Framing: Presenting Clients a Clearer Look into Their Financial Window

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When presented with the same conditions, framing impacts how individuals assess situations, infer judgments, and make decisions. When responsibly utilized, framing is a powerful, distinctive, and functional tool that financial advisers can effortlessly add to their advising toolbox. The remainder of this article will focus on framing bias and its implications for client communications, retirement planning, and intervention strategies.

Behavioral Finance and 'Normal' Investors

Standard economic theory posits that all investors are rational (Pompian 2012). Moreover, it suggests that rational investors are not susceptible to emotional or cognitive errors, and that focus is given to the maximization of one's objective position, such as a focus on wealth accumulation (Statman 2019). Under this premise, all investors make investment decisions using information and a rational thought process, which leads to the best objective investment decision (Altfest 2014; Pompian 2012). Rational economic theory, as applied to investors, includes foundational theoretical assumptions that are rooted in classical decision theory, risk aversion, and the efficient market hypothesis (Baker and Ricciardi 2014).

Financial professionals, economists, and psychologists have drawn conclusions that suggest investors succumb to irrationalities, and these drawn conclusions have served as the genesis of behavioral finance. Behavioral finance offers an alternative model to human decision-making, which is a model that accounts for the irrationalities of investors. This model of human decision-making incorporates investors' "normal" behavior, such as their cognitive and emotional heuristics and biases (Statman 2019).

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In a home remodel example, Statman (2019) explains cognitive and emotional shortcuts and errors using a rational approach and a "normal" approach. A rational homeowner considers the benefits and costs of all potential remodels and selects the best choice from all available possibilities. "Normal" homeowners may find the process daunting and decide to narrow their search based on factors that do not affect the remodel, such as contractor distance, personal values, and the like. The "normal" homeowner's approach does not guarantee the best remodel for the best price. Replacing the example of a home remodel decision with an investment decision illustrates the differences between a rational and a "normal" approach to investing. Shortcuts become errors, which may place investors in the position of making less than optimal decisions. Often, shortcuts are developed using cognitive errors, which present in the form of biases.

Framing Bias in Financial Behavior

Shortcut strategies taken in decision-making are common and are influenced by available information, current mood, past experiences, feelings, and emotions (De Martino, Kumaran, Seymour, and Dolan 2006; Pearson 2021; Pompian 2012; Statman 2019). These factors are categorized as cognitive and emotional biases. The shortcuts are taken in lieu of the larger considerations of the complexities surrounding a decision (Wright and Goodwin 2002). These shortcuts are heuristics and may not always result in the best outcome (Baker and Ricciardi 2014; Pompian 2012; Statman 2019).

The framing bias effect on decision-making is dependent on how an individual is presented with different information or options (Kreiner and Gamliel 2016). Framing is a mental structure, a structure that individuals create when formulating a shortcut or simplifying a decision (Russo and Shoemaker cited in Wright and Goodwin 2002). Like a single frame in a film, framing information only offers one perspective per frame.

Framing bias, as a condition, appears when two logically equivalent options are presented as either a gain or a loss, which results in a decision based on the presentation of the decision itself (Kreiner and Gamliel 2016). The positive and negative labeling of an attribute results in respective coding, or categorizing, by an individual and thus affects an individual's perception of the same condition (as cited in Kreiner and Gamliel 2016). For example, compared to products with a 50 percent discount, individuals are more likely to purchase two products listed as buy-one-get-one-free (Leković 2020).

The authors posit that retirement preparation is an important and continuous process that should not be adversely affected by framing. The communicating and presenting role of financial professionals affords an opportunity to mitigate framing bias, resulting in an increase in the likelihood of improved client decision-making.

Impact of Behavioral Biases on Saving for Retirement

Private sector workers covered by defined benefit pension plans fell from 56 percent in 1994 to 14 percent in 2018, and 52 percent had access to only defined contribution plans in 2020 (Greenblatt 2020). The burden of saving for retirement and investment decision-making increasingly weighs on the shoulders of employees rather than employers.

