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Financial Planning: What the Social and Brain Sciences Have to Offer

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Abstract

This paper addresses the potential linkage of the disciplines of financial planning and the social and brain sciences from the combined perspectives of a financial planning expert and a business psychologist. It seeks to offer practical guidance on how to utilize insights from recent research and practice in the social and brain sciences to address the issue of effective financial planning in a time of multiple widespread international crises.

The article will review the traditional approach to financial planning, indicate where the profession appears to stand now, describe advances in social and brain science, and provide some practical tools for use by practicing financial planners. The paper will conclude with a summary of its key points.

Key words: brain sciences, financial planning, social sciences, psychology of financial planning, risk management

Introduction

Certainly, the early 2020s have been an exceptional and challenging period worldwide. A recent consumer study on personal finance published by eMoney presented that 61% of U.S. adults said that COVID-19 has made their financial situation worse; 68% of the adults feel stressed about their financial health since the onset of COVID-19; and 28% of those who reported worse financial health have sought the help of a financial advisor (eMoney, 2020). Additionally, the overall economic situation has been greatly exacerbated by rising interest rates, supply chain issues, and the war in the Ukraine.

The pandemic has also had a big impact on U.S. Gross Domestic Product or GDP. Gross Domestic Product is the total market value of goods and services produced by the economy in a specific period of time. According to the U.S. Bureau of Economic Analysis (2022), GDP decreased at an annual rate of 1.5 percent in the first quarter of 2022. This followed an increase of 6.9 percent in the fourth quarter of 2021. Additionally, the present inflation rate (the general level at which the prices of goods and services is rising) in the United States is estimated at 8.6 %. This is the highest recorded rate since 1981.

The pandemic and associated governmental stimulus packages have also had a significant impact on the jobs market. The U. S. Bureau of Labor Statistics (2022) reported that in March of 2020, just as the pandemic hit the United States, the civilian unemployment rate was 4.4%. Currently, the rate hovers around 3.6 %. Additionally, market fluctuations, coupled with actions of federal banks to raise interest rates, have caused many Americans great concern about the performance of their retirement accounts. The direct consequence of which might lead to a negative impact on their projected retirement income and the timeframe in which they can attain it.

Additionally, the cumulative catastrophic consequences of the Covid-19, its generative effect on the world economy, the war in the Ukraine and the January 2021 incursion into the United States capital have all contributed to a deep sense of personal and financial malaise. Thus, a major issue for financial planners is how can they best serve their clients in an era characterized by escalating levels of FUD, or Fear, Uncertainty and Doubt?

As the nations of the world wrestle with what to do about multiple serious health, environmental, economic, and political threats simultaneously, what tools are available to planners to best support clients and ourselves in this period of need? In short, how can financial planners best guide their clients through this turbulent time while successfully coping with the simultaneous threats they are themselves experiencing?

The Discipline of Financial Planning

Financial planning involves identifying an individual's short-, mid, and long-term financial goals and developing a personalized strategy for reaching them (CFP Board). Under the guidance of a professional financial planner, an individualized comprehensive financial plan for the future is created. The plan reflects the client's tolerance for investment risk and future income expectations, while considering their personal and family situations. Typically, planning begins with a discussion of the desired future financial goals and the individual's current financial condition, this may be followed by a determination of current net worth and present cash flow. The final product is a comprehensive written financial plan based on a well thought out strategy for realizing anticipated financial objectives with specific implementation plan.

