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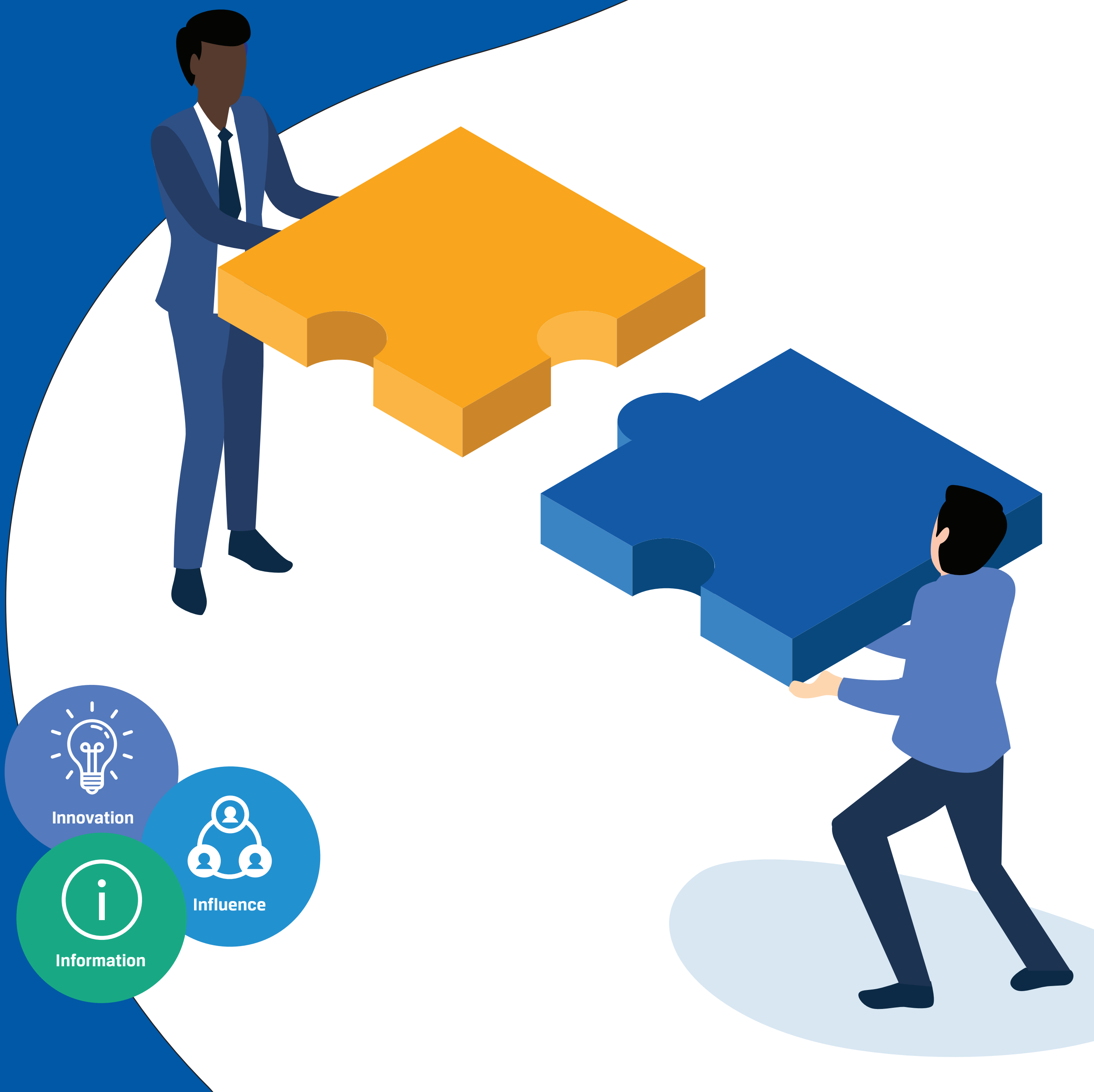
Future of Finance

EXECUTIVE SUMMARY

Earning Investors' Trust

How the Desire for Information, Innovation, and Influence Is Shaping Client Relationships



Executive Summary

What does it take for someone to put their capital at risk and entrust their funds to someone else to manage? The concept of trust lies at the heart of this question.

Trust is a multi-layered concept, and it is essential to the proper functioning of capital markets. Without it, financial interactions would become more inefficient and costly or cease altogether. In this fourth edition of the CFA Institute investor trust study, we examine how trust in the industry has evolved, while the essential characteristics of trust endure.

The essential enduring feature that is often missed is that trust is made up of qualities from the two sides of the relationship—the client's willingness to trust and the institutional investor's worthiness of trust.

We explore two specific types of trust relationships in the investment industry—institutional investors engaged as clients of asset managers and retail investors engaged as clients of investment firms.

Several layers of investor trust—in the financial system, in the financial services industry, and in investment firms—affect how investors view their investments. Investment professionals must understand these influences and their interactions in order to build effective client relationships.

Three themes are contributors to investor trust today:

Information is essential for trust, and the less investors feel informed, the less they trust the financial system. Investors become better informed through information and knowledge derived from financial education.

Innovation and the proactive use of technology can enhance trust, and those who trust the financial system more are also more likely to be early adopters of innovative products and technologies.

