Is Change Possible?

The Role of the Individual in Modifying Financial Behaviors

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Amid the rubble of the financial meltdown and the nation's slow struggle to regain economic health, one thing seems certain: For the security of the nation as well as individual households, people's financial behavior must change. No more vacations on credit cards. Say goodbye to using home equity as a piggy bank. Stop speculating on risky assets. But is changing such behavior even possible? Fortunately, the answer is yes.

This article attempts to equip financial services professionals with the knowledge and tools necessary to tap into the power of change management technologies to assist their clients in achieving their financial goals—and in many cases, their life goals as well.

To illustrate how such change is possible, we shall walk through the case of a couple who are clients of a financial planning firm. This couple, now in their early 60s, had amassed a net worth of approximately $4 million after selling a business and making stock market gains.

The couple now earns about $60,000 per year. They have been withdrawing from individual retirement accounts (IRAs) at a rate of about $300,000 per year for the past several years. The dilemma is obvious: At the current withdrawal rate, this couple will deplete their IRAs well before their deaths.

The challenge confronting this couple—and any financial services professional working with them—is to decrease the amount they spend and to preserve their remaining assets.

Behavior: Beyond Attitude and Thought

Many clients enter the offices of financial services professionals seeking change and improvement in financial status. Yet far too many clients do not know how to translate that goal into reality. Clients say they want to change, but their behavior hasn't caught up with their words. Psychologists explain this as the “wanting-doing” gap.

The relationship between attitude and behavior is weak. “Demonstration of attitude change is insufficient evidence for one's ability to change behavior; only behaviors that correspond to the attitude are likely to change as a result of revisions in attitude” (Azjen and Fishbein 1977, 914).

In other words, walk the talk. This couple sought to modify their behaviors but failed. Like far too many people, they were not “walking their talk” and they suffered from the “wanting-doing” gap. The financial services professional’s job is to jump-start this behavioral change process.

Neuroeconomics: The Lizard Brain at Work

It seems odd that neurology would be part of a discussion about modifying financial behavior. The reality is that human beings are biological beings. Using neuropsychological and functional neuroimaging studies, Spinella et al. (2004) demonstrated that the prefrontal systems of the brain play an essential role in the management of personal finances.

Not all our habits are acquired from experience. Many habits are reflexes and automatic responses, genetically acquired and modified to some extent by the environment. For instance, if you hear an unexpected loud popping sound, then you will most likely exhibit a “startle response.” The sympathetic branch of your autonomic nervous system triggers this response. Your “fight or flight” response will kick in. This is an adaptive response with survival value.

The fight-or-flight response is triggered by a perceived threat—and it does not have to be a physical threat. Learning that you have been fired or have lost your savings might trigger the same response. This is normal and adaptive. It triggers a phenomenon called cortical inhibition. Cortical inhibition decreases the executive functions of your brain, thereby negatively impacting your ability to process cognitive information effectively and efficiently (Porcelli and Delgado 2009). Your decision-making ability is impaired, and you may not make the wisest choices.

To counteract the fight-or-flight response, one must engage the relaxation response. It decreases the overactivation of the fight-or-flight response (Jacobs 2001). Engaging the relaxation response can be as simple as counting to 10. The key is to shift your mind and body into neutral.

Financial services professionals need to recognize how the fight-or-flight response impacts financial decisions and behaviors. Financial services professionals must assess the degree to which clients are engaged in this response and realize any apparent cognitive impairment clients may demonstrate. Financial services professionals have a responsibility to keep clients from making decisions in this impaired state.

Stress presents a similar problem. Many of us make substantial decisions under stress (Janis 1993). As Daniel Goleman (2006, 268) states, stress “handicaps our abilities for learning, for holding information in working memory, for reacting flexibly and creatively,
for focusing attention at will, and for planning and organizing effectively.” This empirical fact takes on increasing importance during times of transition with clients. These transitions include changes in career, wealth, relationships, and health. One of our recommendations for clients is to recognize the importance of not having to make a decision at a particular moment in time. This has been coined the “decision-free zone” by the Sudden Money Institute (www.suddenmoney.com), which specializes in helping individuals and their advisors cope with financial transitions.

