Integrating Behavioral Finance, Financial Psychology, and Financial Therapy into the 6-Step Financial Planning Process

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Executive Summary

- Clients have strong emotions around their money, yet there is a tendency to focus solely on the economic aspects of a client's financial well-being.
- In their work with clients, many financial planners utilize CFP Board's six-step Financial Planning Practice Standards. Traditionally, this framework focuses on financial data-gathering and financial goals, and does not necessarily inlcude the emotional, cognitive, and behavioral aspects of a client's money-related issues.
- This paper provides a framework for integrating behavioral finance, financial psychology, and financial therapy theory and tools into the six-step financial planning process to help planners provide more comprehensive and effective services.
- Financial planning stands to benefit greatly should the profession choose to adopt and integrate behavioral finance, financial psychology, and financial therapy theory and practices.

THE FINANCIAL PLANNING profession is relatively new. Historically, "financial planning" consisted primarily of selling insurance and other products for a commission. It was not until 1969 that a group of financial professionals came together in Chicago to discuss a new way of doing business—providing a service rather than selling a product. Ultimately, this led to the founding of the International Association for Financial Planning (IAFP), the Certified Financial Planner Board of Standards (CFP Board), and the College for Financial Planning (Lytton, Grable, and Klock 2012).

Despite the move to financial planning, Lytton et al. (2012) noted that many professionals did not engage in the process of establishing a client-planner relationship, nor did they collect sufficient information on which to base their recommendations. This led to the development of the six-step Financial Planning Practice Standards by CFP Board in 1995, drafted by CFP® practitioners (CFP Board 2016). Financial planners have used the six-step process successfully for decades, however, the process has failed to take into account psychological aspects of money. According to Klontz, Kahler, and Klontz (2016): "Traditionally, financial advisers have been given little or no training in how to help clients with the emotional factors involved in financial planning and managing money" (page *xvii*).

Historically, financial planners have focused on the economic aspect of their client's financial health, often shying away from the cognitive, emotional, and behavioral aspects. However, clients are not perfectly rational when it comes to money and the financial decisions they need to make. As Trachtman (1999) stated, money is a major concern of nearly every American, yet there remain minimal discussions around it; it is a taboo in our society and is a "serious psychological problem" (page 281). This taboo mentality might help explain why clients disengage with a planner after an initial meeting or fail to act on

the financial recommendations given.

Failure to fully engage clients in the financial planning process is a major concern. Research suggests that financial stress may contribute to clients' inability to fully comprehend the implications of financial planning (Grable and Britt 2012), as well as a client's tendency to disengage with the financial planning process (Grable, Heo, and Rabbani 2014). Britt, Lawson, and Haselwood (2016) support these findings; they found that the physiological stress of clients was negatively associated with intention to change. That is, clients who exhibited higher levels of physiological stress (e.g., lower skin temperatures) were less likely to have intentions to change, while those with lower levels of physiological stress (e.g., higher skin temperatures) were more likely to have intentions to change.

Financial stress and an inability to talk about it and fully engage in the financial planning process can be an added risk for couples. For example, financial stress may cause an increase in financial arguments, which increases the likelihood of divorce (Britt and Huston 2012; Dew, Britt, and Huston 2012). However, it has been argued that "financial planners are uniquely positioned to offer the knowledge, tools, and processes to help clients decrease their financial stress and thereby improve clients' physical health, psychological health, occupational functioning, and relationships" (Klontz, Van Zutphen, and Fries 2016, page 52).

The fields of behavioral finance, financial psychology, and financial therapy have emerged to help bridge the gap between the nuts-and-bolts of financial planning and our understanding of why clients make the decisions they make concerning money.

Behavioral finance is the application of cognitive psychology to financial behaviors, and is based on scientific attempts to understand normal human cognition, perception, and memory and how they influence financial behaviors (Klontz, Kahler, and Klontz 2016).

Financial psychology builds on our understanding of universal cognitive and emotional biases and integrates behavioral finance with "other areas of psychology to design and implement specific, client-centered interventions to facilitate a client's resolution of problems and to promote health" (Klontz, Kahler, and Klontz, page *xx*).

