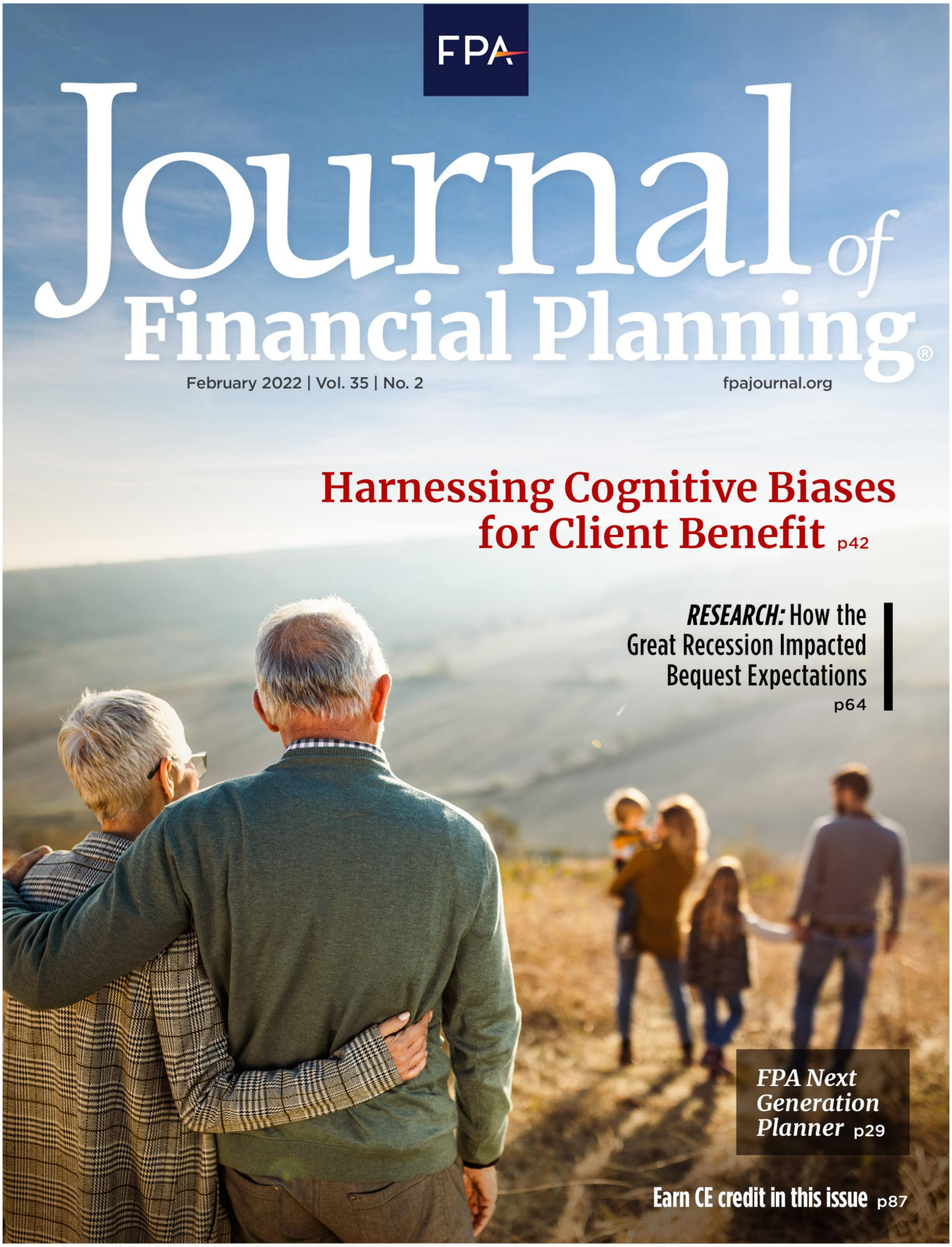

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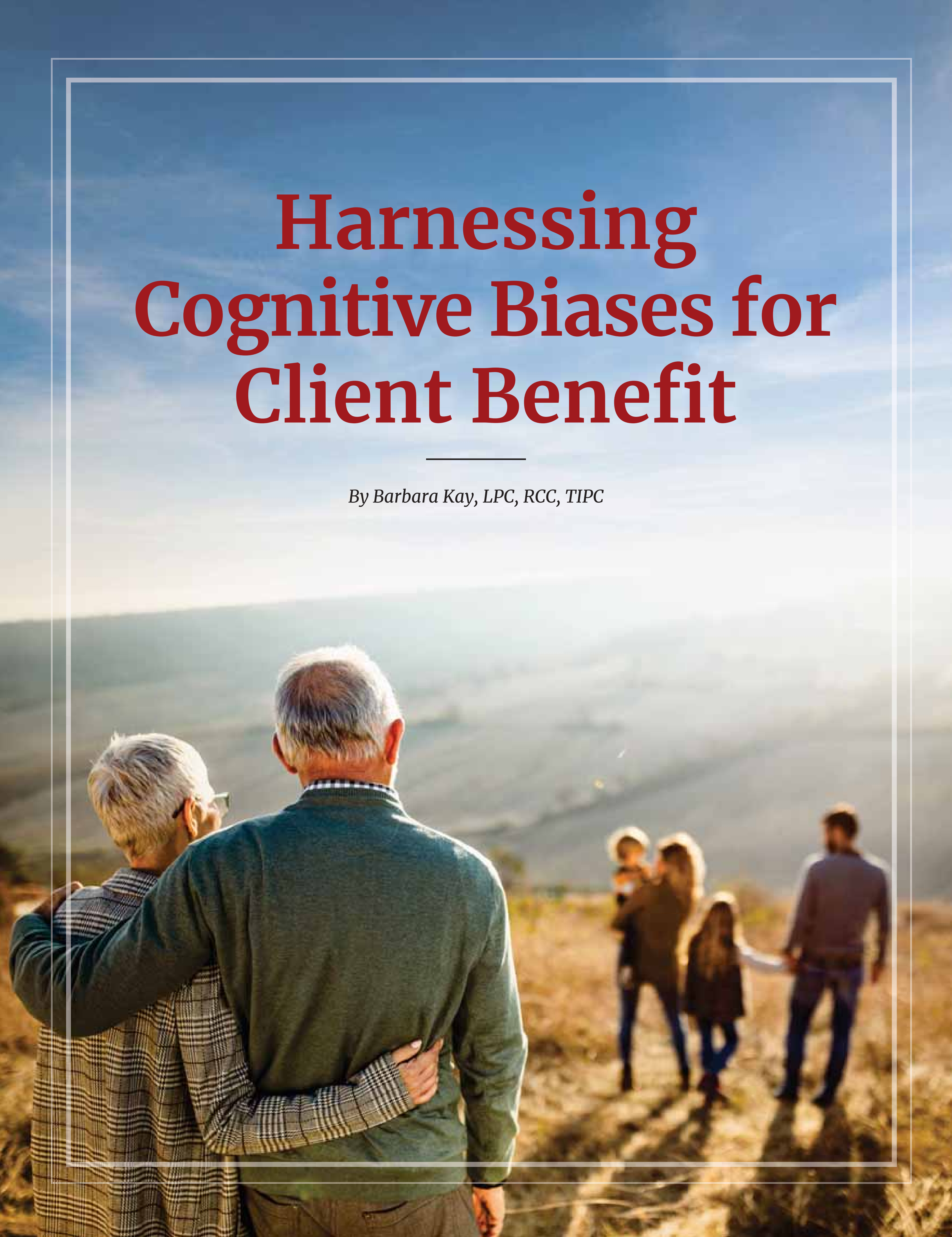
Harnessing Cognitive Biases for Client Benefit

By Barbara Kay, LPC, RCC, TIPC



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The illusion of control and mirage of invincibility evaporated with the arrival of COVID-19. Suddenly, the entire nation faced a threat to good health and financial security. Out of the blue, catastrophe was looming. This jolt to the national psyche is showing up in the insurance marketplace. The first six months of 2021 marked the largest jump in life insurance sales in 38 years, according to the insurance group LIMRA. These sales reflect pandemic-related fears. Surveys show nearly a third of consumers (31 percent) are more likely to purchase life insurance as a result of the pandemic.[1] Families who need life insurance are not the only ones impacted by fear. The millennial generation (18–34 years) launched into estate planning last year. In 2019, only 18 percent of millennials had a will. In 2021, that jumped to 27 percent. In fact, millennials had more pandemic-motivated estate planning than their mid-life peers.[2]

This recent rush to prepare for a catastrophe is a result of the same tendencies that normally lull people into careless complacency. The studies of social psychologists like Harvard's Daniel Gilbert show current events and recent experiences loom large in our minds. Facts are ignored in favor of feelings generated by daily interactions. As a result, humans are dreadful at accurately forecasting and planning for future needs. Hence the rise of behavioral finance, which studies the psychology of financial decisions. This field focuses on understanding human cognitive biases, much of it building on the work of Daniel Kahneman, Amos Tversky, and Richard Thaler. So far, behavioral scientists have identified a dizzying list of 175 biases.[3] That's the bad news.