Our illustrative clients were in denial about the fact that they were running out of money. With such clients, who seem out of touch with the consequences of their destructive financial behaviors, the challenge for the financial services professional is how to amplify the stress response. We consulted a clinical psychologist functioning as a financial therapist and held a joint meeting with the goal to trigger a stress response to enable the clients to experience discomfort. During this session, decisions were limited to having the couple commit to tracking their spending. Because they were stressed, it would have been unwise for the couple to engage in a complex decision. This created the decision-free zone.

**Application of Neuroeconomics: From the Lab to the Office**

Simply knowing that many financial responses and decisions are based on reflexes is enough for many of us to recognize this danger and to commit to mitigating this risk. We can train our psychophysiology to be less reactive and to take a rest between fight-or-flight attacks.

More than two decades of research has demonstrated the efficacy of mind-body interventions (Jacobs 2001). Mind-body techniques that empirically have been shown to be effective include the relaxation response (Jacobs 2001); cognitive restructuring (Jacobs 2001); emotional regulation (Gross 2002); and mindfulness meditation (Kabat-Zinn 1996). This yields clearer decision-making, which better informs behavioral options.

Neuroeconomic tools available to financial services professionals include:

- Model beneficial beliefs and constructive coping methods yourself.
- Refer your clients to mental health professionals who can train them how to relax.
- Offer clients a reading list that addresses the mind/body aspects of decision-making, including Why People Make Big Money Mistakes (Belsky and Gilovich 1999), Why Zebras Don’t Get Ulcers: An Updated Guide to Stress, Stress Related Diseases, and Coping (Zapolsky 1998), and Why Choose? How We Make Decisions (Montague 2006).
- Remember the decision-free zone.

Our illustrative clients were encouraged to track their spending to collect data on their spending patterns and to become more mindful of their cognitive and behavioral habits. Moreover, our clients were informed that they should seek out resources to guide them by applying constructive coping mechanisms. Both the financial services professional and the consulting financial therapist approached the clients in a way that increased their ability to engage in higher-order cognitive functioning.

**Clinical Psychology: Beyond Sigmund Freud**

Modifying financial decision-making and behaviors falls in the realm of clinical psychology because of the link between emotions, cognitions, and behavior. Pring (1993, 24) recognized this relationship:

As soon as money is committed to a financial asset, so too is emotion. Any biases that were present before the money was placed on the table are greatly increased once the investment has actually been made ... A successful investor realizes this and knows that he must try to maintain psychological balance through self-control.

Forman (1987) argues that money behavior in many instances is irrational and thus in the purview of clinical psychology. Clinical psychology can assist individuals facing tough decisions, including financial ones (Vlaev et al. 2007; Bernatzi and Thaler 2002).

Financial services professionals can use a number of clinical-psychology tools. Motivational interviewing is one of the more powerful tools, based upon three decades of scientific research (Bien et al. 1993). One motivational interviewing model is called FRAMES, a mnemonic acronym:

- **F = Feedback:** Client gathers information about retirement account balances
- **R = Personal responsibility:** Client checks balances, maintains contributions
- **A = Advice:** Client seeks information about needed actions
- **M = Menu of options:** Client realizes the choices available
- **E = Empathic counseling style:** Client seeks, either from self or a financial services professional, support that is not overly judgmental
- **S = Self-efficacy:** Client believes in capability to change behavior
In our work with our illustrative clients, we’ve learned that some irrational beliefs or schemas must be identified and challenged. Bem (1981, 355) defines a schema as follows: “A schema is a cognitive structure, a network of associations that organizes and guides an individual’s perception. A schema functions as an anticipatory structure, a readiness to search for and to assimilate incoming information in schema-relevant terms.”

Within the financial planning community, schemas have been referred to as “money scripts” (Klontz et al. 2008). The financial advisor must identify these money scripts and dispute those that are maladaptive.

For instance, our clients suffer from two irrational money scripts: “We’ve always managed to get through tough times and this time is no different” and “Our situation is so complex that it is impossible to unravel and change our situation.”

