

## The Psychology of Retirement Planning

Behaviour	Retirement Consequence	Implications for investors & advisors
Procrastination	Procrastination usually stems from feeling overwhelmed by something that is too vast and complex to contemplate. As a result, clients may put off building a nest egg and run out of time to adequately prepare for retirement.	<p>Because there are so many complexities involved in retirement planning, it is often easier to focus on the immediate concerns of daily living. Short-term needs are right in front of people, screaming at them; long-term needs are a faint voice way off in the distance.</p> <p>Advisors should remind clients that the key to following a long-term retirement plan is heeding the voice that is off in the distance – it will get closer and grow louder faster than they realize. If clients are overwhelmed by the conflicting information they receive from friends, finance magazines and investment programs, advisors can help them sort through the clutter and determine what is actually relevant to their situation.</p>
Overconfidence	Clients may overrate their pre-retirement health and underestimate potential post-retirement health issues.	<p>Many people enter retirement in good health and become overconfident about maintaining that health. As a result, clients may fail to adequately plan for the future should they become disabled or require long-term care.</p> <p>It's not easy to convince retirees who have always enjoyed good health that they may not be able to maintain that level of vitality for the next 20 or 30 years. But clients need to recognize that they will likely incur new medical expenses as they age. The key to managing future healthcare costs is to start early. Clients who plan for long-term care now, while they're still healthy, can prevent their grown children from having to make emotional decisions about their parents' care later.</p>

<p>Myopic Loss Aversion</p>	<p>Because people hate losing more than they love winning, clients may become overly conservative in their investment decisions and lose purchasing power to inflation.</p>	<p>Wanting to avoid loss is understandable, but it should not be the primary objective of an investment strategy. Advisors can provide a voice of reason when fear and emotion drive their clients to make irrational decisions. It's always important to listen to clients' concerns about risk, but it is equally critical to keep them focused on their long-term goals, which should include opportunities for growth as well as principal conservation.</p>
<p>Mental Accounting</p>	<p>Money does not come with labels; people put labels on their money, assigning different purposes for funds from various sources. Mental accounting can be a detriment when it influences the way people spend, save and invest money.</p>	<p>Advisors can help their clients use mental accounting to their advantage by turning this common tendency into a budgeting technique. Mental budgeting can help clients determine different needs and objectives for various pools of money. This strategy helps clients recognize that their total wealth plan is composed of different segments, each of which carries its own investment strategy, risk tolerance and time horizon.</p>
<p>Layering</p>	<p>Credit cards and other cash proxies create layers of separation between consumers and their money. Layering can cause clients to overspend without awareness and accumulate debt that acts as a parasite on retirement savings and investments.</p>	<p>If clients are skeptical about how the format of money can affect their spending habits, advisors may want to consider challenging them to use only cash for one week. Most clients will be astonished by how much they spend when they are not distanced from their funds by electronic statements and layered forms of payment. They will probably return to their credit and debit cards for the sake of convenience, but the exercise may encourage clients to curb discretionary expenses.</p>
<p>Herding</p>	<p>In behavioural finance, herding is all about chasing trends. Following the crowd can result in buying high because everyone else is buying the same thing, and selling low because everyone else is selling the same thing.</p>	<p>For advisors, helping clients break out of the herd mentality is as simple as following the fundamental steps of financial planning. First, help clients understand their objectives and risk tolerance. Next, establish an asset allocation strategy that is designed to help reduce the impact of market and economic volatility. Finally, develop a comprehensive financial plan that includes carefully-defined long-term goals, and review the plan with clients periodically as their financial situation changes over time.</p>

<p>House Money</p> <p>Effect</p>	<p>Clients tend to be more careless with money that was earned by something other than the sweat of their brow, such as windfalls or inheritances. One consequence is depending on home appreciation and home equity to fund retirement.</p>	<p>During the housing boom, countless homeowners fell victim to the <i>wealth effect</i>. As the value of their homes skyrocketed, they believed they were wealthier than they actually were and felt empowered to spend accordingly.</p> <p>To address this behaviour, advisors need to help their clients break out of the mindset that a house is an investment. When they start viewing their home as a shelter and not a nest egg, clients will be more open to considering other options, such as renting in retirement.</p>
<p>Attachment Bias</p>	<p>Clients may refuse to let go of an underperforming security because they inherited it from a family member and it holds sentimental value. This attachment bias can cause investors to be hyper-risk adverse and limit the growth potential of their assets.</p>	<p>For subsequent generations inheriting family money, the attachment bias constricts the fluid movement of capital toward more constructive and appropriate investment portfolios. For example, a client may insist on keeping an inheritance in a savings account that does not match her overall investment strategy because she is sentimentally attached to the money and wants to keep it safe.</p> <p>Advisors can help clients break these potentially damaging attachments by encouraging them to allocate their inherited funds to portfolios or vehicles that have the potential for a higher rate of return. Moving the money gradually, in small increments, may make it easier for clients to manage their emotions.</p>
<p>Number</p> <p>Numbness</p>	<p>Being overwhelmed by numbers that are so large they are nearly incomprehensible. Number numbness can lead to a state of paralysis that makes the prospect of planning for retirement too complex to face.</p>	<p>Advisors can ease their clients' anxiety by helping them develop an income strategy. The process puts the seemingly unattainable retirement nest egg sum in perspective by breaking it down into categories clients can relate to.</p> <p>It's also important to remind clients that every large amount starts as a small amount – the key to making money grow is time and discipline. It may seem overly simplistic, but for clients who are intimidated by the numbers involved in accumulating enough money for retirement, it can be a comforting concept.</p>

Source: Greg Salsbury, 2010. *Retirementology: Rethinking the American Dream in a New Economy*.