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Stop Teaching, Start Coaching

The limitations of the advisor-as-educator role.

COACHING

Sarah Newcomb

"I have been impressed with the urgency of doing. Knowing is not enough; we must apply. Being willing is not enough; we must do."

Leonardo da Vinci

While some advisors see client financial education as a primary service, others are not convinced that the practice has real value. Decades of academic research only serves to intensify the debate because studies can be found to both defend[1] and refute[2] the effectiveness of financial education. How do we make sense of all these (often conflicting) findings? Thankfully, a more recent and careful meta-analysis of over 200 studies on the effects of financial education points to an answer. This article summarizes these findings, as well as original work performed by Morningstar researchers, and offers practical steps to put the findings to use in your own practice.

Effects of Education

What does the research *really* say about the value of teaching financial concepts? Hundreds, perhaps even thousands, of studies have been conducted to measure the impact of financial education on people's financial behavior. Some of these report increases (albeit small) in critical behaviors like saving and debt reduction, while others find no effect of education on behavior.

To better understand what this collective body of work can tell us, a team of three prominent researchers carefully examined the results of 201 individual studies on financial literacy and education.[3] The meta-analysis led to two important conclusions:

1. Whenever an effect was found for financial education on behavior, it was very small. In many studies, there was no effect whatsoever.
2. As with other types of education, the knowledge gained was quickly forgotten.

Given this rather devastating verdict, it would be easy to write off financial education as useless. Yet we can't ignore the obvious fact that financial knowledge matters. Without it, people would be at the mercy of unscrupulous salespeople and predatory products. Without financial literacy, financial experts could not add value, and if knowledge truly had no impact on behavior, experts would make the same bad decisions as novices.

Why, then, do education efforts appear to have little or no effect on behavior? And coming back to the practical question at hand: What does this mean for advisors and other professionals working with investors? It may be that current efforts aren't working, but others could work to help investors. Or that financial literacy is a lost cause, and industry professionals shouldn't waste their time. There are three things complicating financial-literacy efforts:

1 How It's Taught Is Not a Factor

One might propose that the problem is in the methods used to teach. However, the meta-analysis looked at many types of financial education: counseling, high school classes, seminars, workshops, multisession courses, and more. It would appear that the mode of information transfer is not a large factor in the effect of that information on behavior.

2 What Is Taught Has Limited Practical Use

The standard measures of financial literacy are based on simple multiple-choice questions about fundamental financial concepts. They read very much like a high school math quiz and test a person's understanding of interest rates, inflation, and risk. While these are important concepts for investors, they have little to no bearing on day-to-day financial habits or spending behaviors.

3 Other Factors Overpower the Effect of Knowledge

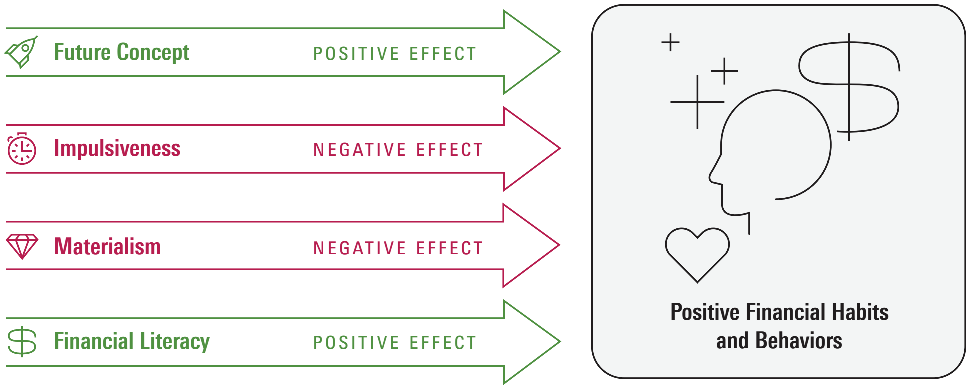
Knowing the right thing and doing the right thing are two different things entirely. We can know that saving is important, but if we are easily tempted by what we can buy today, we may not have the willpower to follow through on what we know is the best course of action. This explanation says, simply, that knowledge itself isn't enough. We need to look at other influences that might be stronger than knowledge when determining financial behavior.