> **"Next to physical health, financial security is fundamental to human well-being."**

Fortunately, many biases share common roots and ultimately arise from a central evolutionary skill set: the ability to react quickly and intuitively. Before agriculture and tools, human survival centered on immediate activities. You seized any opportunity for food, water, safety, and satisfaction. Those who responded to threats intuitively and quickly were more likely to survive. Although human experience has changed drastically, our brains are still wired this way. We hotly pursue what looks and feels appealing. Conversely, we avoid things that look bad, feel bad, sound bad, smell bad, and taste bad. This highly evolved visceral intuition is a key source of today's cognitive biases. It still serves to evade immediate threats, but woefully underprepares us for risks that might not present themselves in two years, 10 years, or 30 years. That's the challenge. What do we do with the many human biases that are wired to pursue today's needs, but not tomorrow's?

Using the Power of Cognitive Bias for Crisis Planning

The pandemic is a great example of how fast people change behavior when faced with a clear threat. A catastrophic event was no longer a vague, unlikely, distant, unappealing thought experiment. The pandemic has been vivid in all the ways that motivate action. It's been dramatic, emotional, highly detailed, ever-present, and personally threatening. This activated the immediate survival instincts, and people got moving.

> **"What do we do with the many human biases that are wired to pursue today's needs, but not tomorrow's?"**

Fortunately, we do not need a global crisis to help people act in their best interests. Financial professionals can follow a five-step process that works with cognitive biases to help clients, of any age, protect their financial security in the event of a crisis.

1. **Activate with prompts.** Recency, availability, and inertia are just three of the biases that delude people into careless planning. We tend to focus on priorities that are directly in front of us. The daily urgencies deliver constant reminders. When a crisis is not a near-term possibility, we don't pay attention. The inertia of maintaining the status quo further dulls any occasional intentions of long-term planning. Advisers have the unique opportunity to bring crisis planning into the foreground with active prompts. Given that daily urgencies operate around the clock, a once-a-year reference is not likely to stay top of mind. Consider ways to keep healthcare and risk-protection planning current with repeated prompts. Regular prompts deliver the recency, and availability bias needed to gain attention. Then continue with the next steps to make it both urgent and actionable.
2. **Make it real now.** A 2021 Morningstar study found that most people have a short-term view of finances.[4] The results showed a few at the extremes and most in the middle. Only a small number planned their finances within a short period of days. However, the same was true at the other end. Only a few planned their finances in terms of decades, and very few thought generationally. The vast majority of the respondents planned across weeks, months, or a few years. The largest group planned only months out.

   In addition, social psychologists have discovered that typical future thinking is unrealistically vague. We don't envision the future accurately, even when we try. This fuzziness makes it very difficult to plan productively. The bias-savvy solution is to make future risks highly detailed, concrete, and current. Uncovering personal narratives is a wonderful technique to awaken motivation. Many people know a friend, colleague, or family member who endured a difficult crisis, made far worse by financial insecurity. When clients recall the day-to-day experience of life in a crisis, the fog is lifted. Ask clients to recall stories of those who experienced terrible financial strain, along with a catastrophe. The more detail they recall, the more powerful the motivation will be. When the vivid picture of pain is remembered, clients will be more ready to take action. This is the moment to move forward with the next steps.

3. **Frame the future clearly.** Psychologists have been using the power of framing for decades. Behavioral finance has discovered it as well. After a client has a powerfully emotional crisis in mind, it's time to shift the frame to the client's risk. Thoughtful framing can activate the biases of loss aversion, anchoring, and cognitive dissonance to move clients forward. People are highly motivated to avoid loss—use that. Clients are firmly anchored to their current lifestyle—use that. Individuals do not like the cognitive dissonance of acting against their cherished values—use that as well.

