When godliness goes up, financial advisor misconduct goes down

August 12 2024, by Benjamin Kessler

Every day, financial advisors take perhaps the toughest ethical test in America. Entrusted with managing more than $30 trillion in assets by
clients who are relatively naïve in the ways of financial markets, they face constant temptations and opportunities for self-enrichment. Seen in this light, it may be no wonder that around 7% of financial advisors have a record of misconduct. Instead, we might marvel at the fact that 93% have apparently kept their nose clean.

In a recent paper for *Journal of Corporate Finance*, Lei Gao, associate professor of finance at the Donald G. Costello College of Business at George Mason University, studies how one unexpected factor—local religiosity—affects advisor ethics. Gao's findings have ethical implications for all employees whose jobs present opportunities for illicit gain.

Gao's co-authors were Arnold R. Cowan of Iowa State University, as well as Jianlei Han and Zheyao Pan of Macquarie University.

The researchers used a data-set tracking misconduct among 462,000 U.S.-based financial advisors, which they cross-referenced with county-level religiosity (i.e. church membership) information from the Association of Religion Data Archives. They found strong evidence of an inverse relationship—the more religious a county was, the less misconduct was found among financial advisors working in that area.

In this context, "misconduct" refers to any financial issues, disciplinary actions or customer disputes disclosed to the Financial Industry Regulatory Authority (FINRA).

"This setting is probably not that common," says Gao, which is why he and his co-authors saw it as ripe for study. "Financial advisors are regulated; they have to do the disclosures themselves. Some of the misconduct is not serious enough to make them lose their job, but we can still see the effects."
Advisors who switched from a county in the bottom quartile for religiosity to the top quartile were 0.15% less likely to commit misconduct, which is statistically significant given the generally low probability of misconduct. The same basic effect was noted for advisors moving down the religiosity scale.

Gao and his co-authors put their findings to a further test, factoring in the localized impact of sexual abuse scandals in the Catholic Church. When religiosity in a U.S. county declined as a result of a church scandal cropping up there, incidents of misconduct among financial advisors subsequently rose.

This is the first paper to document correlations between religiosity and misconduct among financial advisors. Previous studies have noted that misconduct is mostly to be found in areas with high annual incomes and a disproportionately elderly, less educated population. Gao's research suggests that the ethical implications of preying on vulnerable, trusting clients take on greater weight in more religious contexts.

"Advisor certification exams have an ethical component that they must pass," Gao observes. "This kind of teaching is probably correlated with an ethical standard that applies to other fields as well."

Further, Gao's study implies that ambient cultural norms, such as those prevalent in a spiritually oriented community, can affect behavior, regardless of whether individuals personally believe in those norms. The mere presence of sharply delineated ideas of right and wrong in the culture may reinforce the ethical training that financial advisors already receive as part of industry certification.

This suggests that ethical training can be effective over the long term at preventing misconduct in high-temptation scenarios, particularly when combined with corresponding cultural influences.
In sectors prone to illicit temptations, how can companies use these findings to discourage misconduct, if they are located in a less religious area? Without bringing religion into the workplace in a way that might run counter to employment laws, organizations might consider adopting language in their communications that mirrors the moral coloration of religious frameworks. That might mean using standards of right and wrong to describe the consequences of misconduct, in addition to professional and legal standards.


Provided by George Mason University

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