

Introducing a Hierarchy of Financial Wellness

by Chris Heye, Ph.D.



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IF YOU ARE PLAYING a game of financial jargon bingo, you definitely want to have the square labeled “financial wellness” on your card. It seems almost every wealth management firm, insurance company, and employee benefit provider is promising to deliver “financial wellness” to their respective clients.

It is understandable in the new normal of COVID-19 that corporate marketing departments and industry consultants would adopt this language. The term “financial wellness” sounds “healthy,” and attaching it to a firm’s products or services creates the perception that these offerings are endowed with special healing properties. Who doesn’t want to be healthy, especially now?

But what does “financial wellness” really mean? Is it a useful construct, or is it just another marketing slogan that will fade as time passes?

I believe that “financial wellness” is in fact a meaningful concept. It should be regarded as an important goal for all investors, retirees, and their families. But the term should be understood and applied by practitioners within a broader context.

The pandemic has reinforced the reality that it is impossible to separate financial “health” from physical and behavioral well-being. Our financial decisions are not made in a vacuum. Choices about what we buy, how we invest, and to whom we give money are built on a foundation of complex emotions, personal histories, and individual behaviors.

Moreover, as we get older, the biggest threat to our financial security is not a stock market correction or rampant inflation. It is us. Diminished decision-making capacity stemming from cognitive impairment, impulsivity, loneliness, memory loss, anxiety, medication side-effects, or physical discomfort can wreak havoc on personal finances and torpedo even the most well-balanced portfolio.

Financial wellness might best be viewed, therefore, as a tiered pyramid, with each layer building on the one below, analogous to Maslow’s hierarchy of needs.¹ The proposed wellness hierarchy is shown in the graphic.

Organizational Wellness

At the bottom of the pyramid is the stage that deals with basic financial management. According to Tom Rath and Jim Harter, leaders in workplace well-being research at Gallup, financial wellness is “effectively managing your economic life.”² The University of California, Davis defines it as “the process of learning how to successfully manage financial expenses.”³

Defined this way, “wellness” is

shorthand for “good financial management.” This first stage I refer to as “organizational wellness,” as it describes a state of well-organized and managed personal finances.

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Organizational wellness has both quantitative and qualitative components. It means not only that a person has a good handle on managing and tracking expenses, planning for a major expense, or has adequately prepared for retirement (quantitative component). But good financial management—especially for older adults—requires having plans in place for both the successful transition of financial decision-making authority in the case of illness or death, as well as the safe and secure transfer of wealth to the next generation. This requires creating at least a basic estate plan, including a will, trust, power of attorney, living will, etc. (the qualitative component).

Physical Wellness

According to the Centers for Disease Control and Prevention, almost 80



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percent of adults over the age of 55 suffer from at least one chronic illness (like diabetes or asthma or heart disease), and by age 65, that figure rises to roughly 86 percent.⁴ (The average asset-weighted age of a financial adviser client, on the other hand, is 68.⁵) An illness or death of a family member, especially if he or she is the primary income earner and/or main decision-maker, can have a devastating impact on family finances.

Not surprisingly then, virtually every survey of adult investors has found that health-related events are the No. 1 financial retirement fear. For example, 49 percent of the respondents in a large Merrill Lynch retirement survey cited “a costly health issue(s)” as their top financial retirement worry (by contrast, only 16 percent cited low stock market returns).⁶ In a Franklin Templeton study, 47 percent of respondents over the age of 55 mentioned health-related costs as their top expense concern.⁷ Even millionaires in Fidelity’s 2019

annual “Millionaire Outlook” stated that worries about their health were the leading cause of stress.⁸

Other statistics back up these fears. Two-thirds of all bankruptcies in the United States are caused by medical issues.⁹ And 56 percent of people suffer financial hardship due to medical concerns.¹⁰ Healthcare and long-term care costs are growing much faster than the costs of most other consumer goods and services, and many of us can expect to pay for five years or more of long-term care.

So, the link between physical health and financial well-being is clear. But this does not imply that your client needs to be perfectly healthy to achieve financial wellness. It does mean, however, that they have secured access to good medical care, made their healthcare advance directives clear, identified trusted individuals who can help make decisions, and planned for their long-term care (more on the role of preparation below).

Cognitive Wellness

The onset of cognitive impairment, including Alzheimer’s, can occur before a person reaches age 60. At this age, the frequency of cognitive impairment starts to double, and by time a person reaches their mid-80s, they have a 50 percent chance of experiencing at least mild cognitive impairment.¹¹ A Harvard study concluded that the peak age of financial decision-making, on average, occurs at age 53.¹² Another study showed that executive function (i.e., the ability to plan, organize, and connect the dots) has important consequences for financial decision-making.¹³ Finally, many people, even well-educated ones, lack basic financial literacy.

It is increasingly clear that diminished financial decision-making capacity can have devastating impacts on personal and family finances. Estimates of the costs of financial exploitation range from \$2.9 billion to over \$36.5 billion per year.¹⁴ Given the difficulty measuring the size of abuse, and the reluctance

of those who have been scammed to report it, it seems likely that even this high-end estimate is low. Older adults appear to be especially vulnerable, with roughly 37 percent of seniors having experienced financial abuse in any five-year period.¹⁵

Financial wellness is therefore dependent on cognitive health and the safeguards your client has in place, like trusted family members or friends who can help make financial decisions. Your client can have the most well-balanced portfolio, a history of controlled spending, enough savings on hand to afford a comfortable retirement, and then Cognitive changes can occur quickly. Money can disappear fast. Lack of identification and preparation for diminished capacity can have disastrous consequences for any family's finances.

