments and the financial markets are also more likely to view their advisors as trustworthy compared with those who are less knowledgeable. Trust does not vary significantly by gender or advisor channel.[4]

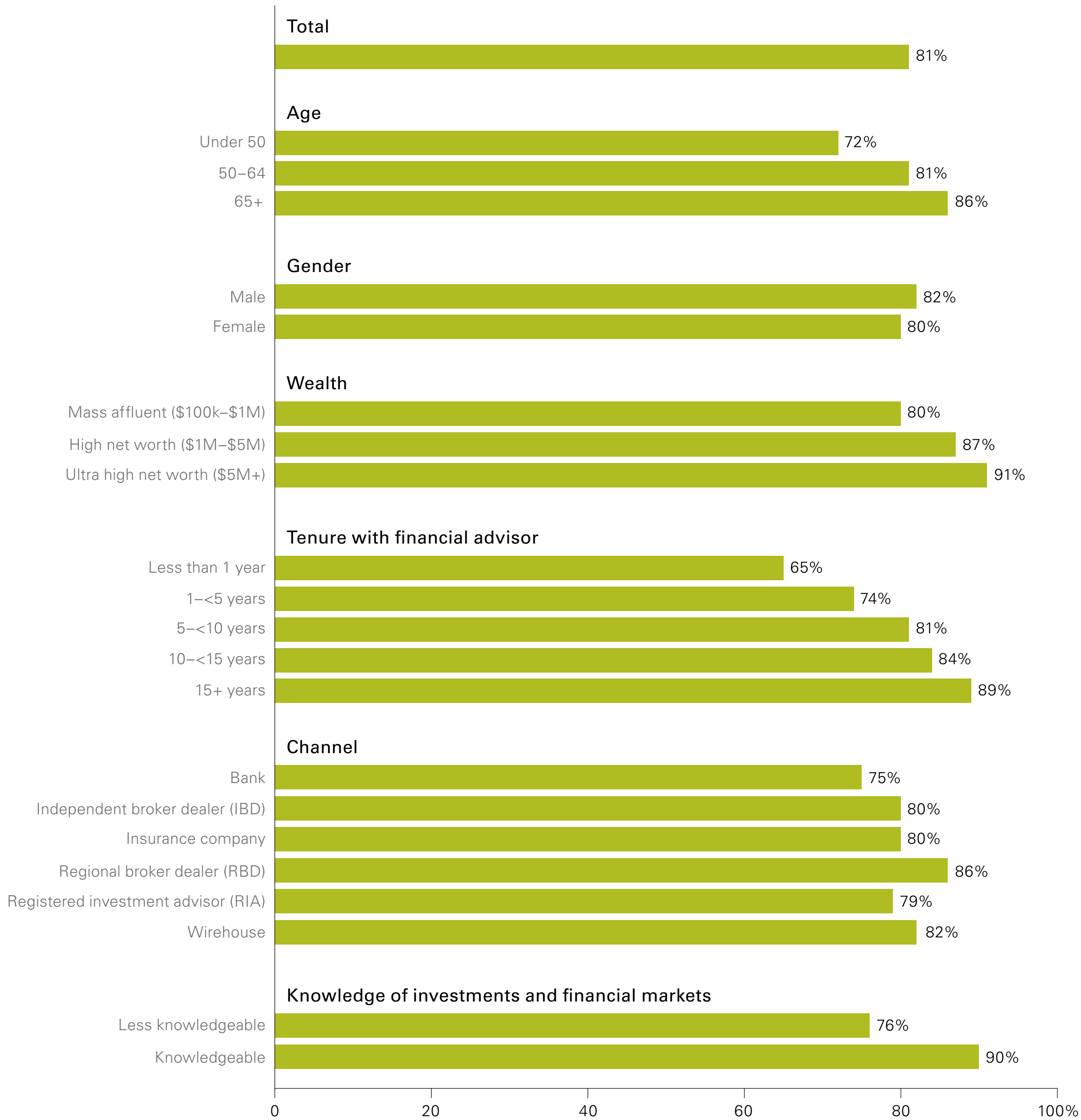
2 The research was conducted in partnership with Chadwick Martin Bailey, Inc., a full-service market strategy firm (cmbinfo.com).

3 The sample included 2,837 mass affluent investors ($100,000 to less than $1 million), 1,018 high-net-worth investors ($1 million to less than $5 million), and 100 ultra-high-net-worth investors ($5 million or more).