   Advisers can begin the framing process by asking questions that shift a client to think concretely about their life during a crisis. The nebulous future risk will become starkly present when clients imagine a daily life of loss. Concrete details will alert the biases to avoid pain. Examples of future framing questions include:

   - What would daily life be like should you lose your income from an illness or disability?
   - What would it feel like to have your current lifestyle change dramatically and permanently?
   - How much are you spending annually on immediate consumables? What would it mean for you to shift some of that to protecting your lifestyle in an emergency?
   - As you provide for yourself and your loved ones, what values are important to you? How do you live those values as you plan for financial security?

   Skillful framing helps clients shift from today's desires to the long-term perspective of tomorrow's outcomes. Once the clients shift their attention to a concrete future vision, keep the momentum going toward execution.

4. **Secure specific commitment.** Ambiguity is the enemy of action. This is why SMART (specific, measurable, achievable, realistic, timed) goal setting is so powerful. It delivers a precise and practical action plan. Adviser conversation that helps a client develop a SMART action plan will keep things moving. Even better, make sure the client proactively articulates next steps and deadlines. Passively agreeing to your suggested next steps is not as powerful as verbally declaring their next steps. If possible, add an extra layer of positive social influence. If agreeable to clients, include any additional individuals involved in the process: attorneys, accountants, or family members. Don't wait; get others involved as soon as possible. The additional social incentive of multiple accountability partners delivers an added boost of motivation. Granted it's not a guarantee, but it's one more nudge. Prompts, powerful recollections, framing, commitments, and social influences are all tools to redirect biases toward productive planning. Then move onto removing the hurdles that block final execution.
5. **Make it easy and painless.** Steps to completion are filled with multiple cognitive bias barriers. The list includes fluency, choice overload, the pain of paying, and more inertia. Start with removing all barriers to fluency. Choice overload and some inertia will be taken care of by delivering fluency. Fluency is a social psychology term for things that are easy and appealing. Studies have found people reject things that are difficult to process. Good information is judged negatively just because it's taxing. You see this in clients who have difficulty with technology. They get frustrated and dislike it because it's hard to figure out. It's not fluent, so they reject it.

   Information overload operates on the same fluency principle. People feel uncomfortable distress when they can't process information. They get stymied with too much information and too many choices because it's not fluent. In addition, inertia kicks in powerfully when the process is difficult. Do anything you can to simplify and create an easy path to completion. Yes, this will likely require more work. The payoff will be more clients who finish. Fluency can also ease the pain-of-paying bias. Where possible, make paying for any financial protection painless and automatic. The less they have to do, the better. The marketplace of non-cash payment tools has invested heavily in removing the pain of paying because it works. Once the client has agreed, clear the path of any execution hurdles.

> **"Uncovering personal narratives is a wonderful technique to awaken motivation."**

Conclusion

These five steps use automatic cognitive biases for client benefit. They're designed to build a crescendo of emotional alerts loud enough to break through the constant drumbeat of daily urgencies. In addition, they strategically shift the client from the here and now to thinking deeply about the future with detailed clarity. This type of thinking activates executive function in the brain. This brain region controls impulses, analyzes, plans, and acts according to cherished values. The first steps alert the client to ignored but serious threats. The middle stage activates the emotional memory and imagination to motivate action. The final steps engage the executive function to plan and follow through on commitments, while reducing the interference of chronic biases.

Some may find a five-step process to redirect biases and activate executive function too cumbersome. Frankly, I agree. It'd be wonderful if people acted in their own best interest with a simple recommendation. Certainly, some do. For others, financial planners have the opportunity and expertise to provide hugely important value to clients. Next to physical health, financial security is fundamental to human well-being. Strategic and thoughtful conversations will help your clients achieve the protection that will deliver satisfaction today and well-being tomorrow. ■

Endnotes

1. See Lazarony, Lucy. 2021, September 9. "Life Insurance Policy Sales Growth at Highest Level Since 1983." *Forbes Advisor*. www.forbes.com/advisor/life-insurance/sales-highest-level/.
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3. Benson, Buster. 2016, September 1. "Cognitive Bias Cheat Sheet." *Better Humans*. https://betterhumans.pub/cognitive-bias-cheat-sheet-55a472476b18.
4. Newcomb, Sarah. 2021, December 6. "The Most Powerful Financial Motivator You've Never Heard Of." *InvestmentNews*. www.investmentnews.com/the-most-powerful-financial-motivator-youve-never-heard-of-214612.