INFO DÉONTO 100% CSF

Survival guide for productive discussions

Advisors must be sure to obtain all pertinent information about their clients in order to better understand them and make appropriate recommendations.

This can be achieved by practicing active listening and using certain guides, including the financial literacy scale, behavioural finance and lifecycle theory.

Let's have a look at how these tools can enhance your interactions with clients.

Active listening

It's in the best interest of advisors to listen to their clients, often beyond their words, and promote the relationship to get to know them better and thereby better serve them. In fact, clients who feel listened to will be more open to talking about their personal projects, dreams and aspirations.

It may be cliché to talk about "listening to the client", since it seems like an obvious priority for advisors. And yet, it happens sometimes that we forget this essential step. There are a multitude of active listening techniques to collect relevant information about clients and also help advisors learn how to know and better understand the person they're dealing with.

For conscientious advisors who want to propose solutions that are truly adapted to their clients' situation, the importance of listening interactively and attentively to clients, including their needs, desires, fears and priorities cannot be overstated. Listening is the cornerstone of a trusting relationship and promotes client loyalty: it gives them the importance they deserve.

Dale Carnegie said it well "You can make more friends in two months by becoming interested in other people than you can in two years by trying to get other people interested in you."[1]

[1] Carnegie, D. (2013). *How to win friends and influence people*, (new edition by Dorothy Carnegie).

Chambre de la sécurité financière

In this tool, the masculine gender has been used solely to improve readability.

Remember that the most popular subject in conversations around the world is "I", no matter the country or culture. Of course, personal information can be shared in many ways depending on the degree of trust held with the other party, but for advisors, two things should be favoured:

- Asking pertinent questions.
- Showing genuine interest.

An unwritten rule in any conversation in the context of client advice is that the speaking time of the advisor should be between 5% and 10%, while that of the client should be around 90% to 95%. Advisors should also not make recommendations too quickly. If advisors want to propose solutions that are adapted to their client's needs and create a true climate of trust, they must ensure they have all the pertinent information to make appropriate recommendations.

Here are some tips to help you practice effective active listening and guide clients through their thought process:

- Listen attentively.
- Ask relevant questions about the subject being discussed.
- Be clear and avoid financial jargon.
- Use visual supports to better illustrate the client's different options.
- Leave some material (paper) in the client's hands.
- Ask for feedback from the client (e.g., Were my explanations clear? What did you understand?).

Financial literacy

To better know their clients, advisors should be in a position to evaluate their understanding of investments. This essential task can be difficult to carry out. The financial literacy scale is an excellent tool for guiding advisors through this process.

The following concepts are considered as the **beginner level**:

- Distinction between needs and desires.
- Role and importance of money in life.
- Necessity of making payments.
- Detection of spending habits.
- Accumulation of money for short-term needs.
- Savings.

The following concepts are considered as the **intermediate level**:

- Taxation.
- Interest.
- Insurance.
- Cost of saving.
- Cost comparison of costs and benefits of financial products.
- Fraud.

Lastly, the following concepts are considered as the **advanced level**:

- Terms and conditions of financial products.
- Tax law.
- Anticipation and planning of savings based on higher spending.
- Asset growth protection planning.
- Consequences of sharing assets following a divorce.
- Their own ideas about financial markets (market risk, beta, correlation, standard deviation, etc.).

The lower a client's financial knowledge, the more an advisor must provide advanced explanations and the more they will need to ensure that their client understands the concepts being discussed. The above examples can thereby help advisors determine the level of client knowledge.

Advisors can also examine a client's personality to help determine a client's level of understanding, by focusing on the following **three personality types**.

- First, there are clients who are **"disinterested"** in financial markets. Advisors should be vigilant with these clients as they have the tendency to put all of the decision-making responsibilities in their hands. With a lot of tact, advisors should therefore thoroughly explain the concepts, simplify them and constantly check that the client thoroughly understands the explanations.
- There are also clients who are **"experts"** in financial matters. For them, advisors must adapt their language level and can go more into detail about the technical description of the products.
- The final group consists of **"educated"** clients**.** This group always want to know more, they want to have explanations about everything and will do their own research. Advisors can simply address them as they would a colleague.

