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, 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?
Does disclosure work?

- Consumers
  - Ignore it (Hampson et al. 2006)
  - Discount insufficiently or erratically (Tversky and Kahneman, 1974; Cain et al. 2011)
  - Do not seek second opinions (Foreman, 2001)
  - Feel increased pressure to comply (Sah et al. 2013, 2014)
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

Sah et al. (2013) JPSP
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, advisors gave biased advice MORE likely to take biased advice.

\[ n = 76 \text{ advisors, } p < .01 \]

- No disclosure: 52%
- Disclosure: 81%

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Opposing forces act on chooser

All p’s < .01

Strongly disagree (1) to strongly agree (5)

No disclosure

Disclosure

Pleased

Trust

Help advisor

Rejection discomfort
Additional studies: reduced pressure

- External Disclosure
- Private decisions
- Opportunity to change mind - ‘cooling off’ period


Does disclosure work?

- Advisors
  - Moral licensing (Monin and Miller, 2001; Cain et al. 2011)
  - Strategic exaggeration
Advisors

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

Evidence that...

- Disclosure can have perverse effects
  - Advisees: Increased pressure (burden of disclosure)
  - Advisors: Increase bias in the advice

- Disclosure can have benefits
  - Advisees: Decreased trust (reduce pressure)
  - Advisees: Increased trust if disclose the absence of COIs
  - Advisors: Advisors reject COIs
  - Advisors: Rein in bias if reminded of obligations
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