Elements of the financial plan often include: budgeting & debt management, education planning, retirement savings & income planning, a comprehensive risk management and insurance plan, a short- and long-term investment plan, a tax planning strategy, and an estate plan (CFP Board). The retirement strategy focuses on ways to accumulate the income needed for a comfortable retirement. The comprehensive risk management and insurance plan is concerned with reviewing life and disability insurance, personal liability coverage, property and casualty coverage, long term care insurance, and catastrophe coverage. Investment considers a plan for specific investment objectives that considers personal tolerance for risk and investment time horizon. Tax planning/reduction strategy relates to developing recommendations for minimizing taxes on personal income within the tax laws. Estate planning arranges for the protection and benefits of any heirs. For example, Herrada-Alcaide, Hernandez-Soles & Topa (2021) have offered an updated model for personal financial planning that emphasizes retirement. Expressing initial interest in possible applications from the behavioral sciences *The Journal of Financial Planning* (2021) devoted a whole issue to the field of Behavioral Economics.

Professional financial planning practitioners include: Registered Investment Advisor (RIA), Chartered Financial Analysts (CFA) and Certified Financial Planners (CFP). The Certified Professional Planner Board is a non-profit organization that employs comprehensive academic and experience standards to certify financial planners. CFP Board's Code of Ethics and Standards of Conduct requires CFP® professionals to uphold the principles of integrity, objectivity, competence, fairness and confidentiality. The CFP® professionals make a commitment to fulfill the fiduciary roles by always putting their clients' interests first when providing financial advice (CFP Board, 2019).

Current State of Financial Planning

The prolonged pandemic situation has seen an increasing demand for fiscal guidance from financial planning professionals as pressures mount on the monetary circumstances of individuals and families. A recent consumer study (CFP Board, 2020) conducted by the CFP Board assessed the impact of the pandemic on financial planners and their clients. The survey results showed that 78% of the survey participants reported seeing an increase in inquiries from existing clients and 34% of the participants indicated increase in inquired from perspectives. Even with imposed physical lockdowns and subsequent travel restrictions, some consumers have still been able to accumulate additional cash by capitalizing on reduced levels of spending. Additionally, as a direct result of the heightened uncertainty, many foresighted individuals started reexamining their wills and insurance policies to ensure their families are adequately covered during this troublesome time.

In total, it appears that as a direct consequence of a need to respond to the effects of the concurrent crises, many potential clients have chosen to seek professional financial counsel (CFP Board, 2020). Others have responded more aggressively responded to the crises as a means of exploiting the situation to their benefit. These individuals have envisioned the advice of a financial professional as an excellent way to significantly increase their financial assets.

With regard to risk management and insurance planning, concerned clients have started revisiting their insurance policies to ensure their families are adequately covered during these troublesome times. Many consumers also appear to be seeking professional recommendations on retirement planning. Taken together, these actions encompass such areas as proper financial asset allocation for wealth generation, investment options for retirement accounts, and social security claiming strategy as well as for Medicare plan guidance. Finally, the creation and development of client-specific estate planning documentation such as power of attorneys and wills has gained wider recognition by the public.

There is a growing demand on psychology for financial planning expertise in practice; understanding how people think and their decision-making process helps financial planners to better communicate with their clients and forge long-standing relationships with trust. Recognizing the need for this expertise from the 2021 Practice Analysis Study (CFP Board, 2021), the Certified Financial Planner Board has incorporated the psychology of financial planning component into the Certified Financial Planner exam starting 2022 as a required skillset by financial planners (CFP Board).

Advances in the Social and Brain Sciences

As odd as it might seem, structurally our brains are much the same as they were some 500 centuries ago. We still react to perceived threats in much the same way as did our early human ancestors by fighting, fleeing or freezing. These survival reactions have persisted despite the fact that the diverse environments in which our brains presently operate have undergone drastic changes.

Clearly, the modern world is very different from the savanna of our earliest ancestors. Reacting emotionally to the outburst of an upset client is not quite the same as being immobilized with fear at being confronted with a hungry predator seeking its next meal. Like early warning radar, our modern brains still retain emergency systems that allow us to rapidly react to perceived danger. These danger signals stimulate the brain to create chemical substances like hormones and neurotransmitters that mediate and control our stress reactions. If the apparent threat is evaluated as high these more primitive brain areas can overwhelm the newer more rationally focused regions and initiate immediate bodily actions.

