The Banker's Oath And Financial Advice

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Financial misconduct

- Misbehavior in the financial sector is widespread and costly [Reurink, 2018]: the largest U.S. financial institutions paid a total of more than USD 12 billion in fines between 2013 and 2016 [WSJ, 2017].

- Much broader phenomenon than often thought: 7% of financial advisers in the US are found to have misconduct records, reaching more than 15% at some of the largest firms [Egan et al., 2019].

- Misconduct can be contagious: advisors with a history of misconduct can increase their coworkers' propensity for misconduct [Dimmock et al., 2018].

Financial advice

- The market for financial advice is particularly susceptible to misbehavior:
  - credence good market: customers often cannot fully appreciate the quality of the offer, neither ex ante nor ex post (Dulleck and Kerschbamer, 2006).
  - conflict of interest: financial advisors should provide advice in the customers' best interest, but are also expected to increase the profits of their employer.

- This conflict of interest is often solved in the favor of the employer [e.g., Mullainathan et al., 2012, Fecht et al., 2018, Hoechle et al., 2018].

Regulation - The Banker's Oath

The **Netherlands introduced**, next to other policy interventions, the **Banker's Oath** (1st country to do so by law).

- Since 2015 **every employee in the financial sector** in the Netherlands is legally required to take this oath.
- Employees are personally responsible for compliance and can be held accountable for non-compliance.

I swear / promise that, within the boundaries of my function in the banking sector, I will:

- Execute my function ethically and with care;
- Draw a careful balance between the interests of all parties associated with the business, being the customers, shareholders, employees and the society in which the business operates;
- **When drawing that balance, making the customer's interests central**;
- Will comply with the laws, regulations and codes that apply to me;
- Will keep confidential that which has been entrusted to me;
- Will not abuse my knowledge;
- Will act openly and accountably, knowing my responsibility to society;
- Will make every effort to improve and retain trust in the financial sector.

So help me God! / This I pledge and promise!

Study outline – audit study and prediction task

- 5 years after the general introduction of the oath, we study:
  - whether **moral nudges & reminders**
  - that directly or indirectly remind bank employees of their oath
  - affect the quality of their financial advice.

- We implement a **large-scale audit study**:
  - 51 professional auditors, disguised as normal customers,
  - visited 201 bank branches in the Netherlands,
  - and confronted financial advisers with a pre-tested ethical dilemma.

- Online survey (**prediction task**) that describes all three audit study treatments; participants predict the effect of the nudges:
  - 122 regulators from the Netherlands; 502 subjects from general population.

Audit study (ADVISERS); Treatment CONTROL

The auditors (mystery shoppers) approached financial advisers with a **conflict of interest** (after some pilot tests):*

- I want to buy a car for €8.000,- and I am considering to do this with a loan (of the same amount).
- I have €12.000,- in savings, but I consider to keep that in reserve (and I do not have any specific plans what to do with that money).
- I am currently employed as a temporary worker and I earn a regular income of €2.100,- net per month.
- I am single, have no children, and I do not have a mortgage or other debts.
- I currently have an account at another bank but I am willing to switch banks.

*The scenario presented to the bank employees is similar to an ethical dilemma used in Harms, Job: "Essays on the Behavioral Economics of Social Preferences and Bounded Rationality." PhD thesis, Erasmus University, June 2018

Main measurements

- Then the auditors asked the bank employee about their possibilities and options.

- In an environment with higher interest rates for loans than for savings, the **customer-friendly advice would be to use the savings first.***

- *Directly after the visit* ***the auditors recorded the response of the advisor:***

Question	6.	How strongly did the advisor recommend to take out a LOAN?						
On a scale from 0 to 6, where 0 is 'Not at all' and 6 is 'Very strongly'.		0 Not at all	1	2	3	4	5	6 Very strongly
		?	?	?	?	?	?	?

Question	7.	How strongly did the advisor recommend to use your SAVINGS?						
On a scale from 0 to 6, where 0 is 'Not at all' and 6 is 'Very strongly'.		0 Not at all	1	2	3	4	5	6 Very strongly
		?	?	?	?	?	?	?

***Even after accounting for an emergency buffer**: according to the web-calculator of NIBUD the buffer for this situation is advised to be €3,800 (https://bufferberekenaar.nibud.nl). Hence, there are enough savings to finance the car without the need to take up a loan ($12,000-3,800=8,200$).

