PRACTICE MANAGEMENT

From Irrational to Rational

6 steps to guide clients to productive decisions

by Barbara Kay, LPC, RCC

In modern society, money is the primary tool for survival, security, and satisfaction. In previous hunting, agrarian, and bartering societies, money was one of multiple sources of sustenance; today, it's *the* source. Consequently, every primitive survival and pleasure-seeking drive is intensely focused on capturing and guarding money. These drives are involuntary and highly emotional—they emerge more quickly and forcefully than logical analysis, making it hard for people to be objective.

Even rational thinking is frequently unreliable. Daniel Kahneman describes two kinds of rationality in his authoritative book on cognition, *Thinking, Fast and Slow*. One makes rapid judgments based on learned patterns and sweeping assumptions. The other is intentional, slow, and difficult. Productive financial decisions require the second kind, but regrettably, humans avoid hard thinking. We much prefer to make quick, easy judgments, but this quick intuitive thinking is filled with biases we don't recognize.

Given the plethora of unconscious drives and biased assumptions, especially about money, how can financial planners guide clients to more reasoned choices? First, be aware of the biases that arise from emotional instincts and intuitive thinking (these biases can be grouped under three categories: pain avoidance, appeal, and accuracy biases). Then, follow the six steps presented here to make better decisions.

Pain Avoidance Biases

Humans are wired to avoid pain with irrational intensity. As a result, we are susceptible to loss aversion and overestimation bias. Loss aversion is the experience of feeling losses two times more painful than the gratification of gains. Consequently, we avoid losses more aggressively than we pursue gains. In addition, the overestimation bias drives us to irrationally avoid highly unlikely negative events with one of the following characteristics: vividly traumatic; repeatedly communicated; personally relevant; or strongly emotional.

This is why some clients are overly fearful of another financial meltdown. The Great Recession fit not just one of those characteristics, but all four. It was traumatic, the media repeated the story incessantly, and clients personally experienced the impact with powerfully painful emotions. Constant reporting of recent market gyrations trigger a strong overestimation bias that another meltdown is coming and a powerful loss aversion drive to avoid it.

Appeal Biases

Not only do people irrationally avoid unlikely painful events, they are also swayed by positive impressions that lack credibility. The appeal biases create more natural, but faulty conclusions.

Individuals gravitate to things that are easy and attractive. Consequently, if it is appealing, we assume it must be true and desirable. As a result people:

- Judge by ease of viewing over substance (fluency bias)
- Believe just because it appeals (affect heuristic)
- Focus on the story over credibility (Kahneman's "what you see is all there is" or WYSIATI rule)
- Believe a good first impression predicts the future (halo effect)
- Believe only positive and reject negative evidence (confirmation bias)
- Assign cause and value judgment (causality bias)

This is how clients are persuaded that the "sure thing" artfully displayed on

television or described confidently by a colleague must be true. It looked good and there was early success; the promoters must be right, because it can't just be an empty promise or random luck.

Appeal biases work negatively as well. Negative impressions are equally difficult to dislodge once established.

Accuracy Biases

Accuracy biases are the result of our preference for patterns and conclusions over fact. They lead us to:

- Believe something just because it has been repeated (repetition bias)
- Believe something is likely because it happened recently (availability bias)
- Overestimate the truth based on few examples (law of small numbers)
- Follow other people, regardless of personal relevance (herding)
- Cling to old expectations despite new circumstances (anchoring)
- Decide for current pleasures over future pleasures (affective forecasting error)

This is why clients are so panicked about inconsequential downturns. The news focuses on negligible drops, which reminds clients of other downturns, which *proves* the negative predictions, despite little evidence. Other people are acting, so clients feel compelled to act too. In addition, they may be fixated on protecting a perceived value. Moreover, clients can't accurately predict how badly they will feel when an impulse decision leads to future regret.