Financial therapy has been defined by the Financial Therapy Association as the integration of cognitive, emotional, behavioral, relational, and financial aspects of well-being (see Financial TherapyAssociation.org) with the goal of improving clients' well-being and overall quality of life (Archuleta et al. 2012).

The purpose of this paper is to offer a framework for integrating behavioral finance, financial psychology, and financial therapy theories and tools within the six-step financial planning process so that financial planners can provide holistic and effective financial planning services. Doing so offers the opportunity to improve a client's financial situation, to improve their overall relationship with money and financial behaviors, and to help reduce their stress and anxiety. It is argued that integrating financial psychology theory and tools into the financial planning process can result in a better financial planning experience for both clients and practitioners and increase the likelihood of clients following through on financial planning recommendations.

What follows is a brief overview of CFP Board's six-step Financial Planning Practice Standards. After each step is introduced, tools that can be used to enhance the financial planning process are presented based on work being done in behavioral finance, financial psychology, and financial therapy.

Step 1: Establish and Define the Relationship with the Client

CFP Board (2016) has identified the importance of establishing and defining a relationship between the planner and client. This requirement is satisfied when the financial planner and the client have *mutually* defined the scope of the engagement. It is important for this to be completed prior to any service being provided.

A planner must also disclose any conflicts of interest and define their compensation structures. Responsibilities of each party must also be determined along with the estimated duration of engagement. Although the scope of the relationship is important, the planner must establish rapport to effectively build the relationship with a client.

Step 1, In Practice

Establish rapport. Rapport is commonly defined as a relationship of mutual trust or emotional affinity. One of the best ways to establish rapport is to "join" with your clients, and use reflective listening to understand what your clients have to say. Joining occurs not only in the initial meeting, but also throughout the entirety of the client-planner relationship and helps the planner learn why the client is seeking help (Archuleta, Grable, and Burr 2015).

At the beginning of a client meeting, a financial planner may join with the client by simply saying, "Thank your Mr. and Mrs. Jones for coming in today. I know we don't know each other very well, so I appreciate you coming to meet with us about your financial concerns and goals." Then, follow up with other types of questions to help build the relationship, such as, "What is it that brings you in today?" "At the end of the session today, how will you know that our meeting has been successful?" and

"What should I know about you that would be useful in our work together?" (Archuleta et al. 2015).

According to Klontz, Kahler, and Klontz (2016): "the establishment of a trusting relationship with a facilitator is as important to a client's financial health as the specifics of an estate plan or the performance of a portfolio" (page 13). They argued that truly listening to a client creates a lasting bond and an atmosphere of trust, and is perhaps the most important goal for initial meetings with clients. Although rapport is established initially, it becomes the support for all subsequent client interaction and is continuously developed throughout the client-planner relationship.

Listen well. According to Klontz, Horwitz, and Klontz (2015), "reflective listening involves a concerted effort to discover what someone is trying to say, even though he or she may not be articulating it fully or effectively" (page 351). It is important to avoid asking questions when possible and instead use reflective statements, as they are less likely to evoke resistance from a client (Klontz et al. 2015; Klontz, Kahler, and Klontz 2008; Miller and Rollnick 2013).

Reflective listening helps clients, because they get the benefit of hearing what they have said. Reflections are more likely to elicit change in clients, because they are coming from the clients themselves, and this helps clients feel as if they have been heard and understood (Klontz et al. 2015; Miller and Rollnick 2013). When done effectively, reflective listening entices the client to continue talking and exploring ideas (Miller and Rollnick 2013).

Klontz and Klontz (2016) offered financial planners a seven-step process for listening that they referred to as the "flow process." They noted that listening is such an underdeveloped skill for most people that just being in the presence of a skilled listener can be a transformative experience for clients. The seven steps include: (1) start the conversation with an invitation (e.g., "Before we tackle my agenda, tell me more about what concerns you most today."); (2) listen intently; (3) summarize what you heard; (4) ask if there is anything you missed; (5) when the client's energy drops, repeat steps 3 and 4; (6) pick a word, phrase, idea, or concept and invite the client to provide more information; and (7) end with a grand summary.