4 Trust is related to tenure and the average tenure among our respondents varies slightly by channel. When controlling for tenure, the high-trust measure becomes very similar by channel. The regional broker-dealer channel remains at 86%, but all other channels are equal at 81%. Also, while wealth appears correlated with trust, its independent effect disappears when controlling for age, tenure, and investment knowledge.

Figure 1. Advisor trust by investor demographics

Percentage giving financial advisor a high trust rating



Question: "Overall, how much trust do you have in your current financial advisor?"
Note: High trust is equal to a rating of 8, 9, or 10 on an 11-point scale, where 0 is the lowest and 10 is the highest.
Source: Vanguard, 2017.

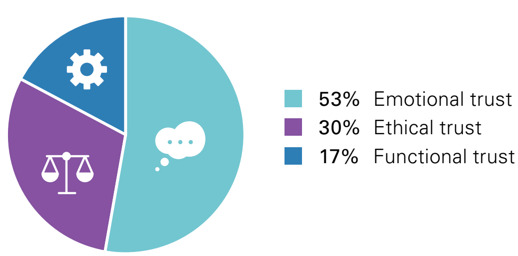
Components of trust

We assessed 32 attributes representing various advisor skills, practices, and behaviors as potential determinants or drivers of trust. We probed natural groupings of these attributes using factor analysis[5] to arrive at the three components of trust. We estimated the relative weight of the components in order to assess their impact on overall trust in a financial advisor.

The attributes tested can be grouped into three categories: functional, emotional, and ethical. We call these the three components of trust (**Figure 2**).

- ***Functional factors*** describe advisors' credentials and skills, and the day-to-day operations of their practice. These include, among other aspects, financial industry qualifications, creation and execution of a financial plan, and proactive communications. Functional trust accounted for 17% of overall trust.
- ***Emotional factors*** are intangible aspects of the relationship between the investor and financial advisor that bring about positive feelings or sensibilities in the investor. Examples would include the investor's being able to say the advisor "is my advocate," "provides a sense of relief," or "makes me feel my portfolio is important." Emotional trust was the largest component, accounting for 53% of total trust.
- ***Ethical factors*** cover practices or behavior that are consistent with socially set expectations of correct conduct. Absence of a conflict of interest, charging reasonable compensation, and acting in the best interest of the client are examples of ethical attributes. Ethical trust represented 30% of overall trust.

Figure 2. Components of trust



Source: Vanguard, 2017.

It may seem counterintuitive that the functional aspects of trust—the aspects directly relevant to the task advisors were hired to do—have the least effect on overall trust. However, it may help to think of functional trust as the first layer of trust that investors place on their advisors. This begins at the advisor selection phase, where trust is based on "proof." Objective, tangible criteria are used to evaluate advisors. This is where advisor credentials and referrals are important, as are activities that get the job done right, such as timely follow-up or response to inquiries.

As the relationship matures, the investing and planning aspect of the relationship becomes routine, or on "maintenance mode." The functional aspects become secondary and the personal aspects, emotional and ethical trust, become more salient. This is where a deeper trust can be cultivated.

Drivers of trust

Putting the components of trust into effect requires knowing the specific qualities or behaviors associated with each type of trust. We began with the 32 attributes, which were grouped into the three trust components (**Appendix 1, see page 11**). For each type of trust, we determined the relative impact of each attribute under it. As an example, we ask, "Which of the functional trust attributes had the strongest contribution to overall trust?" Then we go through the same exercise for emotional trust and ethical trust. At the end of the exercise, we identified the 19 attributes—across the three components—that had a statistically significant impact on overall trust.

Being the client's advocate and acting in the client's best interest are the top two factors that determine overall trust, at 17% and 15%, respectively (**Figure 3, see page 6**). Each has almost twice the influence as the next factor, "Is someone I can relate to." The rest of the attributes have progressively weaker effects on overall trust. Note that the aspect of functional trust with the highest impact on overall trust—having the ability to "conceive, execute, and reassess a financial plan"—is ninth on the list. It is one of the most important reasons for hiring a financial advisor and yet has just a 4% impact on overall trust.

5 Factor analysis seeks to describe a collection of observed variables in terms of a smaller collection of (unobservable) latent variables, or factors.

