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Learning to behave

By Andrew Penn

THE Government's latest Intergenerational Report is a further reminder of the significant demographic changes that will play out in Australia over the next half century.

The report shows that in the next 40 years the proportion of people of traditional working age will reduce to below 60 per cent. The number of people aged between 65 and 84 will double and those aged 85 and over will more than triple.

At the same time, savings ratios in Australia remain low and, unless these increase, the economic impact of demography will put greater and greater stress on our tax and social security systems.

The Government has responded with important structural changes to superannuation, such as those announced in the 2006 Federal Budget. These are to be applauded, and without question make superannuation the preferred long-term savings vehicle.

On the most part, we enjoy a wonderful standard of living in Australia today. However, it is a sad fact that not all of us will be taking this lifestyle into retirement.

To take advantage of the opportunities superannuation presents and to enable us to afford and enjoy a better quality of living, we need to plan carefully. For the most part, we need quality financial advice. In this regard, we are fortunate the financial advice industry in Australia is one of the most advanced and professional in the world.

However, at a time when there is more need than ever for quality financial planning, the number of advisers in our industry is declining. Since 2000 alone the number has decreased by 20 per cent to around 16,000 today. This is not enough to service the population of Australia.

As the industry debate on fees versus commissions and conflicts of interest reaches fever pitch, our biggest challenge seems to go unnoticed.

I am not saying these other topics are unimportant, but, frankly, most of the debate entirely misses the point. What is crucial is giving customers choice and ensuring they can exercise that choice with knowledge through appropriate and helpful disclosure.

What is more important to debate now is why the number of advisers in Australia is declining and how to turn this trend around.

The two most important industries in the next 20 years will be health care and financial services. Why? Because with increasing longevity, our health and financial well-being are the two things that influence the quality of life we all enjoy.

When it comes to matters of money, we rarely act rationally. We typically do not save enough. When we do save enough we often invest in the wrong mix of assets. And even when we invest in the right mix of assets we chop and change our investment strategy and investments too often.

We also systematically underinsure because the perceived benefit of the peace of mind life insurance offers is not sufficient to offset the instant gratification of spending the money needed for the premiums.

What is interesting in all of this is that it is our behaviour, as much as what is happening in the financial markets, that determines how well we can fund our lifestyle needs and aspirations. Behavioural finance is an increasingly common body of work that sheds considerable light on why we do what we do when it comes to matters of money.

Behavioural finance tells us that, as individuals, we do not always act in the highly rational way that mainstream economics assumes we will.

Behavioural finance suggests that providing people with the means to save does not mean they will, or if they do, that they will increase their savings to the extent necessary.

Behavioural finance tells us that people tend to be overconfident in their judgements and are unrealistic about their prospects. When investing, this can manifest itself in the belief that we can pick winners. And in being so confident in our judgement we are often surprised by unpredictable events.

This overconfidence can also cause us to deliberately ignore new information or develop convoluted arguments to refute the new, while justifying the old.

Financial decision-making is complex and there is a tendency to simplify things.

We take short cuts based on previous experience and see patterns, which either do not exist or cannot be established statistically. We use intuitive 'rules of thumb' called heuristics to make many financial decisions. But these produce outcomes that are systematically biased in comparison to a decision reached by rational analysis.

At a time when changing demographics should be alerting us to the need to do more individually, statistics suggest that the attraction of immediate consumption is proving overwhelming for the majority of us. It may be that the demographic statistics just seem too distant.

So how do we make these things more personally relevant? How do we move from the academic and esoteric to the practical?

Well, that is exactly what financial advisers do every day, working with their clients, developing financial plans and strategies and helping them stick to those plans over time. Making sure they do not succumb to the traps behavioural finance shows exist.

This is why I am so personally concerned about the decline in adviser numbers in our industry.

It is advisers who work with people to make sure they avoid behavioural finance pitfalls, match their financial resources with their lifestyle aspirations over time and adequately insure for those unexpected events that unfortunately do arise.

The industry needs to promote advice for what it is. We are not about flogging products; we are a profession working with people to help them make the right decisions for their financial future and meet their lifestyle aspirations. Australia needs more financial planners.

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