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BY DAN IANNICOLA, JR. AND JONAS PARKER

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SOA research has uncovered some interesting findings about why middle-market consumers don't seek much-needed FINANCIAL ADVICE.

MANY EXPERTS PREDICT that even after America emerges from its present economic problems, a more formidable financial challenge looms just over the horizon as its citizens have fallen behind on saving for retirement. A confluence of factors have contributed to what many term a "retirement savings crisis" including the shift from defined benefit to defined contribution employer retirement plans, the sustained rises in health care costs, increased life expectancy and the possibility of future reductions in government-provided retirement benefits. Compounding this crisis is the average American consumer's inability or unwillingness to address it. Numerous studies reveal that American adults lack the knowledge they need to manage important financial issues. Other studies show that most consumers fail to plan for predictable life events, such as a child's education or their own retirement, with only 42 percent reporting that they have ever tried to figure out how much they need to save for retirement.[1]

The bottom line is that Americans need help with their finances. What's the consequence if they don't get it? Experts contend that millions may enter a future where they outlive their savings, are uninsured for predictable risks, lack financial reserves for health emergencies and are without a plan to financially provide for family members. If ever there was an urgent national problem for which financial professionals are uniquely equipped to solve, it is this.

FINANCIAL ADVISORS TO THE RESCUE … OR NOT

It would seem that in this hour of national need, accountants, financial planners, actuaries, brokers, insurance agents and other financial professionals would be stepping into the breach to fill this gap of financial knowledge and planning. For the affluent this is certainly the case. However the majority of Americans that fall in the middle- and low-net-worth markets are largely underserved when it comes to financial advice. In fact, a 2006 survey by the Financial Planning Association (FPA) found that only 11 percent of its members serve clients with a net worth below $250,000.[2] Additionally, the same study also stated that FPA members are providing financial planning services to only about one- to two-percent of the potential 108 million households in the middle market. However, responsibility for this state of affairs rests not just on the financial services industry, but on middle-market consumers themselves, for in many cases individualized, professional financial advice is neither offered *nor sought*.

Why is it that the same consumers, who visit the doctor when they are sick, call the fire department when their home is ablaze and get a lawyer when they receive a summons, are reluctant to hire a professional to address their money problems? And, likewise, why don't for-profit financial professionals see the profit incentive in developing an untapped market of low- and middle-income consumers in need of financial guidance? Last fall, we probed these questions in a study sponsored by the Society of Actuaries titled "Barriers to Financial Advice for Non-Affluent Consumers." In the study, we reviewed relevant academic research and practitioner literature, and spoke with national experts to explore and understand perceptions and misperceptions that have caused this massive disconnect between the supply side and demand side of the middle market for individualized, professional financial advice. We have summarized our findings below.

DEMAND-SIDE FACTORS

Middle-market consumers often do not seek the help they need from the professionals qualified to give it. Instead they may take no action, follow the unqualified opinion of family and friends or rely on personal finance experts in the media who cannot provide individualized advice. Why then aren't these consumers opting to use financial advisors?

LACK OF BASIC, "ON-RAMP" FINANCIAL KNOWLEDGE

Studies consistently demonstrate that most American consumers lack an understanding of basic financial concepts necessary to manage one's money effectively. While some might believe this reality should drive consumers to seek financial advice, the opposite turns out to be true. For example, recent research shows that the less financially knowledgeable someone is the less likely he or she will obtain financial advice or participate in the stock market.[3] Perhaps this reluctance is fueled by intimidation or fear of the unknown. One television investment expert sees it as a matter of basic confidence. As she put it, "People feel ashamed of what they don't know. First they need to know [the] jargon, like what is an annuity, and then they can go talk to someone who is going to advise them on annuities."[4] These findings are all consistent with the behavioral economics principle of ambiguity aversion: people avoid what they do not understand.

The implication of this is that consumers need a prerequisite understanding of financial matters—what might be called "on-ramp knowledge"—before they feel they can avail themselves of financial advice. Moreover, this suggests a new way to look at financial education: not as replacement for professional financial advice, but as gateway to greater engagement on financial matters which may include the use of a financial advisor.

LACK OF TRUST IN THE ADVICE DELIVERY SYSTEM

As one article puts it, "Personal finance is, after all, personal."[5] Before consumers can permit financial advisors to discuss and handle their money, they must first trust those advisors. Unfortunately several features of the advice delivery system undercut that trust and keep middle-market consumers and their money away from financial advisors.

First, consumers have serious concerns about advisors' objectivity and are justifiably suspicious that advisors are putting their own interests before those of their clients. This suspicion derives from advisors' compensation structure which, in many cases, is based on product sales. This sales incentive can undermine the advisor's purported role of giving unbiased guidance. As one author put it, "You're looking for sage advice. Chances are your advisor is looking to hit sales targets. However much your advisor's office strives to impress clients as a place of refinement and learning, behind the wood paneling it's a sales culture."[6] In the view of many a leery consumer, an advisor can either sell products or give unbiased advice, not both. Even an unsophisticated consumer is sophisticated enough to spot a potential conflict of interest and avoid falling prey to it.

Second, neither the pricing of the advice nor its value is clear to many middle-market consumers, which also leads to distrust of financial advisors. In most cases, pricing of financial advice is not listed on the Internet or in company materials and is frequently embedded in the price of the product. A senior marketing executive at a major insurer observed that this lack of transparency across the industry deprives a potential middle-market client of the chance to comparison shop or to ever really know if he or she got a good deal or even a fair one.[7] Not listing a price reduces consumers trust in the advisor and also leaves the consumer to conclude that the services must be expensive.

