

# APPLYING BEHAVIORAL FINANCE IN YOUR FINANCIAL PLANNING PRACTICE

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- Decision-making & the human brain
  - Dual Process Theory – Kahneman



System 1  
Fast, automatic, emotional,  
subconscious



System 2  
Slow, effortful,  
logical & rational, conscious

- If System 1 drives so many decisions, can we help align System 1 with System 2?

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- Decision-making & the human brain
  - The Elephant, The Rider, and the Path



Source: Xavier Verges,  
<https://secure.flickr.com/photos/xverges/5276822875/in/photostream/>

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- Behavioral techniques can be used...  
...or abused



- Use "The Force" for good, not evil!

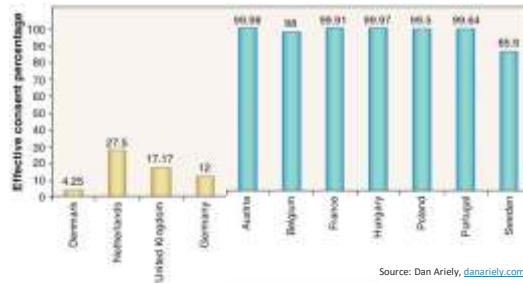
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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #1 – Defaults Matter
  - Encouraging organ donation



- Gold bars = Opt-in
- Blue bars = Opt-out

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #1 – Defaults Matter
  - The importance of choice architecture
    - Can influence the outcome... *all else being equal*
  - Business model implications
    - AUM fees vs commissions
    - Renewal plans vs ongoing retainers
    - The difficulties of hourly fees
  - Planning practice implications
    - Planning by default, or an 'extra' service?
    - Low cost & passive defaults?

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #2 – Price Saliency
  - The cost of (changing to) electronic toll booths



Tolls up 20% to 40% over baseline



Sensitivity to tolls *down*

Source: E-Ztax: Tax Saliency & Tax Rates, Amy Finkelstein, NBER Working Paper

- Less salient pricing = less sensitive to increases
- Less salient pricing = *more* willing to use!?

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #2 – Price Saliency
  - How salient are your financial planning costs?
  - Business model implications
    - Commissions vs Fees
    - Automatic payments vs writing a check
  - Planning practice implications
    - Clients using credit vs cash to control spending
    - Increasing the saliency of “bad” behaviors
    - More awareness vs irrational awareness?

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #3 – Write It Down
  - The power of John Hancock



- When we *act* by writing it down, we subsequently try to *act consistently*
  - From Chinese prison camps to setting goals to “testimonial contests”

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #3 – Writing It Down
  - Can you engage your clients this way?
  - Financial plan recommendations
    - Fill-in-the-blank goals
      - “I will save \$\_\_\_\_\_ in the coming year”
    - Fill-in-the-blank implementation
      - Rank the action items to be implemented
      - Write down *when* they will be done
  - Business model implications
    - Asking clients to sign to commit to planning?
      - Even check marks can help!?

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #4 – Get Commitment Incrementally
  - Getting your foot in the door...
  - A small commitment (sign) leads to willingness for a large commitment (billboard) later...
  - Even “mostly” unrelated commitments work!



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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #4 – Get Commitment Incrementally
  - Help clients change & engage over time...
  - Financial plan recommendations
    - The real reason we implement plans we pay for?
    - Help clients *truly* prioritize
      - “Do everything now” can actually be demotivating!
    - Having some planning successes leads to more
    - Applies to changing problem behaviors, too
      - The debt snowball approach
  - Business model implications
    - Are you asking your clients to buy too much at once?

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #5 – Faster Feedback = Faster Change
  - It's hard to change when you don't know how you're doing!
- Faster feedback helps us moderate our behavior
- Regular weigh-ins effective for maintenance too!



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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #5 – Faster Feedback = Faster Change
  - Are you giving *timely* and *relevant* feedback?
- Financial plan recommendations
  - Can clients really implement change when feedback only occurs at plan updates?
    - Technology to support ongoing monitoring
    - Increased information leads to *less* stress!?
- Business model implications
  - Is your business structured to support regular client feedback?
    - Are you prepared to close the timing gaps?

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #6 – Interactivity For Better Decisions
  - Do you really want to *own* it without a test drive?



- We like to touch, feel, and interact with something to get comfortable buying it
  - The same is true to get buy-in for behavior change!

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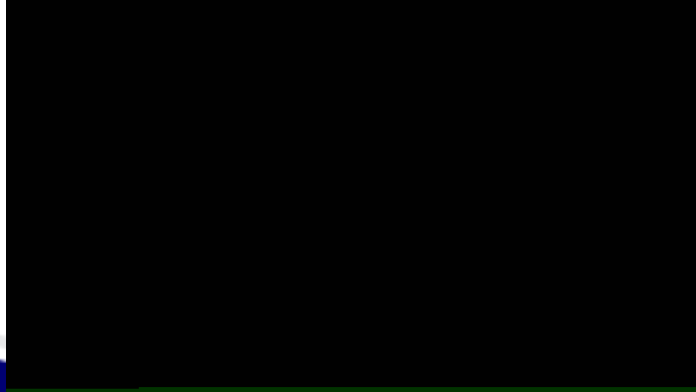
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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #6 – Interactivity For Better Decisions
  - Can you take your *plan* for a test drive?



