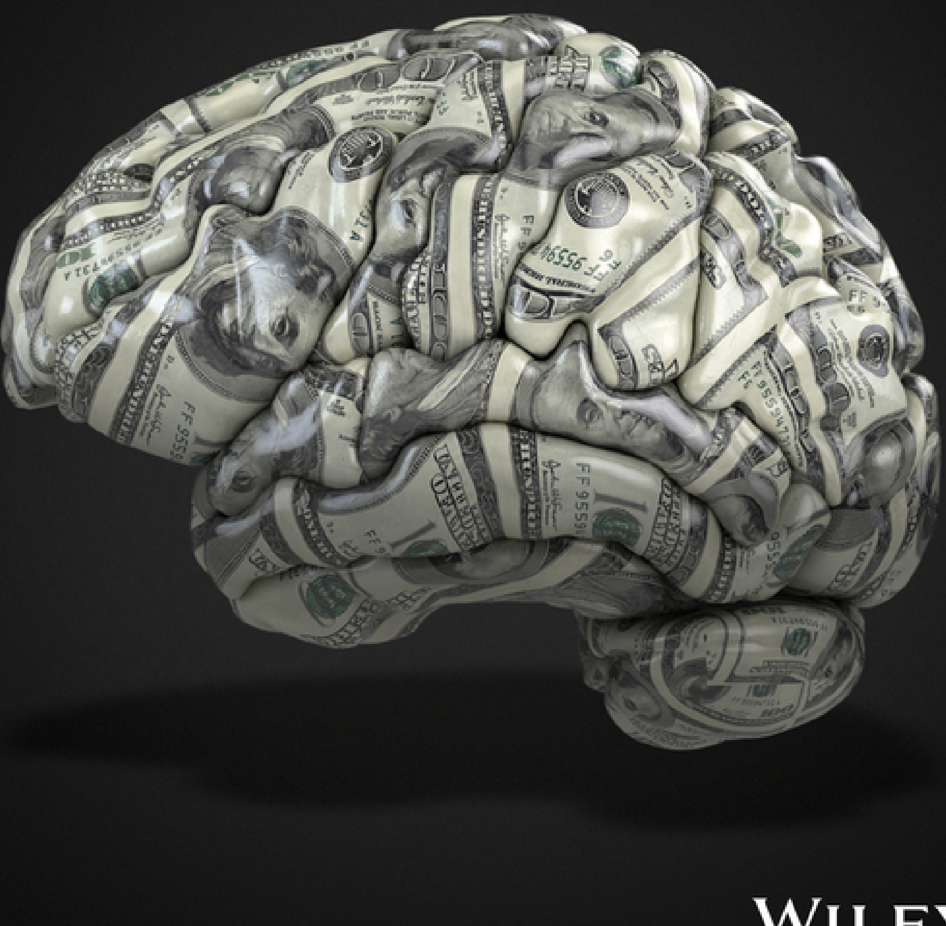
CFP BOARD CENTER FOR FINANCIAL PLANNING SERIES

CFP BOARD CENTER FOR FINANCIAL PLANNING

CLIENT PSYCHOLOGY

EDITED BY

DR. CHARLES R. CHAFFIN



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Client Psychology

Client Psychology

CHARLES R. CHAFFIN, EdD
EDITOR

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Acknowledgments

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Thank you to Kevin Keller, CEO of CFP Board, and Marilyn Mohrman-Gillis, Executive Director of the CFP Board Center for Financial Planning for their commitment to the Academic Home for the Center for Financial Planning. This work started in 2011 with a vision—a platform where members of academe from multiple disciplines as well as practitioners from across financial planning could present, publish, consume, and discuss research that impacts our academic discipline—our profession—in new and profound ways. It is truly satisfying to see that vision come to fruition.

Thank you to all of those individuals and organizations who support the CFP Board Center for Financial Planning, particularly TD Ameritrade Institutional for their support as Lead Founding Sponsor and Northwestern Mutual as Founding Sponsor. We are grateful to all of the firms, CFP® professionals, and friends from across business models and professions who have joined us on this journey to build the Academic Home for the profession of personal financial planning.

In the end, I take responsibility for this work—a work that I hope will help serve as a catalyst for expanding the financial planning body of knowledge to include the biases, behaviors, and perceptions of the individuals who entrust this profession with their life's work: the client. The objective of this book is not to be the last word in client psychology, but the first word. I hope that the text found within these pages will fuel both new lines of inquiry and innovative approaches to financial planning practice, making our profession more impactful, relevant, and most important, client-centered.