Behavioural finance

Behavioural finance is a complementary avenue that advisors can use for inspiration while evaluating the potential strategy to propose to their clients.

The influence of client behaviour during their financial decision-making sometimes involves the client not necessarily making good decisions relative to their position. Clients are human. As soon as they invest, they make decisions that are sometimes irrational, influenced by their level of financial knowledge, and also by their emotions and biases. The knowledge of a client's possible reactions allows advisors, for example, to better plan their portfolio so as to assuage their fears and reassure them if the market suffers a loss; this therefore favours the development of a relationship of trust between clients and their advisors.

The study of behavioural finance generally classifies behavioural biases into two categories: **cognitive** biases and **emotional** biases.

Cognitive biases include information processing errors, for example, a client who won't buy or sell a stock until it reaches a certain price. Since clients are subjected to incredible amounts of information that they cannot assimilate, they try to simplify the task. For example, they will opt for a fund that has the best returns over a given period. In this case, an advisor's advice will be particularly beneficial to put these biases in context and remove or, at the very least, mitigate the affect of the biases on the client's investment decisions.

Cognitive biases include the following:

- Excessive self-confidence: a client who overestimates their capacity to predict returns after reading an article about a fund, for example, could take excessive risks and have a poorly diversified portfolio. This is one of the most problematic biases.
- Representativeness: a client who classifies a new product into a category they already determined in order to simplify the task. They would then classify products with similar characteristics in this category as good opportunities. They won't notice that this product isn't necessarily a good opportunity because of different criteria.
- Cognitive dissonance: a client who prefers collecting two products in the same category over trying something mentally discomforting following information about a new product.
- Availability: a client that believes that a product is a good product because they have often heard it being talked about.

Emotional biases are linked to feelings and intuition. They emerge spontaneously as a result of perceptions or beliefs.

Emotional biases include the following:

- Possession: a client who places a higher value on the products they hold. They will keep their investments rather than sell them, even if their value diminishes, rather than profiting from the best opportunities.
- Aversion to loss: a client who has more fear of undergoing a loss that they are of the possibility of producing a similar gain. This aversion prevents the client from selling unprofitable investments even if the possibility of improvement is low. However, if the value of an investment from this client grows, they will have the tendency to sell prematurely, because they are seeking instant gratification. They deprive themselves therefore of a potentially better profit.
- Aversion to regret: a client who holds onto an investment even if it lost a lot of value because they cannot admit that they made a mistake. This would also be the case of a client who loses a large amount, who says that they were unlucky rather than admitting that they made a bad investment choice. The loss is therefore less painful. If there are a lot of people who lost money for the same reason, they feel even less regret.
- Status quo: a client who holds onto an investment because they are familiar with it. They display a sort of emotional attachment to the investment.

Behavioural finance has also observed gender specific behaviours. It claims that, in general, men are more confident and optimistic than women, that women are more susceptible to holding on to an investment for a longer time because of emotional attachment, and that men are more tolerant of risk.

Financial crises certainly have an effect on client behavioural changes. Following a financial crisis, older clients who realize that the value of their investments has dropped in half become more fearful about the return of their investments. However, in the event of a significant drop in the market, the client should avoid reacting hastily, advisors should instead help their client understand that markets can improve quickly.

Obviously, financial literacy and client education can thereby reduce biases. The role played by advisors to inform and advise in these circumstances is particularly important, so clients base their decisions on more rational elements or place less importance on their cognitive biases. However, emotional biases are more difficult to manage. In fact, a client may have difficulty giving up the instant gratification from a transaction, even if they know it would be better to wait before doing so.

Life cycle theory

Life cycle theory is concerned with people based on their stage of life. It claims that a client's personal and financial situation, objectives and investment knowledge, as well as their risk tolerance evolve with age. Generally, advisors can therefore assume that:

- Older clients tend to have a lower tolerance to risk than younger people.
- Younger clients often have more short-term objectives than older clients.
- Older clients are often more concerned about their retirement.
- Older clients generally value prudence and consider savings to be more important than younger generations.
- Baby-boomers, born between 1944 and 1960, are more likely to appreciate consumption and credit.
- Generation Y clients, born after 1980, have the tendency to be pragmatic and more impatient and don't usually plan.

