Couples' financial risk preferences may lead to divorce

Dr. Marta Serra-Garcia

UC San Diego
RADY SCHOOL OF MANAGEMENT
The Brandes Center

Thoughtful advisors may keep couples on track toward their financial goals—and out of divorce court.

Research by Dr. Marta Serra-Garcia, professor at UC San Diego's Rady School of Management, shows "...couples who had the *most* dissimilar risk attitudes are twice as likely to divorce, compared to couples with the most similar preferences," as described in a press release issued by UC San Diego on Serra-Garcia's work.

Overall, couples exhibiting any differences in attitudes toward financial risk have a 12% higher rate of divorce.

Results of Serra-Garcia's study were published in *The Economic Journal* and "...measured the risk preferences of 5,300 couples in Germany from 2004 to 2017. Participants in the survey—conducted annually by the German Socio-Economic Panel—were asked how willing they were to take risks..." in six different areas such as careers, sports, driving and finances.

While couples had better odds overcoming differences in other areas of risk-taking, financial matters proved the most divisive.

"The main result of the paper is that spousal differences in risk attitudes predict future separation," Serra-Garcia said during an in-person interview. "Differences in risk attitudes toward financial matters are most important."

But what about relationships that do *not* end in divorce? How are partners in couples with differing risk attitudes able to stay together?

Serra-Garcia said there may be two optimal compositions of risk attitudes within a household. On the one hand, for partners with *similar* risk attitudes, it may be easier to make decisions regarding housing, vacations, saving, etc. "If your optimal level of risk is the same as mine, we don't have to negotiate."

On the other hand, when we think about individuals uniting as a couple, "opposites" may not only attract, but they may provide economic benefits. "It's not romantic, but why do we benefit from being together? If partners have different approaches to risk, they may balance each other out. In this case, heterogeneity is a plus," she said. "If we have risky income streams, as partners, we can mitigate shocks that are idiosyncratic. From this point of view, different risk attitudes are better. Ex ante, we do not know if it's a good or bad thing if we're different in terms of risk attitudes."

With new information gathered from the couples each year, the data set suggested that similar risk attitudes were best for couples. Serra-Garcia's analysis yielded other interesting findings.

"Our risk attitudes are not set in stone," Serra-Garcia said. "When I look at those who stay together and how they report their risk preferences over time, they tend to get closer and closer. Men tend to be more willing to take risks when they're younger. As they become older, they become less willing to take risks. Women tend to be more risk averse [throughout their lifetimes]."

Serra-Garcia surmised that financial advisors may assess risk preferences when first working with a couple. Personality tests and surveys designed to reveal such preferences tend to be part of the "know your client" rule for most advisory firms. But how often do advisors assess risk attitudes after the initial consultation?

"We know that seeing *other* peoples' choices influence our own choices," Serra-Garcia said. "Within a household, that influence could be even stronger." She suggested couples talk about their preferences. "Have conversations that spell out more clearly why is it that one person prefers a certain kind of [investment] product and the other may prefer a different type of product."

Advisors may find benefits in asking couples to complete risk assessment questionnaires throughout their working relationship—not only at the start.

THE ROLE OF THE FINANCIAL ADVISOR

Karl and Stacey Frank, partners at Englewood, Colorado-based A&I Financial Services, underscored the importance of ongoing conversations with clients about risk.

Karl, a former president of the Colorado Financial Planners Association, said they will ask questions about values and goals during initial "discovery" meetings.

"Sometimes, clients don't want to answer, but we just keep prodding gently to get to that deeper driver of what money means to them. Then, we can relate to clients and what's most important to them. We can do a financial plan, but the point is that the deeper conversations will help them stick with it."

Some of the questions or statements Karl and Stacey pose to couples include:

→ Identify 3 to 5 high priority values.
→ Share a value that serves as an anchor during times of turbulence.
→ How do values show up in your calendar and check book (time and money)?

SUGGESTIONS FOR FINANCIAL ADVISORS WORKING WITH COUPLES

1 | Talk with members of a partnership ***separately*** about risk—or ask them to complete a risk assessment survey on their own. Then facilitate a discussion of the results with each partner present.

2 | Repeat #1 periodically—not only at the beginning of a relationship.

3 | Be mindful of how one partner's risk preferences and/or the broader, macroeconomic environment may influence the other partner's responses.

4 | Carefully consider pros and cons if a couple seeks to maintain separate accounts vs. a joint account.