Charles R. Chaffin, EdD
Editor

Preface

Financial planning is, at face value, a quantitative endeavor. There is a host of numbers that exist within a financial plan, representing a client's savings, debt, investments, retirement, insurance, and other numeric values associated with his or her financial well-being. In the proposed changes to the CFP® Board Standards of Professional Conduct, the CFP Board defines financial planning as ". . . a collaborative process that helps maximize a Client's potential for meeting life goals through Financial Advice that integrates relevant elements of the Client's personal and financial circumstances" (Proposed CFP Board Standards of Professional Conduct, 2017). Inherent within that definition are both the steps of the financial planning process as well as the content areas, essentially the necessary competencies of a CFP® professional, to provide competent and ethical financial planning.

The role of the financial planner is challenging and with it comes a high level of responsibility. Beyond the numbers, clients entrust not only their goals and dreams to their CFP® professional, but also the accumulation of their life's work. Years, and in some cases decades, of long hours in the office and careful investing culminate into a specific set of numbers on a spreadsheet. Clients bring into the financial-planning process their vision for the future as well as their vision for those closest to them. Conversely, clients also bring concerns regarding the current and future well-being of their loved ones. The financial planner is sometimes the first to hear the good news and is also the first phone call or text message when bad news arises, both of which require frank conversation, careful planning, action, and sometimes, thoughtful inaction. Therefore, financial planning is, at its core, a human endeavor.

So what about these clients? How do we help them discover (and then communicate) their hopes and dreams? What about the goals for their spouses, partners, or families? How do the interactions with those around them affect their decisions and financial well-being? How do relationships and communication with their advisors impact the financial-planning process? What do we know about individual behaviors such as spending, debt, planning, and saving relative to a variety of client profiles and contexts? How does stress impact the dialogue between the client and planner . . . what can the planner do to mitigate this stress? How do the cognitive load and attention resources of the client during the development and presentation of a financial plan impact the client's relationship with the planner? How does technology impact a client's willingness to communicate more freely with their financial planner? What about the sociological issues that are inherently part of the relationship between client and planner? Beyond these questions, there are hundreds more that financial planners encounter each and every day, many of which have a direct impact on planner efficacy and client success.

Behavioral finance helps answer some of these questions. It brings elements of cognitive and behavioral psychology to both economics and finance to examine why investors make irrational financial decisions. These irrational decisions in many cases stem from heuristics, or mental shortcuts, that involve only one aspect of a complex program or phenomenon, leading to errors in judgment, or biases. In behavioral finance, the focus is on the individual and not the market. Essentially, and at the risk of oversimplifying, the tidiness of modern portfolio theory becomes rather messy with the arrival of the human and all of his thoughts and actions. Behavioral finance helps explain some of that messiness with an underlying premise that the individuals making the decisions are complex and not always well-informed. All of these ideas are relevant to financial planning. Practitioners need to know about concepts such as choice architecture, anchoring, and availability bias, all of which have an impact in the daily life of serving clients and are helpful in explaining some of these irrational decisions.

But are these decisions actually irrational? From the outside looking in, it may appear so, but it is also possible that these decisions can be explained by a host of other factors. Many psychologists, including preeminent scholars such as Skinner and Freud, saw many of the actions of the individual based predominantly on environmental factors and those within the psyche of the individual. Skinner saw the environment as solely determining the actions of the individual. Essentially, the individual does not make any decisions on her or his own—the environment does it for them. Freud saw the unconscious—the automated and visceral elements of the self and thought processes—as a key determinant of behavior and decision-making. Although Freud and Skinner saw many elements of psychology quite differently (and there are many aspects of their work that have been both confirmed and refuted in recent years), their work identifies multiple factors that impact human behavior and decision-making. Therefore, what is an irrational decision to one may be the best decision, given the circumstance, to another. So perhaps irrational is in the eye of the beholder.

The body of literature from behavioral finance is critical to our current and future work in serving clients (as well as important parts of this book), but perhaps we should think more broadly. We need to further investigate stress, cognition, interpersonal relationships, communication, identity, and other basic elements, all within the framework of financial planning. We need to invite researchers from fields such as clinical and cognitive psychology, sociology, education, and others to better understand the rationale behind client perceptions, behaviors, and decision-making and then specifically outline the implications of this work (the "So what?") in an effort to help practitioners and CFP® professionals do their work better.