Step 2: Gather Client Data

CFP Board (2016) states that the "financial planning practitioner and the client shall mutually define the client's personal and financial goals, needs, and priorities that are relevant to the scope of the engagement before any recommendation is made and/or implemented" (page 3).

Additionally, sufficient financial data must be obtained, because the scope of the recommendations is based on the financial information disclosed to the planner. Even so, planners must also gather qualitative client data to help clients holistically. One way to do that is through motivational interviewing.

Motivational interviewing, a psychotherapy developed by Miller and Rollnick (2013), identifies skillful interviewing as a way to help the practitioner better understand what the client is saying, and also as a way for the client to rehear the thoughts they are describing. Klontz, Kahler, and Klontz (2016) first identified motivational interviewing as a technique that can help financial planners establish rapport with clients.

Motivational interviewing has three key elements: (1) a conversation about change; (2) collaboration; and (3) evocation, or attempting to draw out the client's own motivation to change (Hettema, Steele, and Miller 2005; Miller and Rollnick 2013). To a further extent, motivational interviewing focuses on a mutual understanding between the client and practitioner.

It is important for the practitioner to understand that they need not always be right and that it is not their job to tell the client what to do. Rather, the practitioner should help the client discover his or her own motivations for change, because the client holds the power to evoke change within themselves (Miller and Rollnick 2013). The use of open-ended questions and affirmative statements identified by motivational interviewing can be helpful in the data-gathering process.

Step 2, In Practice

Use open-ended prompts. Open-ended questions are a data-gathering technique that can help establish rapport. They stand in contrast to closed-ended questions, which only require "yes" or "no" responses, or simple answers such as a specific dollar amount or a year (e.g., retirement date). While closed-ended questions are efficient in getting answers, open-ended questions allow the planner to gain a deeper understanding of the client's concerns and goals.

Open-ended questions also provide more opportunities for the client to engage in a process of self-discovery and have the benefit of eliciting feelings that the planner is listening well. Rather than using questions, open-ended prompts can be even more effective.

Here are examples of closed-ended questions and open-ended prompts:

Closed-ended question: "*When do you want to retire?*"

Open-ended prompt: "*Describe your ideal retirement.*"

Closed-ended question: "*Do you want to leave money to your children?*"

Open-ended prompt: "*Tell me more about what you want to see happen with your assets when you pass away.*"

The goal with open-ended prompts is not to merely acquire data from clients, but to invite clients to reflect upon their

thoughts and feelings and to help them become motivated to pursue a planned course of action that leads to change (Miller and Rollnick 2013).

Make affirmative statements. Affirmative statements help support and encourage the client (Miller and Rollnick 2013). Practitioners benefit by focusing on what the client has been doing in a positive light; acknowledging client strengths helps increase their willingness to listen to and trust the facilitator and may help reduce any defensiveness that clients may exhibit (Miller and Rollnick 2013).

For example, if a client set up a budget but has not followed through, the planner would affirm and reinforce the positive—they set up a budget! Perhaps a client is bad about keeping records and/or sharing necessary tax documents. When they produce the documents, the planner could make an affirmative statement such as, "Thanks for sending your tax documents. You did a really good job of getting them to me in a timely matter." The point is to focus on the positive rather than the problem at hand.

Research has found that confronting clients on their lack of follow-through decreases the chances that they will engage in positive behavioral change (Miller and Rollnick 2013; Klontz, Kahler, and Klontz 2016). Instead, reinforcing clients for their positive actions is likely to encourage changed behavior in the desired direction.

Step 3: Analyze and Evaluate the Client's Financial Status

In this step, the financial planning professional analyzes the financial documents and evaluates whether the client's current situation meets their stated goals. CFP Board (2016) explained that both personal and economic situations need to be considered. Personal situations to consider are the client's retirement age, life expectancy, income needs, risk factors, time horizon, and any other special considerations specific to the client. Economic considerations include assumptions about the inflation rate and investment returns, along with the client's current and anticipated future tax rates.

As part of the evaluation process, it is also common for financial planners to administer risk tolerance questionnaires. However, recent developments in the profession offer additional tools that may be used to evaluate a client's financial health more holistically.