Living in a modern world means challenges to our brains on a number of fronts simultaneously. These confrontive encounters include physical, technological, cultural, political and environmental tests. Strategic thinkers for the U.S. Army have codified these factors using the label VUCA or Volativity, Uncertainty, Complexity, and Ambiguity (Gilman, 2017).

The amount of instability and unexpectedness that is experienced makes up the Volativity factor. Uncertainty correlates with the paucity of critical information needed to be able to predict and decide with confidence. For example, the initial lack of an effective pandemic strategy, confusing communications of intent, and slow rollout of the Covid-19 vaccine all contributed to the level of uncertainty for the public.

Complexity has to do with the overwhelming volume of available data and to the difficulty in understanding the ramifications of the interactions of a large number of highly interconnected variables. Ambiguity is concerned with the possibility of a variety of multiple informational interpretations.

New Tools for the Financial Planner

The social and brain sciences potentially offer a number of useful insights for the practicing financial planner. For example, decision-making appears to be highly affected by the presence or absence of emotions. Brain areas concerned with emotions, when damaged or surgically removed, appear to render the affected individual incapable of making choices (Damasio,2021). Alternatives can be identified and arrayed but not selected. Research also reveals that our brains have limited attentional capacity. Studies show that multitasking tends to be an inefficient working strategy (Lindsay, 2020). Multitasking consumes considerable brain energy. It comes with high switching costs as attention alternates back and forth between tasks and is subsequently reengaged (Aagaard,2019).

Some of the more recent attempts to apply insights from the brain sciences to financial planning include the work of James (2011) and Fortin, Jensen & Klontz (2020). Additionally, Frydman & Camerer (2016) have suggested that financial decision-making in the economy often deviates from predictions derived from rational information-processing models. Targeted social and brain science approaches include an understanding of: thinking styles, non-verbal communications, the SCARF model, implicit biases, and methods for dealing with client and planner stress.

Thinking styles, an approach to cognitive diversity, was pioneered by Ned Herrmann (2015) while head of management development for the General Electric corporation. Based on his research into brain structure and organization, Herrmann created an assessment instrument, called the Herrmann Brain Dominance Instrument or HBDI. The resultant four basic styles were formed into quadrants ordered by physical levels and left/right structural divisions within the brain. Four distinctive thinking styles were identified, characterized by four Fs: facts, form, feelings and futures. Using a very large data base, Herrmann was able to correlate occupations with the different styles. Potentially, knowing a client's thinking style could be very helpful in tailoring a financial plan to meet a specific client's needs. Additionally, an understanding of HBDI results could be used to enable better client communications, to more artfully construct the financial plan, to create well-received presentations, and to more efficiently problem solve.

Under the broad umbrella of the Social Science discipline of Semiotics (Chandler, 2002), non-verbal communications encompass a number of factors that can be interpreted to improve the effectiveness of the financial planner. These aspects can provide clues to the emotional state of the client and their possible unstated preferences. Possible items to notice include: reading facial expressions; voice tones; vocal inflections; speech intensity; speech rate; and eye movements. Additional useful physical observation factors include: focus and blinking rates; pulse rate; breathing intensity and rate; hand gestures; skin tone and flushing; and overall body language and posture.

David Rock is the founder of the discipline of Neuroleadership and the creator of several brain science-based tools to help practitioners be more effective. His SCARF model (Rock, 2020) is one such tool. SCARF is an acronym that stands for Status, Certainty, Autonomy, Relatedness and Fairness. The model describes rewarding and threating factors that the brain treats as significant survival issues. Interpersonal relationships tend to generate forces that the brain perceives as either consciously or unconsciously intimidating or rewarding.

Status involves the assessment of where you stack up in social rank comparison to others important in your world. Certainty is about the sense of confidence to accurately predict the future. Autonomy relates to the sense of independent control over events. Relatedness is the relative sense of safety around other people. Taken together, a thoughtful evaluation of the client's SCARF factors can tell a great deal about how to work with them and their motivations to financially plan.