Application of Clinical Psychology

Applying clinical psychology to this situation calls for implementing the following:
1. Elicit client’s thoughts, feelings, and habits.
2. Cultivate an empathic relationship with client.
3. Do not allow the client to catch your negative feelings and emotions.
4. Use FRAMES as a process to change behavior.
5. Instruct clients about the relationship between awareness of how they think and the ability to control the way that they think. This is called metacognition (Statt 1998).
6. Teach clients how to recognize dysfunctional beliefs (Wells 2002) and how to challenge these dysfunctional beliefs by becoming their own cross-examining attorneys and asking the question: “What’s the evidence for that belief?”

Behavioral Finance: Mind, Money, and Markets

Behavioral finance has advanced the knowledge of the role of human behavior in financial decision-making and financial behaviors, from trading to saving. Thaler and Sunstein (2009, 114) acknowledge a huge problem in any effort to change behavior: Assuming that “people have enough willpower to implement the relevant plan.”

Thaler and Sunstein propose addressing the lack of willpower with automatic contributions to retirement plans as a default choice and by implementing a “Save More Tomorrow” campaign, in which salary increases are automatically put into a retirement savings plan.

They describe six rules of thumb, reviewed here to equip the reader to spot each rule and guard against its negative consequences:

Anchoring. Nosfinger (2002, 5) writes, “Investors anchor on their stock purchase price and the recent highest stock price.” One of our clients had purchased her home during the real estate boom expecting that her home’s value would continue to increase—but its value declined after the real estate bust of 2008. This client struggled with the decision to sell her home at a perceived loss. This client had anchored on the highest appraisal received—even though this was only a figure on paper, not an actual loss. Once we explained this, she was able to consider selling her home.

Availability bias. Tversky and Kahneman (1973) were the first to introduce the phenomenon that occurs when individuals make a decision, often erroneously, based only upon information that is available. Clients who tap the expertise of a financial professional get additional perspective on a financial decision.

Representativeness bias. This bias is often referred to as the “hot hand” hypothesis. The classic example is that of a basketball player who shoots a series of shots without missing a basket. The representative bias blinds us to the longer-term trend. Mangot (2007, 20) points out the danger in the representative bias: “Investing in a fund simply because it has performed well in the short-term means that one is not betting on the particular abilities of a manager, which can only be determined from long-term performance, but on his hot hand.” The central lesson here is to warn your clients of the dangers of chasing past returns.

Overconfidence. Mangot (2007, 42) also captures the dangers of overconfidence, which he describes as a behavioral bias that makes “investors think that they ‘understand’ the market and are capable of anticipating its short-term fluctuations, even in extreme circumstances.” One of our clients periodically calls us, all excited about a new investment opportunity, saying that this is “too good to pass up.” Our task is to listen but then share the possible downside to this sure bet.

Loss aversion. Loss aversion also is known as risk aversion. Nosfinger (2002, 32) illustrates this behavioral bias: “Snakes don’t often bite people, but when it happens the person becomes more cautious. After having been unlucky enough to lose money, people often feel that they will continue to be unlucky. Therefore, they avoid risk.”

Status quo bias. Individuals tend to stick to what they know (Samuelson and Zeckhauser 1988). We recently facilitated a town hall meeting with our clients and focused upon the “new reality.” Our main premise was that the investment landscape will change in response to changes in economics, politics, technology, and financial innovations. As such, we encouraged our clients to consider investing in a wider range of assets than previously considered.

Conclusion

Changing financial behavior is difficult, but it is possible. Returning to
our couple, over the past year, they still are struggling to cut back but are more mindful of their behavioral patterns and in touch with the long-term consequences of not changing their behavior. Their commitment to change has increased as they become more aware that money for many retirees is a finite—not an infinite—resource. With the help of a supportive financial services professional, motivated clients can cross the bridge from wanting to change destructive behaviors to actually changing those behaviors.

But just as today’s economy is new and different, financial services professionals may need to look to new arenas in order to provide genuine help. The ideas we have explored here are drawn from varied fields: neuroeconomics, clinical psychology, and behavioral finance. They provide valuable tools for helping financial services professionals help clients navigate the new reality.

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