Behavioural Finance in Practice

If academics as a group have a bad reputation, it is for our legendary "ivory tower" mentality and bad habit of having our heads in the clouds while we work on topics of little relevance to those toiling in the "real world". While as a scholar I was trained to conduct standard research in the domain of financial economics, the rebel in me was naturally drawn to topics that were considered non-standard for my very conservative field, and those topics leaned toward the highly practical. As a doctoral candidate in the 1990s, I did not realize it at the time, but I was working on ideas that would ultimately find a home in the (then barely existing) field of behavioural finance. As a discipline, behavioural finance cannot help but be practical and mould-breaking in its focus. People doing work on behavioural finance topics seek to explain puzzling phenomena that we observe in real financial markets and to uncover ways in which the prediction of theoretical financial models are at odds with the ways actual humans make financial decisions.

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By developing an expertise in the stark discrepancies between conventional financial models and what happens in actual markets, I found my research projects increasingly drew the attention of the media and financial market professionals. As a result, I started to find my words quoted in the press, and invitations started arriving for me to speak to small and large groups of professionals. The following is a selective and necessarily brief compilation of some of the topics I'm most asked to speak and write about, grouped by the types of professionals that I most frequently address.

Investment Advisors and Financial Planners: The main lesson of behavioural finance has been that individual investors are prone to making sub-optimal decisions when it comes to managing their own funds and planning for retirement. Overconfidence, mental accounting, loss aversion, and narrow framing are just a handful of the many behavioural tendencies that can have adverse consequences when investors self-manage their portfolios. The opportunity then emerges for well-armed advisors to intervene and act as mediators between investors and their portfolios. Evidence has emerged that financial professionals may not themselves be completely immune to behavioural biases; nevertheless, they can help naïve investors develop sound, long-range plans that are designed to withstand some of the most common and most dangerous obstacles facing investors.

Banks, Insurance Companies, and Other Financial Institutions: In the business of helping people hedge risks, the financial industry is in a position to tailor their sales pitches to cater to the natural cycle of human risk preferences. My extensive research shows that investors are especially sensitive to financial risk in the fall and winter, and are especially keen on risk in the spring and summer. Why not, then, time financial product marketing pitches accordingly? It makes sense to encourage safe types of bond investments in the fall, when people are more risk averse, rather than in the spring, when RSP season happens to peak but also when people are keener to adopt relatively riskier investment products.

Pension Managers: The world of choice architecture, or nudging, provides an abundant array of tools that can be used by the pension industry to help investors plan for retirement. For example, making the default option to contribute a non-trivial sum (while still allowing for ease of opting out), automating the contribution process, and incorporating automatically escalating contribution amounts. These are all nudges that can help investors to save more.

Overall, behavioural finance highlights important pitfalls in the investment context, but it also affords savvy professionals an opportunity to offer creative interventions that help investors fare better than they would otherwise. It's encouraging to see the behavioural flavor of finance research embrace practical applications that stand to improve the welfare of consumers.

LISA KRAMER

BIOGRAPHY

LISA KRAMER is a Professor of Finance at the University of Toronto where she teaches undergraduate and graduate courses on topics such as investments and behavioural finance. She is currently spending a sabbatical as a Visiting Scholar at the University of California, San Diego, Rady School of Business. Previously she was a Visiting Scholar in the Psychology Department at Stanford University. Her Ph.D. in finance is from the Sauder School of Business at the University of British Columbia. During the years 2008 to 2011 she was the Canadian Securities Institute Research Foundation Limited Term Professor.

Professor Kramer's research focuses largely on the overlap between human nature and financial decisions, including topics such as risk aversion, emotions, market seasonality, and investments. She has presented her research at conferences, government agencies, and university seminars around the world. Her scholarly articles have been published in peer-reviewed economics, finance, and psychology journals, including most notably the *American Economic Review*. She has written for popular press outlets including *The Wall Street Journal* and *The Globe and Mail*, and her research has been profiled by global media outlets including *The Daily Telegraph*, *Der Standard*, *Die Presse*, *The Washington Post*, *Bloomberg Business*, *Time*, *Business Week*, *The National Post*, CBC Television, CBC Radio, and NPR. Lisa Kramer routinely posts about behavioural finance topics under the Twitter handle @LisaKramer.

TESTIMONIAL

I am very grateful for having had the opportunity to serve as a Canadian Securities Institute Research Foundation Limited Term Professor. It is unlikely that my first sabbatical, at the Stanford University Department of Psychology, would have been feasible without the funding that accompanied this prestigious honour. My time spent at Stanford, interacting with top-notch psychologists and neurologists interested in financial risk-taking, helped to strengthen my expertise in behavioural finance. Specifically, I was able to become more proficient in experimental methods which are a core element of my research tool kit today.