Moral Nudge Treatments: DIRECT & INDIRECT

- **Direct nudge & reminder (DIRECT)**: asking about the banker's oath directly ex ante.

> "I recently saw in a consumer program/ read in the newspaper/ heard from an acquaintance that each bank employee has taken the banker's oath." Then you ask: "What is actually the purpose of the oath?"

- **Indirect nudge & reminder (INDIRECT)**: asking about the oath's most central element without mentioning the oath directly ex ante.

> "I have the feeling that my own bank cares more about their own profits than about what is best for their clients." Then you ask: "How does your bank protect the interests of their clients?"

Implementation of the audit study (ADVISERS)

- **Data collection**: Aug 15, 2019 to March 3, 2020.

- 51 professional auditors, 201 offices, 102 cities/towns, 2 Dutch banks (~60% of total NL coverage).

- Financial advisors: random assignment to one treatment (N=67 per treatment).

	mean	sd	min	max	N
AUDIT STUDY					
AUDITORS					
female rsp	0.57	0.5	0	1	51
age esp	47.96	9.6	26	56	51
no of visits	3.94	2.44	3	15	51
ADVISERS					
female adv	0.46	0.5	0	1	201
age adv	37.24	8.77	26	56	201
bank	0.60	0.49	0	1	201
length visit (min)	18.62	12.31	2	89	201
length talk (min)	9.61	5.68	2	41	201
reaction to DIR Q	4.03	1.63	0	6	67
reaction to IND Q	2.94	1.67	0	6	67
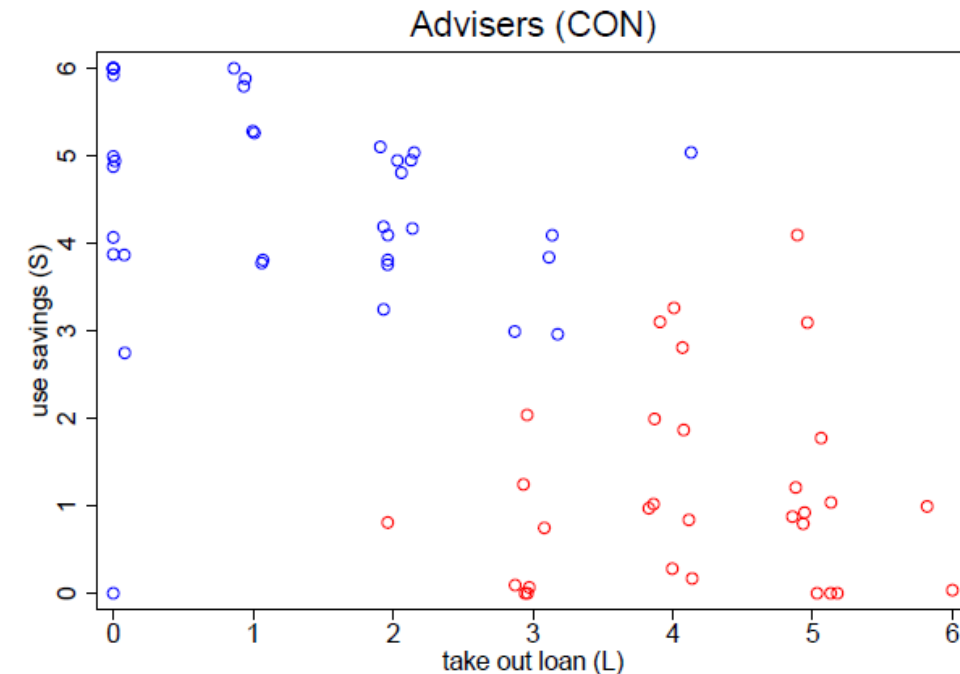
Advisers (CON)

Outcome variable 1: Loan Priority (LOANPRIO)