Figure 3. Nineteen drivers of advisor trustworthiness

Drivers	Advisor trustworthiness: Functional	Emotional	Ethical	Impact
Is my advocate, pursuing my goals almost as if they were his (her) own		✔		17%
Will act in my best interest at all times			✔	15%
Is someone I can relate to or make a connection with		✔		9%
Provides me with a sense of relief and allows me to sleep better at night		✔		7%
Offers products and solutions that are in tune with my financial goals and risk tolerance		✔		7%
Has integrity, acts morally			✔	5%
Gives me time and attention without making me feel rushed		✔		5%
Makes me feel that my portfolio is important, regardless of size		✔		5%
Knows how to conceive, execute, and reassess a financial plan	✔			4%
Is compensated in a reasonable manner			✔	4%
Is able to view the world from my perspective		✔		4%
Willing to admit what he or she doesn't know			✔	4%
Proactively contacts me regarding my investments or portfolio	✔			3%
Has relevant financial industry qualifications	✔			3%
Has no conflict of interest or ulterior motive			✔	3%
Does what he (she) says he (she) will	✔			3%
Shows awareness of trends in the financial markets	✔			2%
Is able to make suggestions on the spot	✔			2%
Is well connected in my community	✔			1%

Source: Vanguard, 2017.

The list identifies the key areas that financial advisors could work on to foster trust with their clients. While emotional and ethical attributes weigh heavily, it is still important to make sure that functional aspects, such as standards for day-to-day operational activities, are maintained.

Breaking trust

We were interested in understanding how trust is broken in an established advisory relationship. On average, investors in our survey have been working with financial advisors for 17 years and with their current advisor for ten. This means that some have worked with other advisors in the past. In fact, over half have switched advisors, while about one-quarter have had an experience that undermined their trust in their advisor (**Figure 4**). This experience could have occurred with their current financial advisor or a previous one.

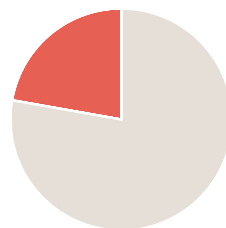
While there may be multiple reasons for distrust, the reasons most commonly cited related to investment performance and neglecting the relationship. Additional reasons included other emotional and ethical aspects of the relationship.

Consistent with our earlier findings, the trust components are vital in creating the foundation for overall trust. While their relative impact may vary, each component—functional, emotional, and ethical—is critical. A breakdown in at least one component can be enough to compromise trust. Obviously, a multicomponent failure will have a detrimental effect on trust.

One element we tried to capture was whether higher trust in advisors has an insulating effect—or at least a dampening effect—on experiences that may undermine trust. In other words, do investors with a deeper emotional relationship with their advisor tend to give him or her more leeway when problems arise? We were unable to determine this from the current research and it remains a question to pursue in future research.

Figure 4. When trust breaks down

A. Incidence of undermined trust with a financial advisor



B. How trust is compromised

Asked of clients who said they had an experience that undermined trust in their financial advisor (multiple answers allowed)

Reasons for broken trust	Percentage
Caused my portfolio to underperform	46%
Did not pay enough attention to me or my portfolio	44
Steered me toward poor investment choices given my risk tolerance and goals	43
Did not achieve what they set out to achieve for me	35
Did not make me feel that my business or portfolio was important	34
Lack of timely communication	34
Did not follow up or do what they said they would do	25
Condescending	22
Did not explain things to me in a way that I understood	21
Did not take my concerns or questions seriously	20
Did not understand me as an investor	19
Did not act morally	18
Did not respect my spouse as an equal partner	6
Took advantage or acted in own interest	5
Poor advice or investment decisions	4
Acted illegally	3
Unclear about fees (and other fee-related concerns)	2

Source: Vanguard, 2017.

Outcomes of trust

A high level of trust is associated with client loyalty and improved business development for the advisory business (**Figure 5**).[6] Investors who have high trust in their advisor almost unanimously say they are highly satisfied and likely to recommend the advisor. In fact, over three-quarters of the "high-trustees" have already recommended their advisor compared with fewer than half of those with medium trust. Referrals are the most important source of business for financial advisors[7] and building trust is a pathway to generating referrals spontaneously.

Not only does trustworthiness help build the advisory business through new leads, high trust is also positively associated with increased share of a client's investable assets. Seventy percent of high-trust investors say they are likely to give their advisors additional money to invest, while only one-third of investors with medium trust would do the same.

