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To trust is good, but to control is better: How investors discipline financial advisors’ activity*

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Abstract

Using a survey of clients from one of the largest Italian banks, we find that investors with low level of trust in professional advisors seek financial counselling, but make their decisions autonomously. We investigate whether these investors exert some form of control over the recommendations they receive, and, if so, which one. Investors can push advisors to provide better recommendations either by asking for a second expert’s opinion, such as in the case of credence services, or by monitoring closely the advisor’s activity themselves. We find that three quarters of investors do not exert any control on advisors. Different types of financial competence – self-assessed or test-based – serve different purposes. The investors featuring higher self-assessed financial competence are more likely to control the advisor’s activity. The mechanism through which investors exert control over the advisors’ activity depends instead on the investors’ degree of test-based financial literacy. Investors with high financial literacy directly monitor the advisors’ activity. Investors with low financial literacy are more likely to seek a second professional opinion in support of the recommendations previously received. Our findings suggest that improving investors financial knowledge may foster direct control of the advisor’s activity. Moreover, facilitating the comparison between financial products by standardized and centralized information may be very effective to protect poorly literate investors.

Keywords: Financial advice, Financial literacy, Credence services

JEL Classifications: G11, G24, D80

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