In medicine, evidence-based practice is where medical professionals use relevant data to make healthcare decisions for individual patients. Clinical practice, patient values, and the best available research and data are all integrated to formulate a healthcare plan. Perhaps most importantly, individual characteristics and preferences—so essentially what works best for each patient physically, psychologically, emotionally, and spiritually—are primary drivers in determining treatment. It is not, therefore, merely a matter of one-size-fits-all nor a sole focus on the action of the physician, but rather, a personalized approach to medicine based upon the patient's health status, research, and desired outcomes: a patient-centered approach.

Similarly, in education, the classroom approach for decades was teacher-centric, where the actions and knowledge of the teacher were considered the primary drivers in determining the success of an educational offering or program of study. If the instructor performed his or her actions well, then the assumption was that the students must be successful. But then, a few decades ago, educational psychologists identified key attributes associated with cognition and learner development to help better understand the student learner. These advances placed the focus of teaching pedagogy (essentially, the practice of teaching) on what works for the learner, not the teacher. We now almost universally define success in education as not what the teacher knows or does, but rather, by whether the student learned a concept or not: a student-centered approach.

Perhaps we are at a similar juncture in financial planning, where the profession has begun to realize that the knowledge and actions of the planner are critical, but useless if the client is unsuccessful. No financial planner says, "My client failed to reach her lifetime goals, but not to worry, I myself was competent throughout the financial planning process." We as a profession can follow medicine and education and develop deeper insights into our practice and focus more closely on the individual. Ultimately, taking this evidence-based approach to financial planning, specifically the characteristics of the client, would yield new findings that could help prepare future generations with the competencies and skills that directly relate to the human element of this profession. The basic fundamentals of investments, taxation, insurance, estate planning, communication, and so on would still and likely always be vital, but these content areas and competencies can be developed and refined solely with the client in mind: a client-centered approach.

Against that backdrop, I present *Client Psychology*. This book brings together the expected research areas such as financial planning, behavioral finance, communication, and financial therapy. Just as importantly, client psychology invites new fields (or those new to financial planning) such as sociology, cognitive psychology, education, social work, and others. This interdisciplinary approach, bringing diverse fields, methodologies, and researchers together to focus on the financial planning client, can lead to new knowledge that has a significant impact on our profession. As we all know, all of this new knowledge has limited relevance if we cannot answer the "So what?" question. We hope to do so here.

There is an added dimension to this work given the influence of technology in financial planning. As the use and access of artificial intelligence and technology expand, there are a multitude of opportunities and threats to the profession as it strives to be relevant to the population it serves (and perhaps is hoping to serve). The profession has the opportunity to be creative in delivering competent and ethical financial planning through a combination of in-person and electronic delivery, all based upon client needs and preferences. In order to fully serve each client and maximize market potential, the profession needs to have a full awareness of the tendencies and perceptions of the user. In addition, at the tap of a smartphone or tablet, clients now have access to increasing amounts of data, whether their own accounts or financial advice from others, potentially altering the complexion of (and potentially the need for) the client-planner relationship. Taking an evidence-based approach to financial planning, we can use much of the body of literature found within client psychology and then utilize or build technology that fits the needs of our current and future clients. As we all know, learning as much as possible about clients will make our profession more relevant to clients.

Client Psychology is not the final and definitive word in financial planning. Rather, it is a commencement to an approach that brings together many fields of study that can have some impact on the financial planning client, always with their best interests in mind. Our attempt is to provide a new theoretical underpinning through a body of literature from across the academy. Each chapter represents a formal introduction of these new concept areas to a broad audience of practitioners and scholars. As you read each chapter, my hope is that you will be drawn to the argument as to why each of these diverse topics is important to our field. Some chapters draw explicit connections to financial planning and others ask the reader to infer where specific concepts fit into daily practice. I hope that scholars from within and beyond financial planning will be challenged to think about new lines of inquiry within this framework that help us as a profession become more client-centered. To summarize this book and at the risk of giving away the plot, it is a new theoretical framework with contributions from a variety of academic disciplines to enable financial planning to become more client-centered.