Trust is also related to client retention. Advised investors who have high trust are less likely to think about switching advisors. The opposite is true as the level of trust in an advisor declines.

The association of trustworthiness with higher client loyalty, increased advisor referrals, increased asset consolidation, and better client retention illustrates why building trust should be an essential feature of a financial advisor's business model.

Summary and implications

Trust is the basic tenet that underpins the financial system, including the provision of financial advice. A successful financial advisory relationship is based on deep trust. We identified three components of trust—functional, emotional, and ethical.

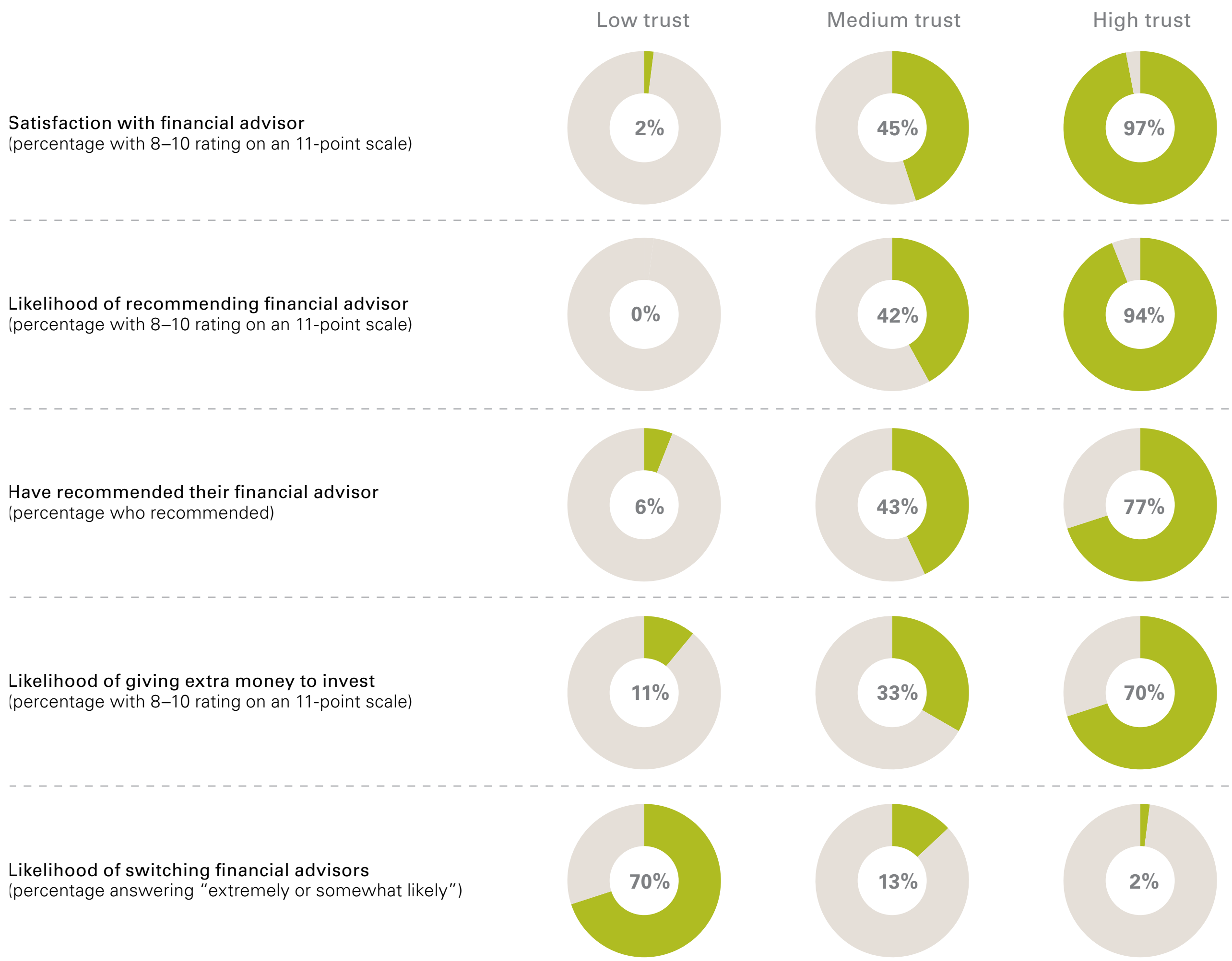
While the emotional aspect of trust is regarded as most important, each component contributes to the overall assessment of an advisor's trustworthiness. It is not enough for financial advisors simply to do what they were hired to do. An advisory relationship needs to be continuously nurtured to build trust. Being the client's advocate and acting in his or her best interest top the list of 19 attributes that are central to building trust. However, trust can be undermined by reasons associated with any of its three components. Examples of these are poor investment performance, communication issues, neglecting the relationship, and advisors' self-serving behavior.