The cascade of pain avoidance, appeal, and accuracy biases create a combination of intense feelings and unreliable conclusions that financial planners routinely face. Recognizing them is the first step. Then, six corrective steps can be employed to lead clients toward more thoughtful decisions.

Step 1: Predict Irrationality

Predict that human beings are frequently not rational decision-makers, especially

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about money. In psychology this is called *normalizing*. In effect, we take the surprise out of irrationality. It takes away the guilt and the feeling that there is something wrong when clients have a hard time being logical. Set the expectation that this natural faulty intuition will arise frequently, then explain how you will help avoid this risk. Clients will be more cooperative when they expect proactive intervention for a natural phenomenon.

Step 2: Listen for Emotions

Rationality is suppressed when emotions are high. When faced with an irrational client, listen for the underlying emotions—likely fear, anger, or both. Remember that anger may be a cover for feeling fearful. Don't react to the anger. Instead, ask the client to describe their most important concerns. Often this will clear away misleading complaints and uncover the core fear that is driving the cascade of emotions. Rational decisions cannot be made until the irrational emotions are addressed.

Step 3: Acknowledge and Normalize

After the emotions surface, acknowledge the experience of the client by verbally reflecting what you hear. Do not agree with anything irrational or false. Instead, acknowledge how they feel. It is difficult for people to move forward until they feel heard. This is an opportune time to wholeheartedly validate their experience. After all, their experience is completely normal and expected. Then, reinforce your role in helping them sort through the feelings and facts to come to a thoughtful decision.

The key in these conversations is to show genuine concern and respectful humility. We encounter the same human fallacies, so we can certainly relate to their experience. After we reveal the emotions, we can acknowledge their experience and come alongside as a guide, and various tools can be used to develop a more reasoned way forward. The next three steps are useful methods for activating analytical thinking. These techniques elevate the client's perspective out of the shortsighted perceptions that reinforce the most risky impulses and intuitions.

Step 4: Repeat the Big Picture

People routinely fail to remember the past. We are myopically focused on the limited evidence and feelings of the immediate present, especially when emotions are heightened. We need regular reminders of the big picture. Use graphics and visuals to put today into the long-term perspective. Given all the pain avoidance and accuracy biases triggered by daily media onslaughts, it's not surprising that clients need frequent support. You will be less frustrated by the need to review again if you set your expectation that this is normal.

Step 5: Use Vivid Fluency

Make your points with easy-to-understand vivid graphics. People remember concrete images much better than abstract numbers. In addition, we feel good about things that are easy and dislike messages that are confusing or hard. Complex data presentations will likely make clients feel worse. Ideally, the adviser relationship will be a source of calm and comfort, not increased stress, otherwise, pain avoidance biases may emerge, leading clients to avoid their adviser. At every opportunity, use simple, colorful graphics to display information; seek to provide appealing clarity and comforting relief from anxiety.

Step 6: Visualize Future Feelings

People are very poor predictors of the impact of current decisions or future feelings. Therefore, we tend to pursue immediate pleasure over future benefits. To counteract the urgency of "now," use images to portray the impact of today's decision on tomorrow's future, where possible.

Research has found that people save more for retirement when they are shown photos revealing a future of scarcity or comfort. When photos are not practical, have clients describe how the results of various decisions will look and feel in the future. Until people can picture themselves experiencing their future, they will focus more on obtaining immediate pleasure. Visualization of future feelings is also helpful when clients are overwhelmed with fear. The intense need to relieve anxiety today can easily lead clients to underestimate the feeling of future regret and the impact of impulsive decisions.

The challenge for financial advisers is to recognize and productively guide clients away from impulsivity and toward rational thinking, which goes against human nature. Fortunately, good tools will shift the perspective and illuminate a productive path forward. ■

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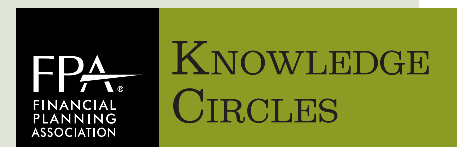

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