Priority for loan / product sale: LOANPRIO = 1 if L > S (otherwise 0)
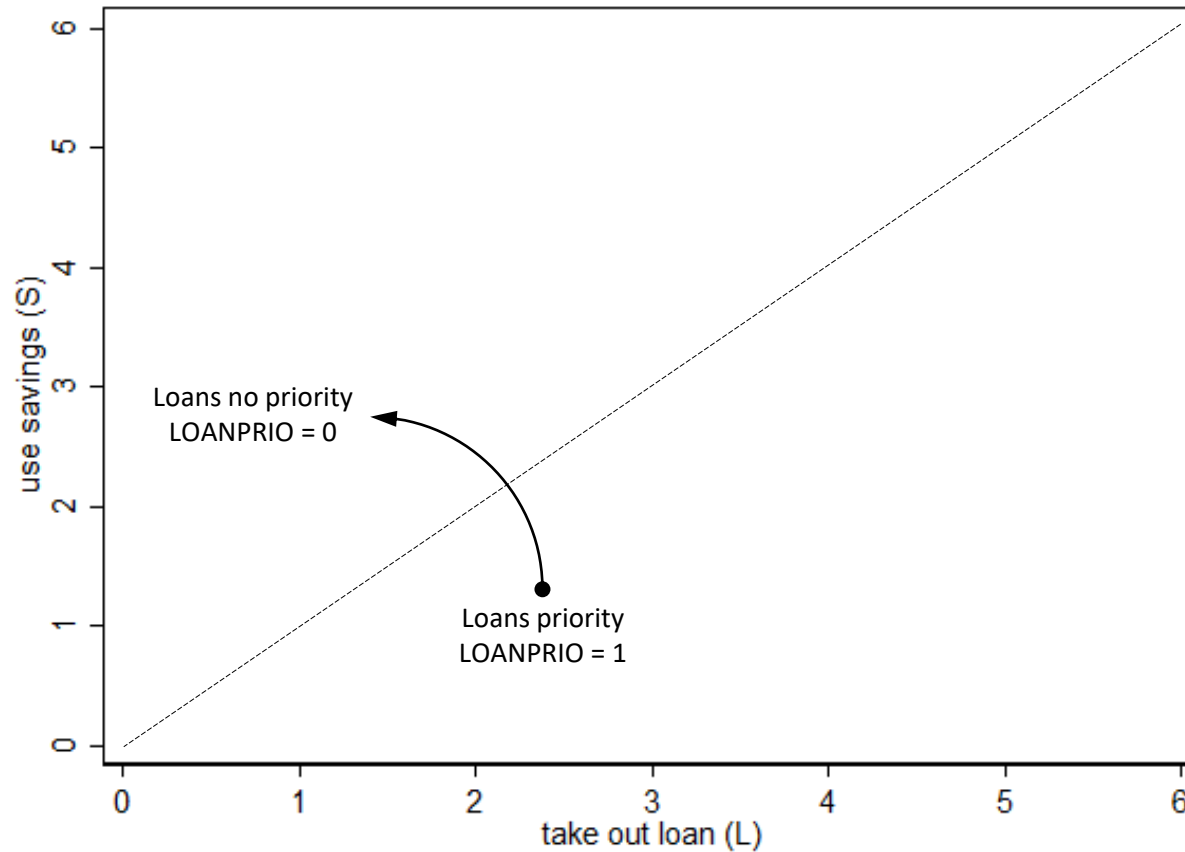
Result Nudges (ADVISERS)