Implicit or unconscious bias concerns attitudes and beliefs that occur outside of our conscious awareness and control. This type of predisposition is an example of what Nobel Prize winner Daniel Kahneman (2013) termed System 1 Thinking. System 1 is highly relevant to day-to-day thinking, decision-making and problem solving. It needs very little in the way of energy and attention. System 1 is fast, intuitive, automatic, and unconscious; however, it is also very prone to bias.

Unconscious bias operates in opposition to a person's conscious beliefs without ever being overtly recognized. A large number of biases have been identified thus far that can impact the financial planning situation (Cerulli, 2020). For example, it is possible to express explicit liking of a certain social group or approval of a certain action, while simultaneously being biased against that group or action on an unconscious level. Representative types of biases encountered in the work situations include: affinity, confirmation, attribution, conformity, horns effect, and gender.

Affinity bias is the tendency to want to connect with people who share like interests, backgrounds and experiences. Confirmation bias is defined as the inclination to draw conclusions about a situation or person based on personal desires, beliefs and prejudices. Attribution bias is a tendency to judge a person's behavior based on prior observations and interactions you've had with them indifferent to their actual merit. Conformity bias, or peer pressure, is a proclivity to act in a manner similar to the people around you regardless of your own personal beliefs. The horns effect is the tendency people have to view another person negatively after learning something unpleasant or negative about them. Gender bias is the tendency to give preference for one gender over another. Knowing about different kinds of bias can alert the financial planner to undetected potential areas of conflict with clients as well unconsciously slanting financial plans in undesired directions.

Major health, economic, environmental and physical crises have become a signal characteristic of our current times. These perilous conditions often result in human stress effects induced by biochemical reactions originating in the brain. Popularly, this reaction to stress has become known as the fight or flight response. Stress symptoms may include: increased anxiety, low moods, irritability, poor sleep, reduced ability to concentrate, unpleasant dreams, and emotional ups and downs.

Over many eons the brain has evolved a built-in threat processing system triggered by perceived threats to survival. Sometimes called the HPA axis, for the names of its key physical components (Hypothalamus, Pituitary, and Adrenal). This system is initiated by a brain-based threat detector, the amygdala gland. This gland constantly scans the environment and makes instantaneous threat assessments. When aroused by potential danger, the amygdala initiates a cascade of bodily changes. Among the effects are: skin flushing, sharper vision, sweating, release of additional energy to the muscles, reduction of blood flow to non-vital organs, increase of blood clotting factors, evacuation of the bowels, and a reduction in cognitive function.

An awareness of possible stress factors for both clients and planners can help preclude difficult communications and unexpected negative reactions. If detected, they may call for a time-out, reassessment, joint problem solving, deliberate acknowledgement of the stress situation and, if possible, removal of the stressor.

Summary

This paper has explored the challenge of living in hyper-challenging times for financial planners. It has combined the unique lenses of a financial planner and a psychologist to explore the ways in which financial planning is currently done, looked into the current state of the field, introduced advances in brain science, and offered options for using potentially powerful tools and techniques.

The authors believe there is more than a grain of positivity among all the dire descriptions of our current crisis condition. Collectively, we humans have a history of addressing and courageously overcoming adversity. Thoughtful financial planners can also make a deliberate choice to see the confluence of multiple crises as an opportunity. They can, under admittedly very trying circumstances, choose to rise to the occasion and further demonstrate their worth to themselves and to their clients.

Perhaps one of his country's first unlicensed financial planners, American revolutionary polymath Benjamin Franklin was known for both his wit and his common sense in financial matters. Franklin, the editor of *Poor Richard's Almanack,* was no stranger to financial hardship and international scale crises himself. This revelatory quote is attributed to Franklin (1999). "By failing to prepare you are preparing to fail." Franklin's prescient wisdom may serve as important counsel to financial planners as well as social scientists and brain scientists alike.

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