In our view, this third factor is of primary importance. If factors other than knowledge are overpowering decision-makers' ability to apply

1 See Lusardi, A. 2008. "Financial Literacy: An Essential Tool for Informed Consumer Choice?" National Bureau of Economic Research, Working Paper No. 14084.
2 See Mandell, L. & Klein, L.S. 2009. "The Impact of Financial Literacy Education on Subsequent Financial Behavior." *Journal of Financial Counseling and Planning*, Vol. 1, No. 20, pp. 15–24. See also Newcomb, S. 2015. "Psychological Barriers to Sound Money Management: Advances in Theory of Human Decision With Practical Applications to Financial Education." ProQuest Gradworks, Dissertation & Theses.
3 Fernandes, D., Lynch, J., & Netemeyer, R. 2014. "Financial Literacy, Financial Education, and Downstream Financial Behaviors." *Management Science*, Vol. 60, No. 8, pp. 1861–1883.

EXHIBIT 1

Four Factors of Financial Behaviors Studies have shown that future concept and financial literacy have positive effects on financial habits. Materialism and impulsiveness have negative effects.



Source: Morningstar.

that knowledge, then our focus is best placed on these other influences.

In 2014, before working at Morningstar, I conducted a study designed to compare the *relative* impacts of several factors on financial behavior.[4] The goal of the study was to learn whether or not psychological factors had a greater impact on behavior than knowledge.

In this study, based on numerous previous works, we chose to measure the effects of financial literacy, materialistic values, impulsiveness, and one's conceptualization of the future (**EXHIBIT 1**). We then compared the effects of all four factors on self-reported financial behaviors.

First, we saw a result that was similar to the results in the meta-analysis. The effect size of financial literacy was small but positive, consistent with the findings of previous studies.

However, while financial literacy was positively associated with good financial habits, other factors were also significantly related to behavior.

The *relative* magnitude of the effect sizes is what really matters here, and what we found was that other factors had effect sizes that were similar to, and often greater than, financial knowledge. In other words, someone who has a lot of knowledge but is also highly impulsive, or thinks in the very short term, may still exhibit bad financial habits because knowledge on its own is not enough.

These findings support the idea that people's financial habits are influenced by a lot more than knowledge. Impulsiveness, future thinking, materialism, and other factors play into the decision-making process as well. What this means for advice-givers is that if these other factors are not addressed, financial knowledge may never translate into action.

How Coaching Can Help

The concept of coaching is different from financial-literacy teaching, though some elements overlap. Teaching is about knowledge transfer, while coaching is about action and skills. Teachers may lecture and assign work, but coaches are right there with people as they make their attempts to excel.

The analogy of a fitness trainer may be especially apt here. Fitness coaches do not lecture for weeks on nutrition, muscle groups, and metabolism. Instead, they offer real-time advice and feedback on a person's posture, technique, and diet. Coaches have deep knowledge of many things, but their job is not to teach all of their knowledge to the one being coached. Instead, they offer just enough information for the task at hand and use the events of the moment to train the person being coached into developing positive habits over time.

As other articles in this issue mention, a behavioral coach might help clients to understand their own decision-making biases, help them overcome the inevitable obstacles that emotions and cognitive biases bring to the mix, and challenge them to focus on how their own behavior (more so than the market's behavior) affects their ability to meet their goals.

With this in mind, here are some ways advisors can practically coach client financial behavior:

1 Take a Just-in-Time Approach to Teaching Clients
Memory retention research shows a clear pattern of knowledge decay over time (**EXHIBIT 2**). The rate of memory decay is exponential, meaning that it drops off extremely quickly.