Direct moral nudges that remind financial advisers of their oath (**DIRECT**) **significantly decrease the likelihood that recommendations prioritize product sales (loans).**
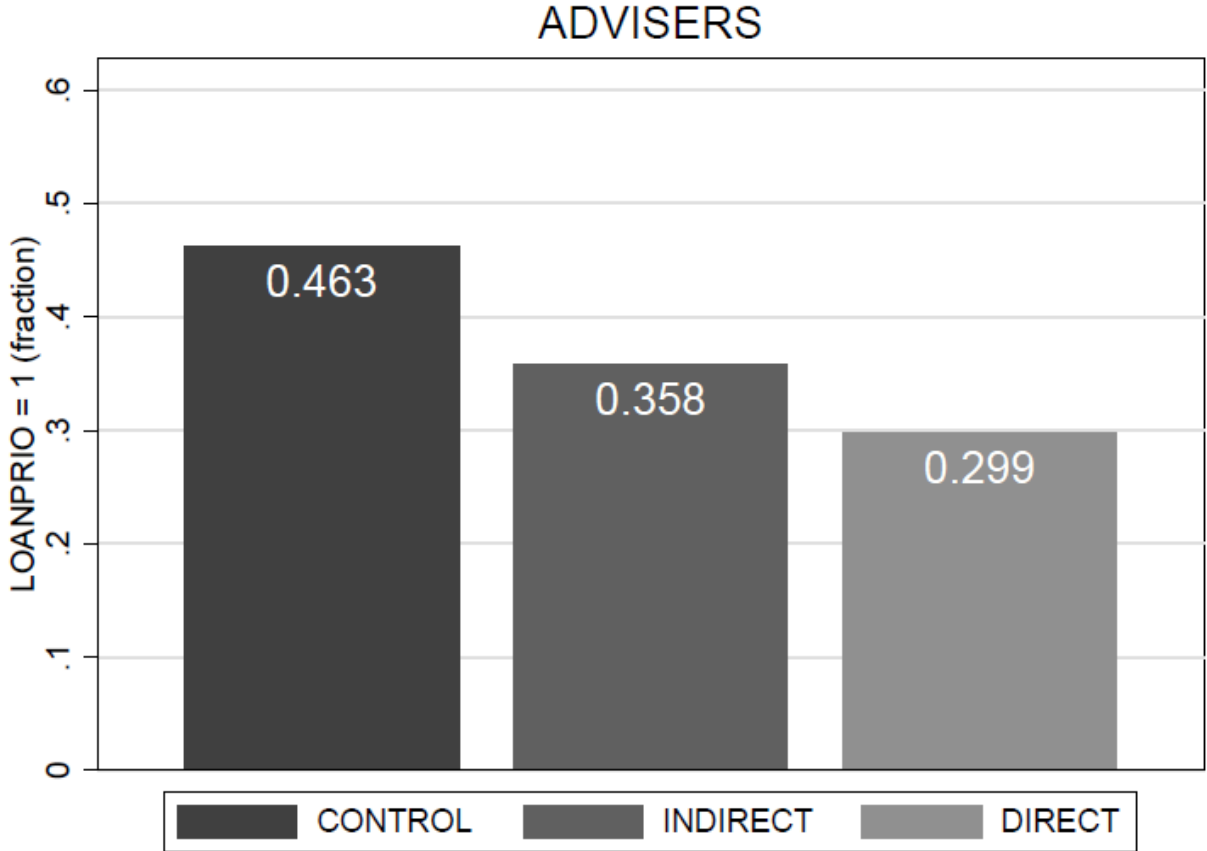
Table 2: **Estimations on LOANPRIO, audit study**: Logistic regressions with LOANPRIO as the dependent variable and clustered standard errors per auditor. 'DIRECT' and 'INDIRECT' are treatment dummies. 'permute p' (table bottom) reports the p-values of the corresponding treatment dummy coefficients, obtained from permutation tests with 1000 random draws (accounting for respondent strata). 'level' is s+L. The month of the visit and the position of the visit per auditor and month (pos=1,2,3) are included as trend variables. Remaining variables are defined in the notes of Table 1. The table reports odds ratios with z-values in parenthesis. *0.05 **0.01 ***0.001 denote levels of statistical significance.

ADVISERS

|	(1)	(2)
DIRECT	0.494*	0.482*
	(-2.29)	(-2.18)
INDIRECT	0.648	0.626
	(-1.59)	(-1.60)
level		0.672*
		(-2.52)
bank		1.054
		(0.16)
pos		0.686
		(-1.93)
month		0.931
		(-0.70)
female adv		1.135
		(0.41)
age adv		0.996
		(-0.22)
female rsp		0.697
		(-0.78)
age rsp		0.967
		(-1.29)
constant	0.861	2.59e+24
	(-0.55)	(0.76)
permute p DIRECT	0.036	0.042
permute p INDIRECT	0.191	0.145
Prob> χ^2	0.062	0.089
N	201	201

Outcome variable 2: Loan Strength (LOANSTRENGTH)