So let us begin. I hope that you find *Client Psychology* both challenging and illuminating, but perhaps more importantly, I hope that you finish the book with more questions than when you started. We all still have so much to learn.

Charles R. Chaffin, EdD
Editor

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CHAPTER 1

Client Psychology

Charles R. Chaffin, EdD
CFP Board Center for Financial Planning

Jonathan J. Fox, PhD
Iowa State University

Ben (59) and Colleen (49) Orr are not entirely uncommon clients in the practice of financial planning. While they are entrenched in a successful family business and rewarding careers, they are typical clients with a host of financial challenges, somewhat undefined long- and short-term goals, and a family with complex interpersonal dynamics.

This is the second marriage for both. Ben has three children with his first wife, Nina (58). Nina retained 33% ownership of the private cleaning supplies corporation that she and Ben started 25 years ago and she remains actively involved in company management. Ben and Colleen almost never discuss Nina's continued involvement in the business and family. Of Ben and Nina's three children, Mary Jo (34) and Ernest (32) are principals in the family business and both are married and have children of their own. Their 29-year-old son, Jacob, resides in a local community serving adults with developmental disabilities.

Colleen's first spouse was killed in an automobile accident soon after their second anniversary. With modest life insurance benefits, she completed graduate school and now loves her work as a professor of math education at the state university. She currently has no plans or intentions for retirement. She and Ben married 15 years ago, and have two children, John (14) and Joan (10).

Ben and Colleen are committed to planning for Jacob's needs for the rest of his life. Ben would like to retire in 7 years and wants to transfer ownership of the company to his adult children Mary Jo and Ernest, but he doesn't know what Nina wants to do with her interest in the company. Ben has no clear plans for what he may do in retirement. He just knows the work of the company is all-consuming and he needs a change. Ben and

Colleen are committed to setting aside some funds in a separate account to help support John and Joan when they attend college and believe they have adequate resources to do so.

Another looming concern for Ben and Colleen is Ben's 81-year-old father, Jack. Ben lost his mother to cancer 10 years ago. Since that time, Jack has lived alone in a town about an hour's drive from Ben and Colleen. Ben visits when he can, but makes a point to call and talk with his father at least once a week. Jack is in relatively good health and enjoys several volunteer activities and golfing with friends. Lately, though, Ben has noticed that his father has become more forgetful and he is not sure if what he is seeing is a normal part of aging or the early signs of dementia or Alzheimer's. Ben worries that his father might forget to pay his bills or become vulnerable to fraud. He knows Jack meets with a financial advisor a few times a year. Ben wonders if he should give his father's financial advisor a call, to share his concerns and see what she has noticed during client appointments with his dad. Under most objective measures, Ben and Colleen are financially healthy. Not including the value of the cleaning supplies company, their net worth is approximately $2,600,000. This is comprised of approximately $3,000,000 in assets and $400,000 in debt, in the form of a home mortgage and a personal loan taken to grow the business. A recent independent valuation of the business came in just under $9,000,000. The bulk of their financial assets are in conservative, income-driven investments within qualified retirement plans. Ben has never been a fan of financial risk and equity investing. He still talks about the few equity funds he held, and quickly sold, in 2008. He is more comfortable with direct control over his company assets and has never been open to others controlling his money. Most of the retirement assets are Ben's with Colleen designated as the beneficiary. Colleen considers herself more of a risk taker when it comes to investing and her retirement assets (approximately $110,000) are mostly invested in small cap index funds within her university's 403(b) plan.

Colleen believes Ben spends too much on travel, company and family celebrations, and charity. She is the primary manager of the family budget and tries to keep their spending on track but has been frustrated lately that their annual rate of saving is almost zero, excluding retirement contributions through the company and the university. They own a four-bedroom home in a neighborhood of homes valued between $250,000 and $300,000. Their mortgage balance is approximately $175,000.

Ben and Colleen believe they have adequate protection against the risk of financial loss, but it has been at least 5 years since they have given insurance coverage significant thought. Both are so busy that the thought of evaluating life, home, automobile, health, disability, umbrella liability, and long-term care options seems overwhelming, yet it is something they know they need to do. Colleen has life insurance through the university with benefits of 2.5 times her $88,000 annual salary. She is not sure who her beneficiaries are for the policy. Ben has a $3,000,000 term life policy connected to the family business, with Nina as the primary beneficiary and their three adult children as secondary beneficiaries. They are covered under a group health plan connected to Colleen's university and have homeowner and automobile policies but don't remember the last time they reviewed coverage and costs. Ben and Colleen each drive older, reliable vehicles with no automobile loans. They have a $1,000,000 umbrella liability policy but no disability or long-term care insurance.