Step 3, In Practice

Assess financial beliefs and behavior. Financial psychology offers tools to explore underlying assumptions or beliefs around money. These beliefs are known as money scripts, which are typically developed in childhood and unconsciously followed into adulthood (Klontz, Kahler, and Klontz 2006; Klontz and Klontz 2009; Lawson, Klontz, and Britt 2015).

As financial planners begin to implement comprehensive financial planning services, they may notice resistance to recommendations and other emotional or behavioral issues around money in their clients. To help flag potential psychological obstacles before problems emerge in implementing a financial plan, planners could conduct a more thorough evaluation of their clients' financial health. To this end, a variety of measures have been created to help planners gain a more holistic picture of their clients' financial psychology and financial health.

The Klontz Money Script Inventory (KMSI) (Klontz, Britt, Mentzer, and Klontz 2011) and Klontz Money Script Inventory-Revised (KMSI-R) (Taylor, Klontz, and Britt 2015) were designed to give financial professionals insight into money scripts that may be influencing their clients' financial behaviors and financial outcomes. Financial planners can use the KMSIs to help guide their discussions with clients who fall in any one of the four identified money scripts: (1) money avoidance; (2) money worship; (3) money status; and (4) money vigilance (Klontz and Britt 2012; Lawson et al. 2015).

Money avoiders associate money as being bad and would perhaps go so far as to describe money as evil (Klontz and Britt 2012; Klontz et al. 2011; Klontz and Klontz 2009). They tend to avoid responsibility regarding money and believe that it is taboo to discuss money (Klontz and Britt 2012; Lawson et al. 2015). Money avoiders are more likely to have lower income, lower net worth, and suffer from workaholism, financial denial, financial enabling, and not sticking to a budget (Klontz and Britt 2012).

Individuals with money worship scripts believe that more money will make them happier and solve all their problems (Klontz et al. 2011). Like money avoidance, money worship scripts are associated with poor financial outcomes and, when discovered in clients, suggest the need for further exploration.

People who hold the script of money status equate their self-worth to their net worth. They buy the next big-ticket item and try to "keep up with the Jones'" in order to appear as if they have "made it" (Klontz and Britt 2012; Lawson et al. 2015).

The fourth money script category, money vigilance, is associated with good financial outcomes and appears to be a protective factor in clients' financial lives (Klontz and Britt 2012). Clients with this money script believe strongly in the importance of saving, avoiding debt, and being watchful/alert, and are concerned about their finances.

Measure financial health. Financial health is more than just the availability of financial resources. Financial health involves high levels of financial satisfaction, low levels of financial stress, low

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debt levels, and an active savings plan (Joo 2008). Measuring a client's overall financial health in a formal and objective manner can help financial planners gain a more holistic view of the client's financial life, flag potential problems, and monitor their progress.

One such research-based measure of financial health is the Klontz-Britt Financial Health Scale (K-BFHS) (Britt, Klontz, Tibbetts, and Leitz 2016). The K-BFHS measures and scores four distinct areas of financial health: (1) global financial health; (2) money disorders; (3) risk planning; and (4) self-care. These four areas have been found to be associated with a variety of factors, including income, net worth, financial and life satisfaction, gender, race, and money scripts (Britt, Klontz, Tibbetts, and Leitz 2016).

Measure financial anxiety. Individuals with high levels of financial anxiety are unable to effectively manage their personal finances and may have low financial literacy (Shapiro and Burchell 2012). Clients with financial anxiety may not be able to make financial decisions that are best aligned with their interests, which may then lead to negative outcomes and increased financial anxiety (Sages, Griesdorn, Gudmunson, and Archuleta 2015). This circular process can make it difficult for the client to recover.

The Financial Anxiety Scale (FAS) (Archuleta, Dale, and Spann 2013) was designed to measure a client's financial anxiety, where higher scores in the seven-question assessment indicate increasing levels of financial anxiety. This tool may be useful to financial planners, because they can quickly and easily identify clients who may be under the influence of financial anxiety. The FAS can help planners better understand client behaviors and why clients are seeking out advice, allowing planners to better determine how to move forward in the planning process. It may also help signal to the planner that a referral for additional emotional support for the client is needed, as high levels of financial anxiety can put the client at risk for mental and physical health problems.