LOANSTRENGTH = L - S
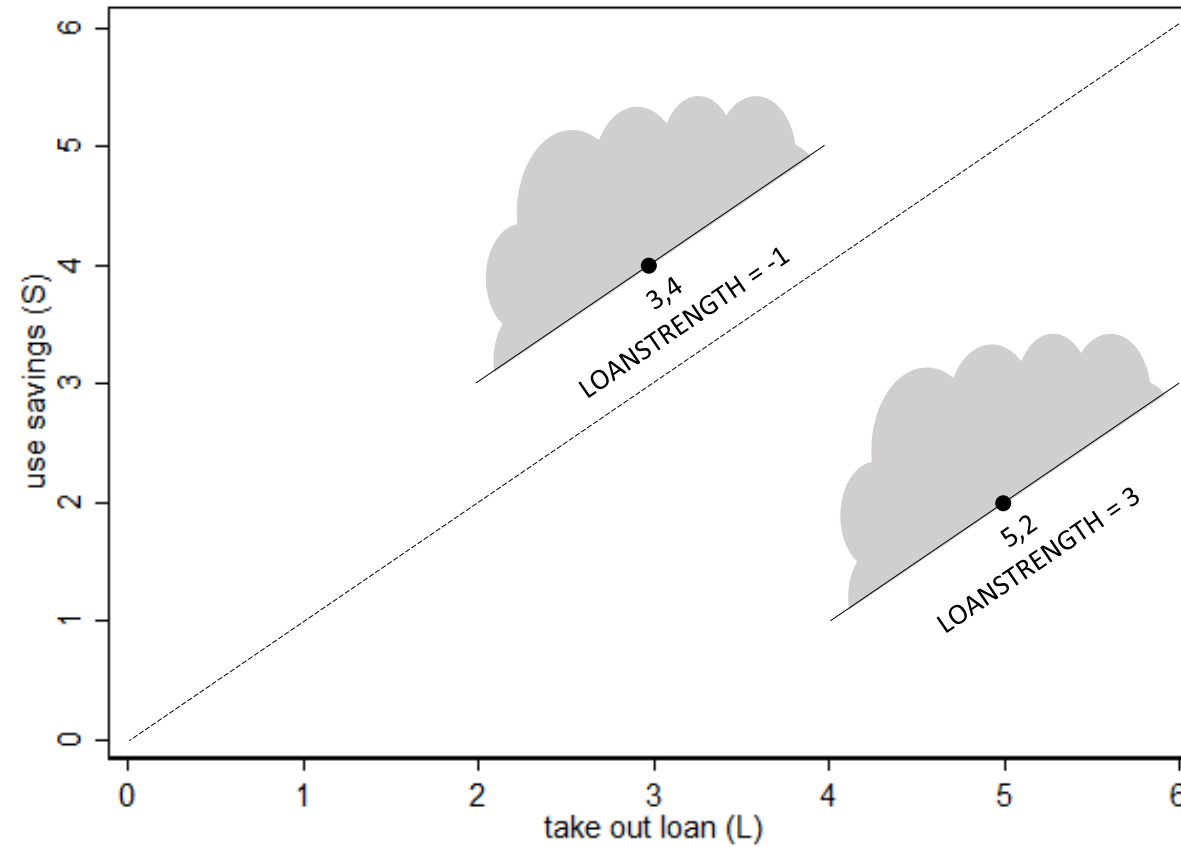
Result Nudges (ADVISERS)

Direct moral nudges increase the frequency of neutral advice
(dep. var: neutral_advice=1, if L=S, zero otherwise).

ADVISERS (CONTROL)

ADVISERS (DIRECT)