5 | Have regular conversations about risk, perhaps asking, "What keeps you up at night?" Or "What ***would*** keep you up at night?"

"I talk about my clients' level of equity exposure and then I ask them how they're doing with it," Stacey said. "That's my informal check-in around their risk tolerance. It's not a formal questionnaire, but I bring it up regularly. I let them talk with me about whatever is on their mind."

The notion of risk remains vital for investors. Peter Gulliver, Principal of The Gulliver Advisory Group in Moncton, New Brunswick, provides investment management services for high net-worth individuals and select institutions.

Gulliver, who has 23 years of experience, said, "More recently, I've included questions such as, 'How are you accessing social media?' That's often key to knowing your client and where they are coming from. Some of those 'know your client' questionnaires are outdated. They are capturing past experience, but it's a different world with social media and narrative economics. Before it was straightforward with behavioral biases, but now stories are being written to ***trigger*** those biases."

"There are ways for FAs who are less emotionally driven and more numbers driven to make an emotional connection and help clients stay on board," Karl said. "That's where the real money is made or lost—on the emotional side."

If couples are exceptionally different in terms of financial risk, would it be better for them to have separate accounts rather than a joint account?

Serra-Garcia said, "The research does suggest that if partners can't agree, they might think about separating the assets. If you have a joint account, it could be a basket of different products. Partners could discuss a balance of products that each prefers more. By pooling their risk preferences in one account, you could have the benefits of hedging or diversification."

"I've never had a couple keep separate accounts due to risk tolerance," Karl said. "I've had them keep it separate due to the source of the money; this is her mom's money or his dad's money, for example."

Stacey described one couple where it's the second marriage for each. "The money they made ***after*** they got married is combined; what they brought to the marriage goes to their [respective] kids," Stacey noted. "At first, she said she didn't like investments and didn't want to participate in any of the conversations. Then, she started to talk with her spouse and it brought up good conversations and brought them closer together. She transferred some other accounts and it turns out she had a pile of stocks and was actually ***more*** risky than she realized. Sometimes, the clients' perception doesn't match the investments."

"I'm not a big promoter of having separate accounts," Gulliver said. "I don't have one of those situations. About 98% of my clients are married. In one instance of divorce, it was exactly what [Dr. Serra-Garcia's] research suggested. When I met with them, she would always say, 'I don't know. I defer. He looks after this stuff.' She would come to the meetings, but not really be that fully engaged. When the marriage broke down, she told me they had different values around money. He'd go out and buy big ticket items and she didn't agree."

Advisors also may wish to consider the potential benefits of asking each partner about her/his risk preferences ***separately***. Or asking each to complete a questionnaire independently. Afterward, the advisor might bring the partners together to discuss the results.

"Asking such questions separately gives you an idea of the level of how willing they are to take risk—and the dissimilarity," Serra-Garcia said. She also noted advisors may have to adjust responses for the broader environment.

"The research shows[i] that when people experience a big recession, for example, they become more averse to risk," Serra-Garcia noted.

"With the 2009 crisis, you see willingness to take risks decreases. For FAs, it's compounded by their clients seeing their portfolio values go up and down. They are also experiencing losses and those losses change us."

Gulliver said many investors really don't understand risk. "I'll ask one partner, 'What does risk mean to you? How do you view risk?' The typical answer is, 'I've never thought of that before.' They rely on the other partner. Then I'll ask the other partner the same thing. And they often say, 'I don't understand that at all. That's why I hired you.'"

Serra-Garcia said her research may point to issues, but doesn't necessarily solve problems. "There's research and then there's policy application. The research hints at potential problems, but the research has not yet tested solutions to the problems of financial advisors. They have to interpret and apply their best judgment given these results."

DISCLAIMER

The Regents of the University of California and UC San Diego are not connected or affiliated with, nor do they endorse, favor, or support, any product or service of Brandes Investment Partners, L.P.

[i] Malmendier, Ulrike, Demian Pouzo and Victoria Vanasco. "Investor Experiences and Financial Market Dynamics." **https://eml.berkeley.edu/~ulrike/Papers/MPV_jun2018.pdf June 4, 2018**.

THE BRANDES CENTER
9500 Gilman Dr
La Jolla, CA 92093

CONNECT WITH US
rady.ucsd.edu/brandes
rpschmidt@ucsd.edu

UC San Diego
RADY SCHOOL OF MANAGEMENT
The Brandes Center