Step 4: Develop and Present the Financial Planning Recommendation

CFP Board (2016) describes this fourth step as the "very heart of financial planning" (page 5). It has three parts: (1) identify various alternative recommendations; (2) develop recommendations based on the alternative options; and (3) communicate and present the recommendations to the client. Financial psychology can offer concepts and techniques to help planners communicate their financial planning recommendations to clients.

Step 4, In Practice

Identify ambivalence toward change. When people have internal conflicts over something they are thinking about changing, they are ambivalent about change (Baek 2010). People are in a state of ambivalence when they simultaneously search for reasons to change and reasons not to change (Miller and Rollnick 2013). Many financial planning clients are likely in a state of ambivalence around one or more areas of financial planning. They know they need to make some sort of change in their financial lives—which is why they are setting up the appointment—yet, they may be hesitant to follow through with all the suggested changes.

The planner's goal when working with clients who are ambivalent about change is counterintuitive. The planner's task is to avoid what Miller and Rollnick (2013) refer to as the "righting reflex" and to not argue for the change or discuss why the change is so important to make. Instead, the goal is to illicit arguments in favor of change from the client and to listen reflectively. Clients who are ambivalent about change will

have already thought of positive reasons to change, so they might challenge with "yes, but…" statements, leading them to reinforce their negative views of the change, and ultimately resist change altogether (Miller and Rollnick 2013). Financial planners could reinforce and expand their clients' motivation toward change by exploring the following:

- "Tell me why you want to make this change."
- "Talk about what you need to do to succeed in making this change."
- "Please say more about why making this change is so important to you."

The goal of these open-ended questions is to allow the client to freely discuss why they want to change and feel engaged, understood, and empowered (Miller and Rollnick 2013).

Develop a discrepancy. Helping a client develop a discrepancy between where they are now and where they want to be can be a powerful motivational interviewing technique to increase a client's readiness to take action (Klontz, Kahler, and Klontz 2016). If clients were able to achieve all of their goals on their own, they would not seek the services of a financial planner. Inevitably, clients fall short on particular aspects of their financial plan. By highlighting what the client wants and where they are now, the planner can help the client determine how their current actions may be interfering with what their true goals and values actually are.

Step 5: Implement the Financial Planning Recommendations

During this step, the client determines which of the recommendations from the previous step to implement and which to reject. The planner works with the client to determine which party has which responsibility to implement (i.e., will the client delegate any or all of the tasks to the practitioner?). This is also the time in which the planner may refer the client to another professional (CFP Board 2016).

Step 5, In Practice

Give homework. When implementing recommendations, planners often give clients homework. Assigning homework is an important tenet of cognitive behavioral therapy, or CBT, (Beck, Rush, Shaw, and Emery 1979; Dattilio 2009) and of motivational interviewing (Miller and Rollnick 2002; Miller and Rollnick 2013). Homework helps clients reinforce and maintain what was discussed in meetings (Beck et al. 1979; Dattilio, Kazantzis, Shinkfield, and Carr 2011), and also helps the planner overcome roadblocks (Dattilio 2002; Dattilio 2009). However, the term "homework" can have a negative connotation, so it can be helpful to instead frame the term as "tasks" or "experiments" (Dattilio 2009).

Inevitably, clients fall short on particular aspects of their financial plan.

An example of this might be having the client write down every purchase and bring that list with them to the next meeting so that the practitioner and client can enter the data into budgeting software together. Or, the client may be given a task to call and meet with an estate planning attorney in the next three months. It could be that the planner asks a couple to sit down once a month and discuss their finances and plan for the next month. With each of these examples, it is paramount that the planner reviews the assigned tasks and follows up with the clients, because it helps confirm the importance of the tasks to the client (Dattilio 2009). The planner should give a summary of this to the client to show that the planner cares about the client and was listening to what the client said, and to help promote an understanding between the client and the planner (Miller and Rollnick 2013). It should be noted that both the client and the planner should be given actionable items to ensure that it is a mutual agreement.