ADVISERS (INDIRECT)
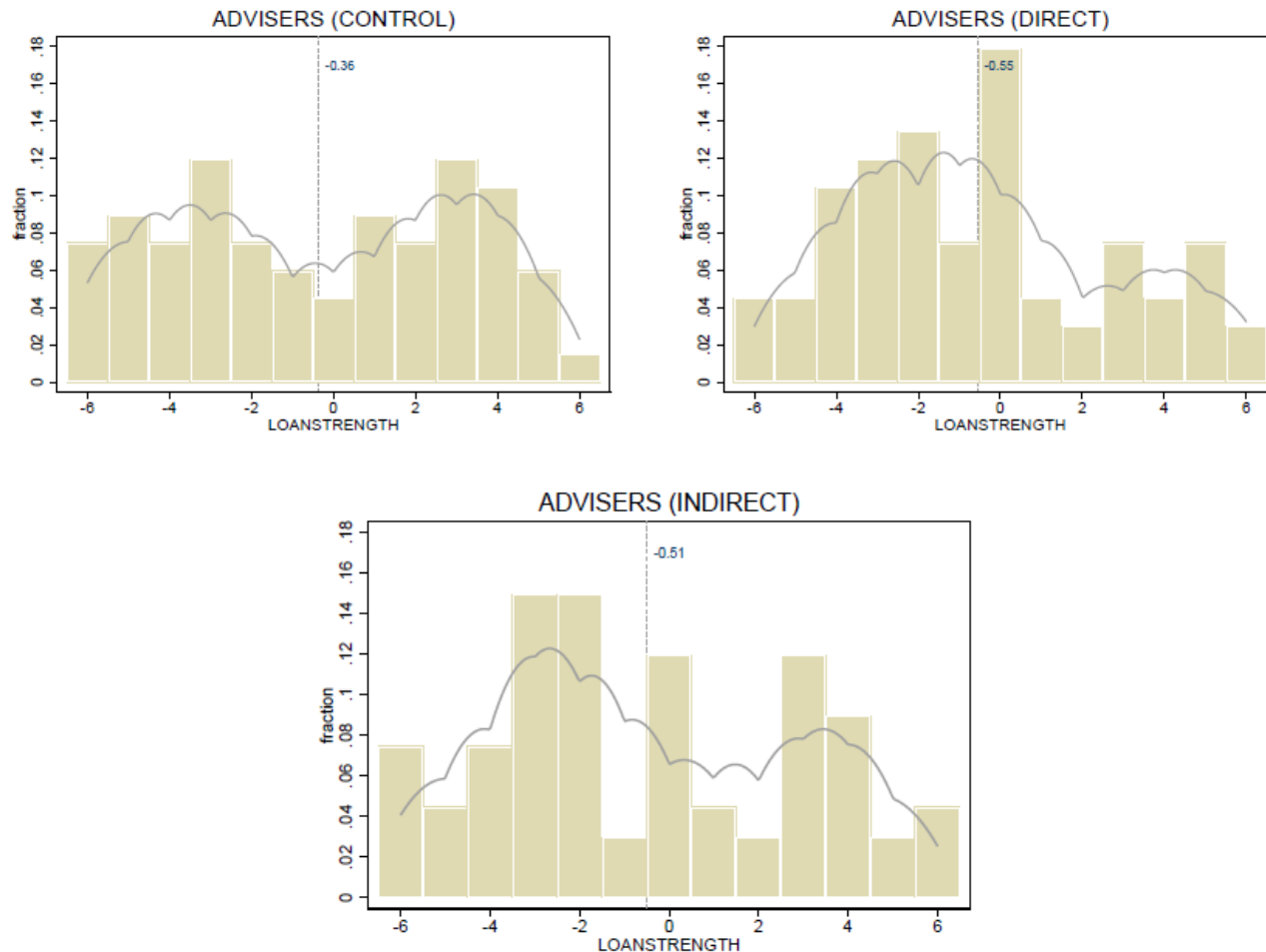
	(1)	(2)
DIRECT	4.655*	5.472*
	(2.36)	(2.43)
INDIRECT	2.893	3.323
	(1.55)	(1.66)
level		0.800
		(-1.42)
bank		2.194
		(1.40)
pos		0.988
		(-0.04)
month		1.068
		(0.54)
female adv		0.999
		(-0.00)
age adv		0.993
		(-0.26)
female rsp		0.299*
		(-2.05)
age rsp		1.039
		(1.41)
constant	0.047***	0.000
	(-5.04)	(-0.58)
permute p DIRECT	0.014	0.012
permute p INDIRECT	0.047	0.054
Prob> χ^2	0.060	0.083
N	201	201

Prediction task (EXPERTS; CUSTOMERS)

Online survey that **describes all three audit study treatments and then incentivizes to predict the effect of the nudges**:

This is the main screen with only six questions. Take your time and think carefully about your answers.

On this screen we will ask you to make six predictions about the advice of the bank employees.

- After completion of this survey (in 3 weeks) we will randomly select *one* of your six predictions below and compare it to the *actual* advice as recorded by the mystery shoppers.
- If your selected prediction matches the actual average (+/- 0.2) you earn €25.
- After completion of this survey you will also get early access to the results of our study.

What do you predict for this intervention? On average, how strongly did the bank employee recommend to...

Not at all ———————————————————— Very strongly
0   1   2   3   4   5   6

...take out a LOAN?
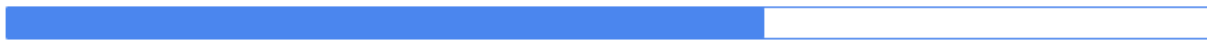
...use the SAVINGS?