CONSUMERS HAVE SERIOUS CONCERNS ABOUT ADVISERS' OBJECTIVITY ...

Moreover, the value of the services provided by an advisor is difficult to demonstrate. Frequently, sound advice will result in a sacrifice today for a return in the future. Indeed, in many cases it will be difficult to determine if advice actually is sound without the passage of time. This reality may make financial advice difficult to take because it runs counter to the behavioral economics principle of hyperbolic discounting, in which consumers have the psychological tendency to overweight present costs and devalue (discount) future benefits.

Third, consumers cannot trust that their advisor has the right certification. Financial advisors bear a number of different certifications meant to clarify their particular area of expertise. Many consumers do not understand the meaning of each of these designations, leading them to doubt if they are speaking to the right professional. Making this more confusing for consumers is the fact that many of these different professionals openly compete with each other in the provision of advice and will discuss with clients the shortcomings of others' credentials while praising their own.

Finally, the recent turmoil in the financial markets has significantly lowered consumers' confidence in the financial services profession. In fact, a 2009 survey put consumer trust at an all-time low.[8] The revelations of negligence, greed and graft of some on Wall Street has tarnished the entire industry and fueled consumer skepticism about the advice, skills and integrity of financial professionals.

SUPPLY-SIDE FACTORS

While many middle-market consumers do not seek financial advice, there is widespread agreement that the industry has traditionally disregarded such potential clients. Instead, most financial advisors build their practices around affluent clients. Consequently, they have difficulty attracting middle-market clients. Specifically, what factors are holding most financial advisors back from tapping the middle market?

ADVISORS' BUSINESS MODEL FAILS TO ACCOMMODATE NEEDS OF MIDDLE MARKET

Financial advice firms have structural factors that keep them from bringing in middle-market clients. For instance, many firms require clients to have a minimum account balance that is too high for middle-market clients. Other firms may have product offerings of the wrong type or at the wrong price for the middle market. Still other firms might be physically located in affluent areas, making access less convenient for middle-market consumers.

In addition to these structural issues, many financial advice firms do not have a core business strategy that allows them to successfully court middle-market consumers. For those firms focused on the affluent, a middle-market client won't conform with their standard product offerings and approach and will be too much work for too little money. Unlike attorneys and accountants, most financial advisors have not been aggressive in developing ways to serve middle-market clients.

Some firms, however, have discovered successful ways to serve the middle market. Initially middle-market clients bring in less money for the same amount of work. Firms can develop efficiencies over time that will permit them to make a profit on leaner margins. One advisor emphasized that firms must make a long-term commitment to make this kind of middle-market strategy pay off. "Building it and hoping they come won't work. One reason planners who try to serve the underserved fail is that if the volume doesn't come in a relatively short period (a year, for example) the model doesn't work well." [9]

Additional advice on serving the middle market comes from a senior executive with a national discount brokerage firm. He said that his firm successfully adopted a marketing and service-driven business model in lieu of the more common sales or business-development model. Because of the firm's size, resources and brand awareness, its advisors can take the time to give good service to middle-market clients. Since the advisor's compensation structure puts less emphasis on commissions, he or she can counsel clients without being primarily concerned with the aggressive selling of products. This in turn generates customer loyalty and referrals. The company views its smaller clients as its "nursery" for the firm, as these clients will grow their nest eggs in the next 10–15 years and become more profitable.[10] Since few firms have the will, resources or patience to adopt either of these approaches, much of the middle market remains underserved.

ADVISORS LACK STRONG CONNECTIONS TO MIDDLE-MARKET CONSUMERS

Financial advisors understand the importance of developing and maintaining close relationships with their clients. This is why most financial advisors spend their time attempting to build connections in affluent communities. Financial advisors also hope that good service to an affluent client will result in referrals to other affluent clients. In fact, in a 2010 survey of financial planners, referrals were the most popular marketing method, used by 77 percent of planners.[11] By contrast, most financial planners neither make connections in middle-market communities nor do they get referrals to middle-market clients. The result is that financial advisors lose their ability to understand issues unique to middle-market consumers or to connect with them. One researcher summarized what her non-affluent subjects said of some financial advisors this way, "They don't want to understand my situation and tailor their advice to my situation." [12]

This disconnect is typically even stronger among recent immigrants to this country. Many such immigrants bring with them their cultural beliefs about money. They also bring along their understanding of the financial system in their home country, which may be nothing like what they find in the United States. These characteristics often create a "cultural disconnect" in which many advisors perceive such consumers as too high-maintenance, and might prefer working with someone from a more homogenous, affluent client pool.

CONCLUSION

Financial advisors and middle-market consumers have been eyeing each other from a distance for years with a mix of curiosity and fear. Each side knows it has something to gain. For advisors it is a large, nearly untapped market. For consumers it is the calm and confi-

dence that comes with steady, well-planned advancement toward one's financial goals. Yet each side is held back by what it might lose. Advisors fear losing money by working with an unfamiliar partner. Interestingly enough, middle-market consumers fear the exact same thing.

If middle-market consumers can become more financially literate they can gain the confidence necessary to get the help they need to better prepare for the future. For their part, financial advisors can address the blind spots in their business model and the flaws in their compensation system. If they do, financial advisors will build the relationships and trust with the middle market they now lack. When the supply of middle-market financial advice meets demand, Americans will be a step closer to averting the retirement savings crisis. ■

To read the full report from which this article is drawn, please visit *www.soa.org/researchbarriers.*

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