Trust is associated with client loyalty and positive outcomes for the advisory business. Therefore, financial advisors should seek to manage trust proactively. So how does a financial advisor earn trust? By focusing on these areas:

- *Ethical behavior.* Operate under principles of integrity and objectivity at all times. Display an ethical culture by requiring not only the advisor but everyone else on the team to adhere to the principles. Reinforce the importance of ethics through various ways such as displaying a physical copy of the profession's code of ethics, or incorporating it into an organization's mission statement.
- *Pricing and quality of products and services offered.* Ensure that product and service recommendations align with the client's needs. Be clear on how recommended products and services relate to the overall financial plan. Ensure that pricing is fair and seek to demonstrate this to clients, when possible.
- *Compensation arrangements.* Institutionalize transparency on how an advisor is paid, which will go a long way toward establishing trust. Offering the information proactively will signal sincerity and a culture of openness.
- *Marketing and client experience.* Review all elements of your brand and client experience to see how they reflect the various ways that drive trust. Provide a solid financial plan, have efficient operational procedures, and adhere to effective communication standards, all of which are foundational to the advisory relationship. At the same time, make a conscious effort to improve your trustworthiness by focusing on the emotional aspects of the relationship—cultivating in clients the feeling of being valued, respected, and understood.

6 What we find are associations of trust with client loyalty and business outcomes, but we do not establish causality. Results should be interpreted accordingly.
7 In our survey, about two-thirds (65%) of the advised investors say they found their current advisor through a referral.

Figure 5. Trust, client loyalty, and business outcomes



Notes: Sample sizes are as follows—high trust n=2,843; medium trust n=612; low trust n=47. Low trust has a small base, so results should be interpreted with caution.
Source: Vanguard, 2017.

The expanding role of technology may change the nature of trust in the advisory relationship. How will the formation of trust evolve in this digital age and how should advisors adapt? Maintaining an online presence may facilitate client prospecting, but advisors should also recognize the growing importance of online customer reviews. Every interaction with a client could potentially be subject to an online review, which in turn provides the rationale for a prospect's behavior or decision. As in any other business, financial advisors will need to ensure a positive client experience and be vigilant in addressing the negative experiences—both personally, with the affected client, and online.

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Appendix 1. List of attributes tested as a driver of trust

✔ denotes key driver of trust

	Functional attributes
	Demonstrates knowledge of investment tools and strategies
✔	Has relevant financial industry qualifications
✔	Shows awareness of trends in the financial markets
	Has other longstanding client relationships
	Is articulate, a good communicator
✔	Knows how to conceive, execute, and reassess a financial plan
✔	Does what he (she) says he (she) will do
	Has clients with similar requirements or experiences to my own
	Is accessible
	Follows up when expected and without prompting
✔	Is able to make suggestions on the spot
✔	Proactively contacts me regarding my investments or portfolio
	Works for a firm whose brand values and reputation I want to be associated with
✔	Is well connected in my community

	Emotional attributes
	Goes above and beyond financial duties to make me feel like a valued client (e.g., asking about my family, sending cards, recognizing special moments)
✔	Is able to view the world from my perspective
	Listens to me closely (probing or following up) to truly understand me as a person
✔	Is someone I can relate to or make a connection with
	Ensures that I feel heard
✔	Provides me with a sense of relief and allows me to sleep better at night
✔	Makes me feel that my portfolio is important, regardless of size
✔	Is my advocate, pursuing my goals (almost) as if they were his (her) own
✔	Gives me time and attention without making me feel rushed
✔	Offers products and solutions that are in tune with financial goals and risk tolerance
	Does not have an ego

	Ethical attributes
	Does not employ hard-selling tactics
✔	Has integrity, acts morally
✔	Has no conflict of interest or ulterior motive
✔	Will act in my best interest at all times
✔	Is compensated in a reasonable manner
✔	Willing to admit what he (she) doesn't know
	Maintains eye contact when speaking to me

Source: Vanguard, 2017.

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