- Sample EXPERTS:
  - **Sample of experts** from AFM, DNB, MinFin, EZ, CPB, and BIN NL (N=122).
  - Online survey: Feb 11, 2020 to March 11, 2020.
  - 60% male; avg age 38 (6.5 yrs exp.); 72% in reg/sup/policy; 39% in res/analysis.

- Sample CUSTOMERS:
  - **Sample of Dutch working population**; N=502.
  - Online survey: Feb 18, 2020 to Feb 21, 2020.
  - Representative sample w.r.t. age, gender, education, region.

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Result Prediction Task (EXPERTS; CUSTOMERS)

- **Experts (regulators) predict that**, without any intervention, **financial advisers prioritize product sales (loans) more often than observed in the field (CONTROL)**.

- **Experts predict that, both, direct and indirect moral nudges significantly reduce the prioritization of product sales**. In the field, this effect applies only for direct moral nudges, which is correctly anticipated by customers.
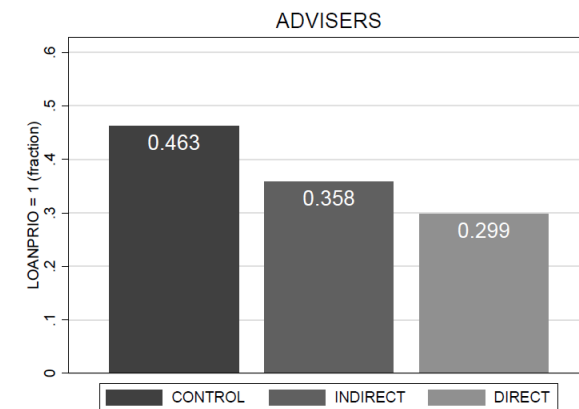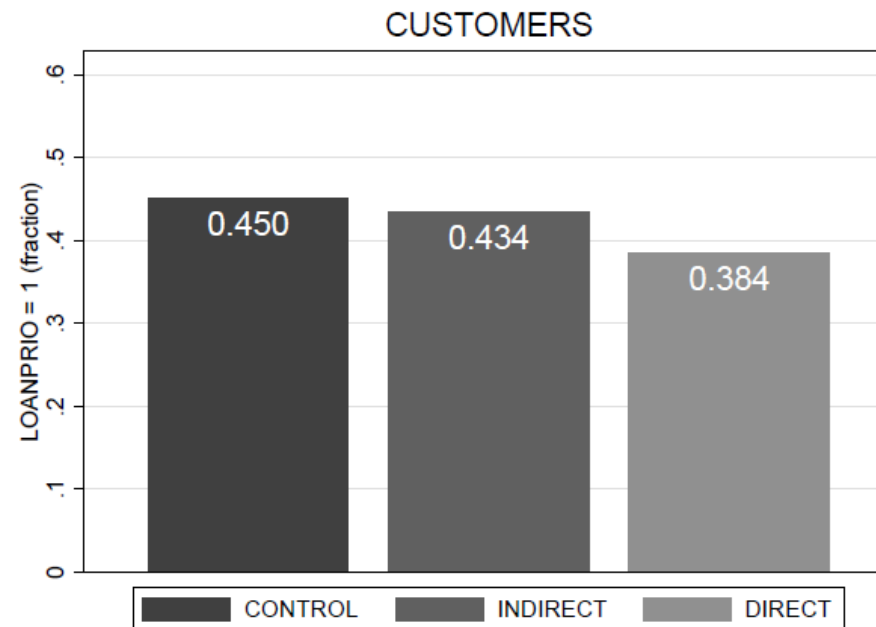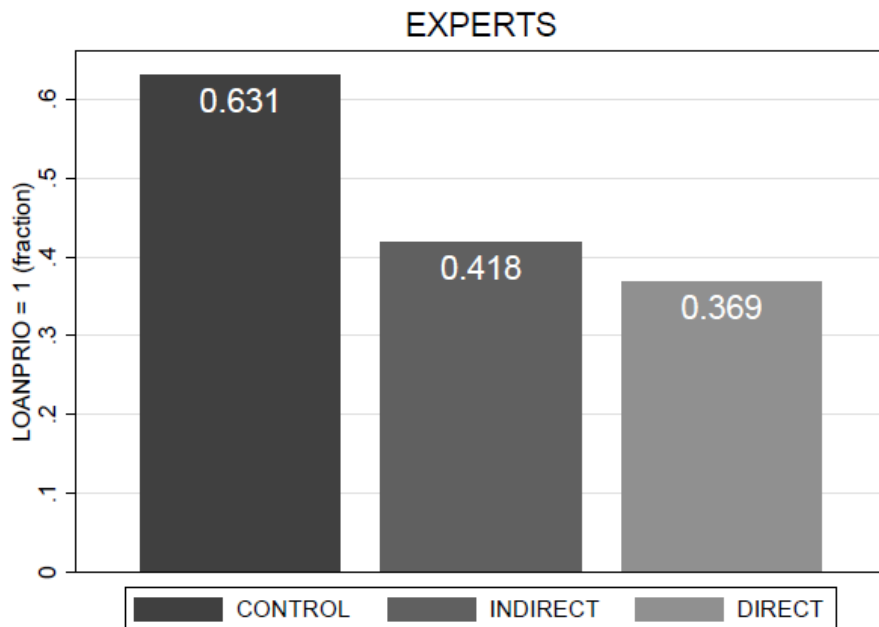
Results LOANSTRENGTH (EXPERTS; CUSTOMERS)