Because knowledge retention follows this exponential decay curve, it is best to offer important information just before it needs to be applied. In many ways, good advisors apply this rule intuitively. Information about the purpose and merits of annuities might fall on deaf ears if clients are focused on building a family, but when they approach retirement, and are curious about how to deploy their assets to ensure a stable income, they will make far better students.[5]

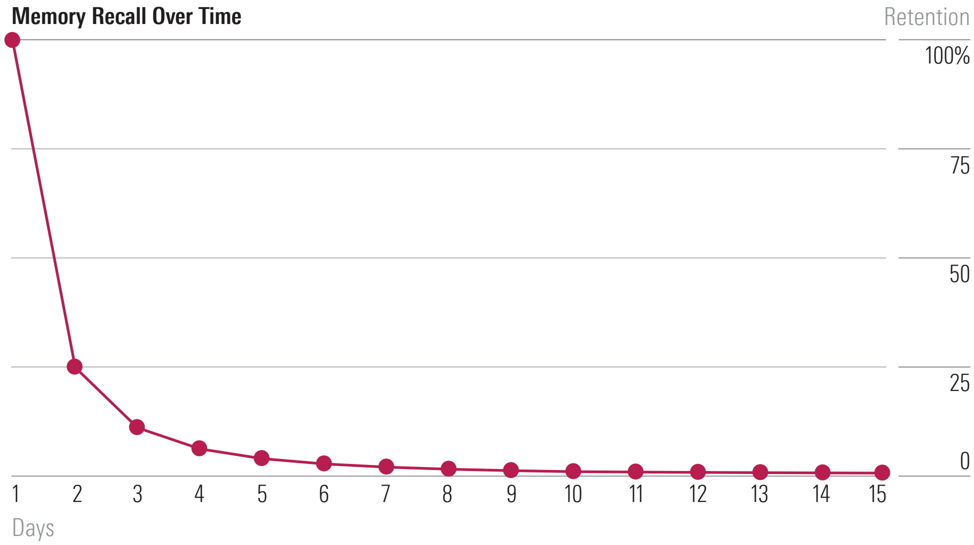
A few other examples of how to perform just-in-time education are:

4 Newcomb, 2015
5 Fernandes, Lynch, & Netemeyer, 2014.

EXHIBIT 2

Forgetting Curve The rate of memory decay drops off quickly.

Memory Recall Over Time



Source: Morningstar.

- Use the death of a parent (once the grieving has subsided) to teach the importance of wills and trusts in your client's own estate planning.
- If market fluctuations generate anxiety for some clients, consider it a moment ripe for teaching the purpose of diversification.
- If a client has a windfall, there may be an opportunity to show the long-term benefits of an early mortgage paydown or a one-time lump-sum retirement contribution.

There are thousands of small decisions that people make that require financial knowledge. Just-in-time information can benefit clients immensely by helping them avoid unnecessary losses or predatory products. The downside to just-in-time education is that it can be hard to anticipate which choices people will face at what time. Advisors are in a unique position to foresee these changes and offer just what clients need to know at just the right time.

2 Use Psychology to Enhance Memory

Even with the best timing, memories decay. Here, we can turn to research on teaching and memory for additional tools to boost the likelihood of memory retention over time.

Make It Emotional

We are more likely to remember things that are vivid and emotionally charged. For example, consider a client who has been offered a jumbo loan with a variable interest rate. Instead of simply explaining that a variable-rate mortgage may cost her more than a fixed rate in the long run, it may be more helpful to ask how she would feel if she had to abruptly change her lifestyle, or else face foreclosure.

Use the Self-Generation Effect

Information is better remembered when it is generated from our own minds. Helping your clients remember an important concept may be as simple as asking them to put it into their own words.

Coach the Whole Person, Not Just the Portfolio

Behavioral coaching goes beyond portfolio management to work with clients on developing and maintaining their motivation, fostering a sense of financial empowerment, and helping them create a vision for their financial future in which they are emotionally, as well as financially, invested.

Most financial advisors already act in a coaching capacity, because it is impossible to completely uncouple our emotional and financial lives. By understanding which areas of psychology have been shown to affect financial decisions, advisors can target their coaching efforts more efficiently.

Where to Find Help

While financial knowledge matters, it is insufficient for changing behavior, especially when other mental factors work against our better judgment. Morningstar has developed several resources to help advisors learn about the areas of psychology that give their clients the best chance of overcoming impulsiveness and developing a healthy attitude toward money.

These tools are available (at no cost) on our Behavioral Insights page at http://www.morningstar.com/company/behavioralinsights. More tools are being added as our research continues. M

Sarah Newcomb, Ph.D., is a behavioral economist with Morningstar.