These are not applicable to every case but can still be used as a reference to establish the potential client profile and thereby serve as a starting point to begin the discussion about their finances.

Here are the different lifecycle phases:

- Start of career (until about 30).
- Family obligation years (from 25 to 35).
- Peak-earning years (from 30 to 50).
- Pre-retirement years (from 45 to 65).
- Retirement (starting at age 50).

Phase 1—Start of career (until about 30)

This phase corresponds to the period beginning with entering the job market and continues until family or other obligations begin to affect financial priorities. In this stage, clients generally don't have any family or financial commitments.

Their need for life insurance is often non-existent, as they don't have any dependents. If their finances permit, they may want to take out critical illness or disability insurance, to ensure they're covered until age 65, if the coverage from their employer isn't sufficient, and thereby benefit from lower premiums due to their young age.

This client could also be interested in saving with short-term investment objectives, for example, the purchase of a car or vacations. They are young and have a rather high risk tolerance. They could thereby opt for more aggressive investments if they want to invest for retirement given that the investment horizon is long term.

Phase 2—Family obligation years (from 25 to 35)

In phase 2, the birth of a child often increases their responsibilities and changes their objectives.

Life insurance can become a necessity with the birth of a child, or if one of the two spouses stops working to raise the child, for example.

The financial burden increases given the expenses incurred for the child, house or car, and the possibility of saving is lower. They generally therefore have a lack of liquidities. Risk tolerance tends to be lower and the investment horizon is rather short term and can become midterm depending on an increase in income. Savings for postsecondary studies could also be a consideration.

Phase 3—Peak-earning years (from 30 to 50)

In phase 3, the client is in the stage where their available revenue increases, as do their assets. They should be in a position to save enough to carry out the goals they set.

The client could be interested in life insurance with an investment component, if they have an inheritance objective, for example. Given that their revenues are higher, this client is more financially able to take out critical insurance or disability insurance to ensure they're covered until age 65, if the coverage from their employer isn't sufficient.

They generally have already accumulated reserves for their needs in the short and midterm. Their objectives are now more often long term, notably with respect to saving for retirement. Their risk tolerance should be the same as in phase 2. Being in a higher tax bracket, they could be looking to reduce their tax burden.

Phase 4—Pre-retirement years (from 45 to 65)

In phase 4, the client usually has the highest revenue possible of their career. The children have for the most part left home, which reduces familial obligations and, in turn, the client's financial burden.

Insurance needs change, notably because the children are now autonomous. This client generally no longer needs life insurance coverage for their family while maintaining their level of lifestyle if they die, at least, of course, if the spouse is in need in this event. However, the need for critical illness and disability insurance continue, as these events are more likely with age.

This client also realizes that they will soon be relying on their savings for retirement and this becomes their main focus. Their profile is therefore more careful than in the previous phase. They may also want to continue reducing their tax burden, as their revenue is generally higher. Their risk tolerance tends to be increasingly lower and this could bring about a decrease in their growth of their funds. Their need for liquidities is usually rather low.

Phase 5—Retirement (starting at age 50)

In phase 5, the client is in retirement. They are using their savings to maintain their new life. If they are in a good financial situation, they may want to provide for the needs of their children or create an inheritance; their familial obligations can also increase. An older client is also more likely to become sick or lose their autonomy; medical resources must then be considered. That said, a retired client is not necessarily old: they could be 50 and in good health. Every situation is unique.

The strategy applied in regard to insurance needs is the same as in phase 4.

Usually, an older client values prudence and saved more than younger generations.

Since their risk tolerance is often low, advisors must be especially careful when determining and checking the client's investment profile.

In general, the client has a more limited capacity than the working population to recover a loss of capital and places a lot of importance on their assets.

As they are also more likely to draw on their savings in the case of a health problem, it's generally preferred to propose a strategy that combines investments that are secure and easily cashable.

The lifecycle theory may be useful for inspiring advisors when determining the strategy, they propose to clients. However, one of the key factors in the analysis of the strategy that will be proposed to the client is the client's psychological ability to assume risk. Certain older clients can have a high-risk tolerance and younger clients can have a lower one. Advisors should not lose sight of the fact that these are just theories and each case must be analyzed independently.