- LOANSTRENGTH (L-S) in prediction task.

- Signed-rank p refers to the null of differences of the particular treatment and the resp. control treatment.

- Diff-in-diff p refers to treatment effect differences between the prediction task and the audit study. **Experts predict a significantly stronger treatment effect of moral nudges than observed in the audit study**.

	EXPERTS			CUSTOMERS		
	CONTROL	DIRECT	INDIRECT	CONTROL	DIRECT	INDIRECT
mean	0.77	-0.75	-0.68	-0.36	-0.93	-0.55
sd	2.52	2.37	2.36	2.84	2.55	2.69
signed-rank z	(3.28)	8.16	8.06	(-2.51)	6.61	3.57
signed-rank p	(0.00)***	0.00***	0.00***	(0.01)**	0.00***	0.00***
diff-in-diff p		0.031*	0.014*		0.579	0.918

Conclusion, Discussion, Take-Aways:

- Without intervention, nearly half of the financial advice is not in the customer's interest.

- **Reminding advisers** of their **oath** can help:
  - they are **less likely to prioritize bank's interests**;
  - they are **more likely to give neutral advice**.

- Reminding advisers of customer interests has little effect.
  - The banker's oath seems to activate a distinct mechanism;
  - maybe it's the special status/solemnity of oath, or addressing moral utility.

- **Regulators expect much stronger, positive treatment effects of both nudges** than observed in the field; customers are well calibrated in their beliefs.
  - Oath as regulatory tool has value, but significance is overestimated.
  - Integration customer opinions in designing regulatory policies (i.e., running surveys with customers in predicting possible policy interventions)?

Discussion

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Appendix

Caveat #1: risk of disciplinary action

- When asked about the oath, an adviser could infer that a customer is more likely to file a complaint:
  - Possible treatment effects in DIRECT would not be due to nudging, …
  - … but due to an increase in adviser's risk of disciplinary action.

- But disciplinary action by the Foundation for Banking Ethics Enforcement (FBEE) is extremely rare:
  - Cases ruled by FBEE: 2016 (3), 2017 (11), 2018 (24), and 2019 (21).
  - Approximately 87,000 bank employees in the Netherlands have taken the oath.
  - Adviser's risk of disciplinary action is practically negligible.

Caveat #2: Nulls & Hindsight Bias

- Randomized controlled trials (RCTs) have limited N and therefore run the risk to produce a Null result:
  - False negatives (Type II errors). Power tests can test this but depend on "realistic" effect sizes that we expect to find.
  - Hindsight bias ("I knew that already!"). Once (Null) results are known, it is difficult to appreciate the contribution [DellaVigna et al., 2019].

- Solution: get predictions about the outcome of the study from
  - employees in regulation/supervision/policy work (EXPERTS);
  - potential bank customers (CUSTOMERS);
  - ➢ and then use the ex ante effect sizes for power tests,
  - ➢ and compare the average effects with the field data.