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BIASES TO BE AWARE OF WHEN PRESENTING RECOMMENDATIONS

This article on behavioural economics and the advice process looks at the final stage – making a recommendation and implementing the solutions.

As you present your recommendations, you should know enough about your client and their objectives to feel confident that your proposals will be received favourably. Nevertheless, there are a number of influences that may come into play for you to consider. We introduced several of them when looking at the earlier stages, but they will often reappear when it's time to commit.

Dangers of following the crowd

One such behaviour is **'herding'**. People will be influenced by what other people are doing for better or worse. So if they're aware that more people are currently choosing drawdown over a guaranteed income for life solution then you might encounter resistance if your recommendation isn't consistent with this.

Biases can be the solution

'Framing' can help combat this. 'Framing' is all about how you present something. For example, FCA research revealed that when presented as a form of insurance, 66% of consumers preferred an annuity to a savings account, but when presented as an investment product only 17% choose the annuity.

Narrowing the options can also help. **'Paradox of choice'** tells us that too much choice makes it more difficult for people to reach a decision. As an adviser, you hold the key. A specific recommendation can direct people through the maze of options. An adviser can also help clients avoid defaults.

Defaults are very convenient when people can't or don't want to make decisions, highlighted by **'Default bias'**. 80% of members in UK DC plans accept the default fund choice, but defaults aren't right for everyone and advisers can add real value in this area. This is particularly true for decumulation where risk, income requirements and longevity have to be taken into account to create a personal solution.

Part of your recommendation may include changing providers. This can be problematic. **'Familiarisation bias'** means that people feel comfortable with the usual. It's reassuring and secure. That means if a client has saved for many years with one company they may be reluctant to move away. Strategies to counter this include giving people time to make the decision so they can get used to the idea, reminding clients of the cooling off period so they have a window within which they can change their mind and providing a clear understanding of the benefits of changing providers.

Look out for these client reactions

There are other behaviours that can influence how your clients react to your recommendations:

- **'Hyperbolic discounting'** is the tendency to live for the day. This behaviour may tempt people to take more income than they should for example.
- **'Optimism bias'** is similar and may convince people who want to take more income than is sustainable that it'll be 'alright on the night'. They may underestimate how long retirement could last or overestimate the investment returns they might achieve.
- **'Availability bias'** is the tendency to take mental shortcuts. Rather than make a rational assessment of the options, we'll often recall an example or instance that colours our view. George Osborne's Budget announcement that 'no one need ever buy an annuity again' is an example of an easily recalled example that may negatively influence views about annuities.
- **'Probability mismanagement'** is likely to occur with drawdown clients who are fearful of investment market falls. Most significant market falls are the result of a major event like a war or an economic crisis. That means they attract a lot of attention and stay in the memory. This can create a false impression of the risk of investing in stock markets. For example, since 1896

there are only 6 out of 120 ten year periods where investors in the FTSE 100 would have lost money.

- **'Regret aversion'** is the tendency to feel a sense of discomfort once a decision has been made. Was it the right decision? Should I have selected another solution? What if I have made a mistake? The cooling off period can mitigate these feelings. Increasingly these days, it's no longer a binary choice. The solution may well include a combination of products and this can help allay peoples' fears.

The importance of review meetings

Finally, you may want to discuss setting up review meetings. One behaviour to be aware of in this context is **'projection bias'**. This is the failure to recognise that future preferences could be different from today. Client circumstances will change during their retirement, but they may struggle to appreciate this. For example, ever shopped for food when you're really hungry? Chances are you'll buy more than you need. Even over a short time horizon we find it difficult to acknowledge that once we've eaten we won't need so much!

Some profound changes take place over the course of a retirement. For example, health deteriorates. A 65 year old can look forward to around 10 years good health before ill health takes hold. Mental capacity declines at around the same time. By 85, two thirds of people have a disability or longstanding illness.

Behavioural economics can help advisers better understand the often irrational reactions of their clients. These insights can be used to help clients overcome negative behaviours where these create barriers to a successful outcome. The end result should be happier clients that have taken sound decisions to secure their future income in retirement. It's no surprise that more advisers are integrating behavioural economics into their advice process. If you haven't yet embraced behavioural economics perhaps now's the time.

Read these articles to discover how behavioural economics and biases impact other stages in the retirement advice process:

Stage 1 INTEGRATING BEHAVIOURAL ECONOMICS INTO YOUR INITIAL CLIENT DISCUSSIONS

Stage 2 OVERCOMING NEGATIVE INFLUENCES IN OBJECTIVE SETTING

Stage 3 THE PERIL OF TOO MANY OPTIONS

Visit justadviser.com for insight and ideas on how to work with biases to create better retirement outcomes.

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