Defined contribution plans, such as 401(k) and 403(b) plans, are retirement accounts that pay no guaranteed benefit during retirement, unlike defined benefit and pension plans. Defined contribution plans have an employer component that may include employer contributions and administration, but requires the employee to make investment decisions, often from a preselected set of choices. The shift in responsibility has transitioned investment decisions from trained financial professionals to the individual employee, who may have little experience in investment selection and financial planning. This combination places pressure on individuals, and orients individuals to the vulnerable position of succumbing to their cognitive and emotional biases (Pompian 2012; Statman 2019).

The delivery or framing of information affects how individuals make decisions (Grima et al. 2019). Identically performing portfolios may be presented differently: one as positive with 70 percent favorable returns, and the other as negative with 30 percent unfavorable returns. Both portfolios have identical returns, but, most often, the positive framing option is selected (Grima et al. 2019; Pompian 2012). Financial professionals are responsible for recognizing the framing bias effect when implementing strategies to mitigate the negative consequences of poor investor decisions.

The increased responsibility of individual investors to select and manage their own retirement savings has resulted in many future retirees challenged to meet their goals (Boddy, Dokko, Hershbein, and Kearney 2015; Byrne 2007; Song 2020). Individual investors are negatively impacted by a number of cognitive and emotional biases. There is a lack of education regarding investment complexities and risk, and failure to begin investing will cause investors to lose out on basic financial principles, such as compounding interest and dollar-cost averaging (Chatterjee, Fan, Jacobs, and Haas 2017; Goda et al. 2019; Hopkins, Pike, and Littell 2016; Mayer, Zick, and Glaittli 2011).

Application for Financial Professionals

Framing bias directly impacts how individuals make decisions, and financial professionals should use this understanding to their advantage when communicating with clients. The authors encourage that framing be utilized as a tool to combat the biases that lead their clients to poor decision-making and to increase client acceptance of adviser recommendations.

A beginning framework for financial advisers, which employs other client communication strategies, is to present information in at least three forms: verbal, written, and graphically or with imagery (Kreiner and Gamliel 2016). Because framing influences decisions, we caution against verbal-only presentations and promoting the financial professional's personal choices or a firm's profit objectives ahead of the client's interests (Entman 2007; Kreiner and Gamliel 2016; Perneger and Agoritsas 2011). Sharing transparent financial information educates the client on the sound basis of adviser recommendations.

We recommend suggesting the client visualize their future self. By encouraging them to visualize their future self and the retirement they desire, the financial professional can frame their choice to spend more on the present self as a loss to their future self. The use of appropriate words such as "invest," rather than "allocate," to signify choices with a potential return keeps planning on track. Automatic contributions should be framed as building wealth, rather than a reduction of current income. Similar automated tools also increase plan compliance efficacy.

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For planners who recommend an annuity as a component of a balanced retirement portfolio, annuities can be framed as "buying future retirement income" and a hedge against potential investment downturns. Returns are a small, albeit important, part of comprehensive financial planning, but often rise to the top of client topics of interest. Planners can frame their services as a comprehensive approach to the overall financial health of their clients—an approach that affords clients the opportunity to meet goals, live dreams, and weather market conditions and life challenges.

Framing discussions on financial returns depends upon the goal of the client, specific investments under consideration, and the philosophy of the adviser. The authors encourage the use of framing the "return conversation" as a conversation orbiting around goal achievement, rather

than year-over-year returns for selected periods. From this vantage point, advisers can shift the mindset of their clients to focus on achieving the financial goals rather than achieving the acquisition of financial assets.

Conclusion

By understanding how behavioral biases can affect an individual's retirement, financial professionals can better understand how to communicate with clients. It is imperative that financial professionals approach clients as normal, irrational investors and be perceptive to any emotional or cognitive influences or behaviors. Financial planners and others can combat biases by educating clients on each topic, sharing known risks and probabilities, comparing diversified performance versus non-diversified performance, and framing information in the appropriate context (Dimmock, Kouwenberg, Mitchell, and Peijnenburg 2016; Özen and Ersoy 2019; Pompian 2012). The most effective client portfolio may be one that addresses clients' biases to a reasonable degree and one that clients adopt and pursue consistently (Yodanis 2020). ■

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