Investors' desire for **influence** and control is growing and provides opportunities for the investment industry to strengthen trust. This desire is evident in expectations for greater customization—in communications, investment design, and products such as those that incorporate environmental, social, and governance (ESG) factors. Investors are also seeking more control over net-of-fee performance results by negotiating fees.

The two major components of trust are credibility and professionalism. Credibility factors can be thought of as observable signals of trust. They are relatively straightforward to identify and provide mental shortcuts to indicate a trustworthy person or organization. Credibility can be demonstrated and earned, but it can also be assigned by a trustworthy source. This "outsourcing of trust" is particularly evident among millennial investors. In contrast, professionalism is more subjective and less easily observed and assessed because it is about mindsets. Notably, the outcomes are both trust and value since these are inextricably linked. Trust cannot exist without value, and value creation without trust is unsustainable.

Trust in the System: **Information** Is Essential

Most trusted industries: The financial services industry ranks in the middle tier of trust. Technology is the most trusted industry among institutional investors, but all investors trust technology less than in 2018. Retail investors trust medicine more than any other industry.

Trust level differences: There is a significant trust gap between investor segments: 65% of institutional investors trust the financial services industry, versus 57% of retail investors with an adviser and just 33% of retail investors without an adviser.

Trust direction: The direction of trust also differs by segment. Overall, retail investor trust in financial services was slightly higher than in 2018 (from 44% to 46%), but institutional investor trust fell from 72% to 65%.

A fair system: For retail investors without an adviser, only 57% say they have a fair opportunity to profit by investing in capital markets, but this increases to 81% for those with an adviser.

Pension promises: Among the 400+ defined benefit pension plans surveyed, 48% said it is likely or very likely (greater than a 60% chance) that their fund will not be able to pay 100% of benefits in the next 10 years.

Trust in the Industry: **Innovation** and Technology as Trust Enhancers

Trust and technology: Approximately two-thirds of institutional investors and nearly half of retail investors with an adviser trust their investment firm more because of the increased use of technology.

Technology versus humans: When forced to choose between access to technology or a human, the trend has been for more technology, and for the first time, retail investors globally have an equal preference for technology and people.

Trusted advice: When retail investors are asked about whether they are more likely to trust a human adviser or a robo-adviser for investment recommendations, 73% still prefer human advice, which is relatively unchanged from 2018.

Artificial Intelligence: A strong majority of institutional investors (71%) are eager to invest in funds that employ artificial intelligence (AI) in the investment process.

Trust in the Investment Firm: The Desire for **Influence** and Control

Fees: 65% of institutional investors have renegotiated some manager fees within the last year.

The customization opportunity: 48% of retail investors would be willing to pay more for personalized products and services.

ESG motivations: 76% of institutional investors and 69% of retail investors have interest in ESG, though their motivations differ. Among those with a values objective, 73% of institutional investors and 67% of retail investors would be willing to give up some return in exchange for meeting their values objective.

Alignment of interests: Only 35% of retail investors and 25% of institutional investors say their investment firm always puts their interests first, unchanged from 2018.

Trusted source of advice: Only 59% of retail investors with an adviser say that their adviser is their most trusted source of advice, somewhat lower than in 2018, when it was 65%. This trust gap can be viewed over time in relation to the effectiveness of the investment advisory industry.

Key Takeaways

The role of information in trust:

- More informed segments of investors are much more trusting of financial services. To be more informed, information and knowledge are needed. Transparency is a factor in information. Education is a factor in knowledge.
- Despite more tools that support better communications and should increase transparency, investor perceptions of transparency have decreased over the last two years.

The role of innovation and technology in fostering trust:

- Using technology well makes investment firms more trusted, but investment advice is still primarily the domain of humans. Economic intuition and experience are still valued in a financial adviser.
- Having an adviser significantly increases the likelihood that an investor will consider new investment ideas and products as an early adopter. Financial advisers and consultants can differentiate themselves by offering new ideas and products to investors early. They also can provide an edge by offering more customized products and services.

The exercise of influence and control to create trust:

- Although the majority of investors believe the fees they pay are fair, high fees are one of the top reasons investors give for leaving an investment firm.
- There is significant interest in more customized products, and many retail investors—especially younger investors—would pay more for them.
- Similarly, the ability to invest in line with one's values is of interest, positioning ESG investing as a promising growth area.

Toward greater trust:

- The following have positive impacts on investor trust: strong performance track record, professional credentials, adoption of industry codes, demonstration of ongoing professional learning, and a strong brand.
- As pension challenges grow, the investment industry is accruing a deferred trust deficit on its collective balance sheet. In time, the industry will have to either participate in designing solutions with policymakers or be prepared to deal with the consequences of an eventual markdown in goodwill.
- The proportion of retail investors that say that their adviser is their most trusted source of advice needs to be higher to diminish the trust gap in the investment advisory industry. The trust gap between asset managers and asset owners is narrower but also needs to be addressed.

About the Survey

Respondents:
- 3,525 retail investors with minimum assets of US$100,000, except in India where the minimum was adjusted to 500,000 rupees
- 921 institutional investors of funds such as pension funds, endowments, foundations, insurance companies, and sovereign wealth funds, with minimum assets under management of US$50 million.

Markets included: Australia, Brazil, Canada, Mainland China, France, Germany, Hong Kong SAR, India, Japan, Mexico, Singapore, South Africa, United Arab Emirates, United Kingdom, and United States.
Visit trust.cfainstitute.org for full methodology.

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