Challenge the status quo. Clients exhibit a bias toward the status quo when they prefer to do nothing or keep what they currently have (i.e., not implement the plan). Prior research has found that people tend to do nothing or select what is considered the "status quo," even if it is not preferential to them (Hartman, Doane, and Woo 1991; Samuelson and Zeckhauser 1988).

Financial planners add tremendous value to their clients by helping them make the most rational decisions given all the available information instead of just keeping with the status quo, which has been found to add significant error (i.e., poor retirement plan implications) (Hartman et al. 1991). When implementing recommendations, planners may run into clients' status quo biases. When they do, the skillful planner avoids confronting the client and instead uses reflective listening techniques by encouraging the client to restate their motivations for making a change.

Step 6: Monitor

Pending the scope of the agreement, this step helps both the client and the practitioner know who will do what when. It provides an opportunity for the planner to provide further value beyond the initial financial plan presentation. Monitoring may also uncover a further need to reinitiate an earlier step of the financial planning process (CFP Board 2016).

Step 6, In Practice

Inoculate against the disposition effect. The disposition effect occurs when people want to sell winners but

hold on to losers. For example, a client who wanted to sell an investment quickly because it was up but would not part with an investment that had lost money might be exhibiting the disposition effect. Ideally, clients sell medium-to-high gains once they become long-term capital gains, and sell losses as they occur because the investment's future performance is unrelated to its purchase price (Shefrin and Statman 1985).

Financial planners can add value for their clients by discouraging hasty decisions and implementing tolerance bands (Kitces 2016) and/or stop-loss orders. It can also be helpful to inoculate clients against the disposition effect and other common cognitive biases by predicting and normalizing them. For example, before suggesting a buy or sell, the planner could talk briefly about the disposition effect and how human beings tend to want to sell winners and hold on to losers. Having this conversation before the client has the opportunity to endorse the bias will lead to a much better result than describing the bias after the client has already endorsed it mentally and presented an objection.

Protect against herd mentality. This bias occurs when individuals are influenced by their peers to follow trends, purchase items, and adopt certain behaviors even if it is not in their best interest. Planners can ask their clients why they are making a specific financial decision, and then compare that decision to the financial plan to see if it aligns. This will go a long way to help ensure that the actions clients are taking are actually right for them and not for someone else. Warren Buffett is known to be a contrarian and generally does the opposite of what the "herd" does, having been quoted to say "Be greedy when others are fearful, and be fearful when others are greedy" (Buffett 2008, page 1). Planners can inoculate their clients against falling victim to herd mentality by talking about how expert investors guard against it.

Educate about confirmation bias. Confirmation bias occurs when someone tends to select ideas, news, or research that confirms their own belief, rather than looking to obtain differing opinions or outside information. Hence, people attach an emphasis to the outcomes they desire. An example would be investing too much into the stock of the company a person works for because it is what they know; they are confirming their decision to work for the company. Consequently, this may drastically reduce the diversification of their assets (especially when considering human capital), which may significantly increase their risk of loss.

Educating clients about confirmation bias may help them understand why they devalue anything contradicting their belief, even if the contradictory belief has been proven to be better. It is also important that the planner realizes his or her own confirmation bias. Arguing with a client about a specific point of view when the client presents a different set of facts may be an indicator that the planner is under the influence of confirmation bias.

Conclusion

The financial planning profession has relatively little theory in which to guide the profession (Warschauer 2002). Buie and Yeske (2011) supported this notion, having stated that "CFP practitioners have an urgent need to develop basic financial planning theory" (page 38). Many respected professions have a large body of research in which they base their processes, services, and training. To that point, the financial planning profession needs to continue its efforts to study the Financial Planning Practice Standards through empirical research.

Financial planning stands to benefit greatly should the profession choose to adopt and integrate behavioral finance, financial psychology, and financial therapy theory and practices. Doing so will enable planners to better serve their clients, particularly in terms of combating client stress and anxiety, helping clients change destructive financial behaviors, overcoming client resistance to change, and keeping clients engaged in an ongoing financial planning process. ■

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