Figlo Planning Software, Concept Video:

<http://www.youtube.com/watch?v=dnB1NOC9LKA>

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #7 – Anchoring & Context
  - What is the value of an intangible service?



- We all make comparisons by anchoring to something and then evaluating the difference

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #7 – Anchoring & Context
  - How can you keep or set the right context?
  - Financial plan recommendations
    - Benchmarking investments & results
      - Percentages vs Dollars
      - Evaluating losses and gains relative to high water mark
      - Relative vs absolute returns
    - Appropriate spending & lifestyle
      - Keeping up with the Joneses
  - Business implications
    - The cost of financial planning... compared to what?
      - If you don't *give* a comparison point, one will be made for you!

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #8 – Social Proof
  - “Because everyone else is doing it...”
  - If others are doing it, we assume they know something we don't
  - The more uncertain we are, the more we trust



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- #8 – Social Proof
  - How do we help clients validate w/ social proof?
  - Beware negative social proof!

“Many past visitors have removed the petrified wood from the park, destroying the natural state of the Petrified Forest. Please do not remove.”

- “Most people don’t save enough, have enough, etc...”

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #8 – Social Proof
  - How do we help clients validate w/ social proof?
  - Financial plan recommendations
    - “What most of our other *successful* clients do is...”
    - Help clients benchmark their success/failure
      - Knowing they save less than others encourages saving!
      - What do successful people *do* that they can model?

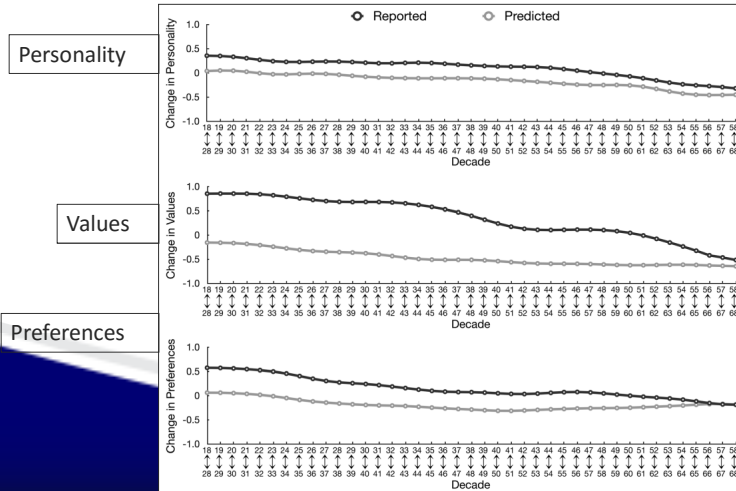
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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #9 – End Of History Illusion
  - Do you really know what you'll be like in the future?



Source: The End of History Illusion, by Quoidbach, Gilbert, & Wilson

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #9 – End Of History Illusion
  - Guiding clients through an uncertain future...
  - Financial plan recommendations
    - Be careful not to overweight current preferences
      - Clients may not really know their retirement lifestyle until they're close to it...
      - ...And may still misjudge their later retirement years!
    - Living prudently in the present vs working towards goals of the future?
    - Flexibility of the plan you create?
      - Be cautious about decisions that limit future choices?

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #10 – People Relate To People

- We are fundamentally social creatures...

- Including a picture with the x-ray results in 5x as many incidental findings!



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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #10 – People Relate To People

- How can you help support social accountability?

- Financial plan recommendations

- Encouraging clients to share their goals
  - Social accountability drives weight loss & exercise!
- Committing to be an accountability partner
  - But doing it tactfully!

- Business implications...

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- #10 – People Relate To People
  - Business implications...
  - When clients visit your website, do they see you?

If you ask him, William Bissett will credit Alan Greenspan for getting him into the world of financial planning. The former Chairman of the Federal Reserve didn't do it intentionally, and it's unlikely he'd recognize William if he ran into him on the street, but the influence was there.

"I was a waiter for a Washington, D.C. caterer from 1990 to the winter of 2000, and we worked a lot of upscale parties. The hosts would always invite the big names in town, and at that time, Alan Greenspan was one of the biggest. I must have seen him about a dozen times in six weeks."

Intrigued by this celebrity of the financial world, William picked up a copy of Bob Woodward's *Maestro: Greenspan's Fed and the American Boom*, and was hooked. When he left the catering job to return to classes at North Carolina State University, William switched his major to economics.

After graduation, he went to work for an insurance company in Charleston, South Carolina. They told him during his interview process that they did financial planning, but William soon discovered that wasn't true. "They were really just trying to sell insurance and annuities," he remembers. Around that time, he learned of an opening for a financial planning associate at Pinnacle Advisory Group, and by the first week of 2009, was the company's newest employee.

He took to the work quickly, and found that his analytical mind and natural ability to connect with people gave him an edge. "At its most basic level, financial planning is simply risk management. When clients tell you they want to retire next year, you need to try to poke holes in their plans. That's the only way you'll find the risks that they may not see. You're looking for every possible way they might get derailed from what they want to do. You can't prevent every problem, but you need to figure out where the real dangers are."



- Are photos of your clients attached to your client software for your staff to see?

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## BEHAVIORAL FINANCE & FINANCIAL PLANNING

- Applying behavioral finance
  - The point is to align system 1 impulses with system 2 rational goals...
  - To help achieve the *client's* goals!



- Use the force for good and not for evil!

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