Ben and Colleen have simple wills and healthcare power of attorney documents that were drafted 13 years ago, just after the birth of John. In their 15 years of marriage, Ben and Colleen have never committed to working with a financial planner. Ben is hesitant to turn everything over to one person or company. He likes bouncing ideas off his many financial advisors (accountant, attorney, retirement investment advisor, and insurance agent), but prefers to make his own decisions in the end. Colleen is growing increasingly frustrated with the lack of coordination between the finances of the business and their household. She has been suggesting that they use the services of a Certified Financial Planner™ (CFP) for years. They have visited with a few planners for initial consultations, but never made the commitment. Ben and Colleen's situation is complex: There are not only difficult decisions to make, but the number of decisions is overwhelming.

As you move through the methods of inquiry in this book, keep a case family like the Orrs in mind. Keep asking yourself, "What really guides Ben and Colleen's decisions? How have these decisions been shaped by both mathematical calculations as well as gut-level intuition? When is it mostly about money, and when is it family relations that matter most? How do clients' understanding of risk impact the decisions they make? How do the dynamics of marriage and communication patterns impact the formulation of life plans and goals? How do personalities, upbringing, and personal identities influence spending and saving patterns and retirement investment choices? How often and in what ways do clients like Ben and Colleen communicate with one another about their goals and vision for the future, and to what extent should that communication matter to you as their counselor and advisor?

Ben and Colleen are in mid-life, but Ben is a decade older than Colleen. How might the aging process affect their decision-making capacities now and in years to come? Will the age difference matter more or less in later life? At what point might each be at risk of cognitive decline and loss of financial capacity? Since Ben is older, what should Colleen understand about age-related changes in cognition? What makes them, and clients like them, more or less willing to trust your advice?

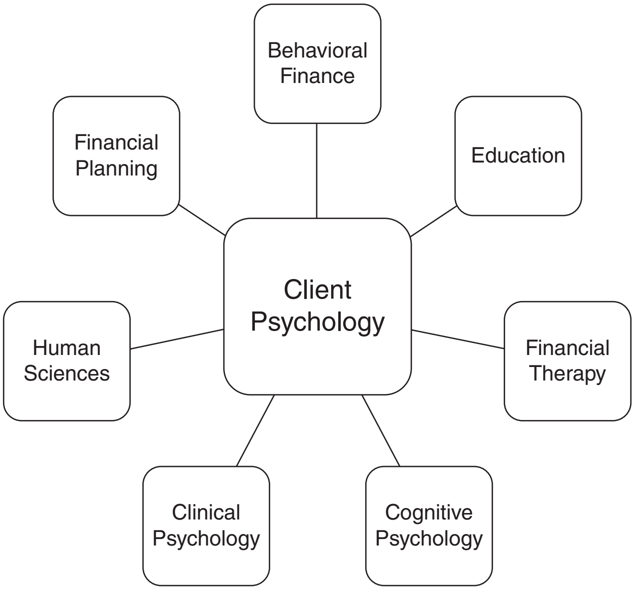

FIGURE 1.1 The Academic Disciplines of Client Psychology

These are the types of questions this book is attempting to address. By working more systemically and holistically beyond the tenets of optimal resource allocation theory and behavioral finance, we find new approaches to the deeply human questions defining the financial lives of Ben and Colleen. All of these questions require an in-depth analysis of multiple academic disciplines to help better serve Ben, Colleen, and their family that goes beyond the traditional content areas associated with financial planning, such as estate planning, taxation, and investments. This leads us to client psychology.

For the purpose of this book, client psychology is defined as the biases, behaviors, and perceptions that impact client decision-making and financial well-being. By anyone's standards, that is a broad umbrella. However, holistically serving a financial planning client requires a broad approach, taking multiple academic disciplines, research methodologies, and traditions from various programs of study and professions. Biases are our inclinations for or against a certain object or person. Client biases may relate to interpersonal matters and could be based upon one's past experiences. Behaviors are our responses to a given situation and stimulus, which, in a client context, are more likely to be observable. Perceptions are recognitions of the lived experiences of the individual, the lenses by which they look at the environment