Humans Are Not Necessarily Rational Thinkers, Especially In Retirement – Part 3

Factoring in human behaviour when building retirement income strategies.

As humans, it's accepted that we have inherent behavioural biases that can influence our thought processes and choices. For an adviser, the ability to pre-empt these factors and recognise how they influence financial decision-making can be a sure-fire way to help build confidence and financial certainty for a client. Left unchecked, these behavioural "blinkers" can significantly impinge on a retiree's capacity to feel a sense of control over their retirement income. Longer-term, it can impact their ability to achieve their investment, or indeed, lifestyle goals.

In part one and part two of Humans are not necessarily rational thinkers we looked at a study conducted by Professor Shlomo Benartzi of UCLA[1], reviewing the first five behavioural factors that can influence a retiree's judgement when it comes to their finances.

In this article, we continue to look at the drivers of human behaviour by exploring *Inertia and Evaluability*. The associated checklist[2] is designed to help overcome these common cognitive behaviours by prompting advisers in identifying questions to explore with clients.
Behavioural Insight - #6 Inertia[3]

In behavioural finance, *Inertia* can be described as a form of resistance, with people likely to stay with the status quo. This resistance may be driven by fear of making a wrong decision (so they will make no decision), a sense of overwhelm or just being time poor. It can manifest as resistance to making a change; complete inaction; or the tendency to stay with a previous choice to seek comfort in the familiar or to avoid regret.

In many cases, inertia can inhibit an investor from making necessary changes to their portfolio. For example many investors flocked to "safe" assets when the GFC hit and inertia is now holding them back from making the necessary changes to their portfolio, to ensure enough growth is generated to see their portfolio last their lifetime.

Inertia can also be harnessed to help clients achieve their goals, this is why defaults are so powerful. For example, as at June this year over a quarter of the total superannuation assets in Australia resided within a default *My Super* account[4].

So, how can advisers help clients minimise *inertia when it's holding them back, or use* ***inertia to help them achieve their goals*****?**

Inertia bias can easily equate to suboptimal investment choices. Regardless of whether the inertia is rooted in fear or a retiree is purely seeking comfort in the familiar, dislodging these behaviours requires significant personal motivation.

Establishing regular savings goals – ones they can opt out of - is a good way to get a client to increase their retirement savings. A series of smaller changes is less likely to meet resistance than a large change. By providing the ability to opt out, it creates a sense of safety for the client, even though *inertia* will mean they are unlikely to actually utilise any opt out feature.

Humans are notoriously bad at imagining or indeed visualising how we will feel in the future. The need to make positive change today for a better future is a constant casualty of this failure. One way to overcome this is to use tools to make the future more vivid for your clients. The facebook app that ages you is a great example of a tool that can help someone to see what they might look like in the future. When the future feels real and a client can really picture themselves in it, they are more likely to overcome any inertia to make positive change.

Checklist question: Are retiree investors, carried by *inertia*, assigning themselves to the most appropriate investment options? [2]
Behavioural Insight - #7 Evaluability[5]

Evaluability looks at our tendency as humans to want to assess and make choices based on like for like comparisons. Further, if presented with two options, one easier to comprehend than the other, we are likely to base our selection on our relative ease - regardless of whether it is the optimal choice for our circumstances.

Professor John Payne of Duke University[5] suggests that to overcome evaluability in presenting retirement income solutions, we need to approach conversations with new language that positions potential implications in quantifiable or measurable terms. This would encompass viewing product features in "apples-to-apples" comparisons, in addition to placing them within a client's own circumstances. He also suggests avoiding the use of complexities or industry jargon, instead "spelling out" relevant points with transparency and simplicity wherever possible.

An evaluability bias in investment terms can be the source of a missed opportunity and at worst, the death of product innovation. As we seek to keep things relatively easy, there is every chance we are overlooking a superior investment outcome. The power of keeping and promoting an open mind, for both adviser and client, shouldn't be underestimated when we look to promote client best interests.

In the context of introducing new or different products, drawing upon an evaluability framework that weighs the likely benefits, consequences and cost will be paramount. This is particularly important when we consider that not all products are comparable in a like-for-like sense, yet may be equally or indeed more beneficial in yielding a particular result. Interactive tools or scenario simulators that bring to life practical examples or use case studies are also incredibly useful.

Checklist question: Does the language and context used to describe the retirement income strategy make it easy to evaluate its features as they relate to the client?[2]

Behavioural finance has the potential to reshape the financial lives of retirees and can help add a human dimension to the design of a client's retirement income strategy. By considering these checklist questions as we share them, we hope you will be better able to evaluate a retirement strategy, before it's put in front of a client.

[1]Source: Behavioural Finance and the Post-Retirement Crisis. Prepared by Sholomo Benartzi, UCLA. Sponsored and submitted by Allianz of America, 29 April 2010.

[2]Source: Behavioural Finance and the Post-Retirement Crisis. Prepared by Sholomo Benartzi, UCLA. Sponsored and submitted by Allianz of America, 29 April 2010; A Behavioural Finance Checklist for Retirement Income Strategies, p17.

[3]Source: Behavioural Finance and the Post-Retirement Crisis. Prepared by Sholomo Benartzi, UCLA. Sponsored and submitted by Allianz of America, 29 April 2010; Inertia, p11.

[4] Source: ASFA, Super Statistics as at 20 June 2019, https://www.superannuation.asn.au/resources/superannuation-statistics

[5]Source: Behavioural Finance and the Post-Retirement Crisis. Prepared by Sholomo Benartzi, UCLA. Sponsored and submitted by Allianz of America, 29 April 2010; Evaluability, p12.