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Behavioral Wellness

The entire discipline of behavioral finance is built around the idea that behaviors and emotions have significant impacts on financial decision-making. The fundamental tenet is that most people do not act rationally in a strict economic sense, but instead are influenced—often negatively—by biases, anxiety, fear, lack of impulse control, and other personality traits and behaviors.

This suggests that financial wellness is also conditional on emotional stability and control. Unfortunately, many of us know individuals who are well-educated, physically healthy, have no apparent cognitive issues, and yet make bad financial decisions. These individuals may struggle with impulsivity, have recently experienced an emotional loss (such as divorce or death of a spouse), are overconfident in their abilities, or are just lonely. (A former U.S. Surgeon General has declared loneliness as the No. 1 disease in the United States.¹⁶)

The works of Daniel Kahneman and Amos Tversky, Robert Shiller, George Akerlof, and others have established the importance of behavioral factors in financial decision-making. And for most of us, money is not just “money,” but it can represent love, self-esteem, security, or anxiety. These emotions are not always the most effective foundation for sound financial decision-making. Like cognitive wellness, behavioral well-being is a critical determinant of financial wellness.

Holistic Wellness

At the top of the pyramid lies holistic wellness. Holistic financial wellness involves the successful management of all of the stages that lie below it. While achieving holistic wellness may seem like a tall order, there are manageable steps your client can take over time that will move them closer to the ultimate goal. In addition to being well-organized, holistic wellness also requires being prepared, staying connected, and demonstrating self-awareness.

Preparation. Your client doesn't need to be 100 percent healthy or have a perfect memory to achieve holistic financial wellness. But you should help them prepare for the inevitable likelihood that they will suffer from physical, cognitive, and/or behavioral illnesses that reduce their capacity to make good financial decisions. Make sure your

clients' estate plans are in order and ask that they identify trusted individuals who can assist in financial decision-making in the event of physical or cognitive incapacity. Make sure that all of their medical advance directives are in place, and that their family members and healthcare professionals understand their end-of-life wishes.

Connectivity. In his book, *Connect*, Ned Hallowell, M.D., refers to personal connection as “the other Vitamin C.” Social isolation is increasingly viewed as highly detrimental to a person's health—especially older adults—potentially as dangerous as smoking or obesity.¹⁷ Social connections are critical to financial wellness. Encourage your clients to stay connected with family, friends, and any other professionals they work with, especially those in the healthcare field. These people are likely to be the first to spot any signs of declining health, loneliness, or other behavioral changes that can impair financial decision-making. Have an agreement with your client about what he or she would like you to do if you suspect they are having difficulty making sound financial decisions.

Self-awareness. Studies have shown that overconfidence is a risk factor for financial exploitation. So, help your client recognize that they don't know what they don't know. (This is good advice for you as an adviser as well.) Encourage them to consider that they might be impulsive, or lonely, or fearful, or just plain wrong about something. Urge them to be humble and seek counsel from others who know more than they do about financial management, or estate planning, or healthcare delivery. Remind them that by doing so, they will do a better job of protecting not just themselves, but their family as well.

So ignore the hype, put away your bingo card, and start moving your clients down the path to holistic financial wellness. ■

Endnotes

1. See the 1943 paper, “A Theory of Human Motivation,” by A.H. Maslow in *Psychological Review*, volume 50, issue 4, pages 370–396.
2. See *Wellbeing: The Five Essential Elements* by Tom Rath and Jim Harter (2010, Gallup Press).
3. See shcs.ucdavis.edu/wellness/financial.
4. See cdc.gov/nchs/health_policy/adult_chronic_conditions.htm.
5. See “The State of Retail Wealth Management: 8th Annual Report,” by PriceMetrix, 2018. Available at mckinsey.com.
6. See the 2017 study, “Finances in Retirement: New Challenges, New Solutions.” Available at benefitplans.baml.com/publish/content/application/pdf/GWMOL/FinanceStudy_AR7JF3BS_2018.pdf.
7. See the “2019 Retirement Income Strategies and Expectations (RISE) Survey.” Available at ftinstitutional.com/institutional.
8. See “The Intersection of Well-Being and Advice: Millionaire Outlook 2019.” Available at clearingcustody.fidelity.com/app/literature/item/9897298.html.
9. See “Medical Bankruptcy: Still Common Despite the Affordable Care Act,” by David Himmelstein et al. in the March 2019 issue of the *American Journal of Public Health*. Available at pnhp.org/docs/AJPHBankruptcy2019.pdf.
10. See “Prevalence and Correlates of Medical Financial Hardship in the USA,” by K. Robin Yabroff et. al in the May 2019 issue of the *Journal of General Internal Medicine*. Available at pnhp.org/news/137-million-adults-face-medical-financial-hardship.
11. See “The Age of Reason: Financial Decisions over the Life-Cycle with Implications for Regulation,” by David Laibson et. al in the fall 2009 issue of *Brookings Papers on Economic Activity*. Available at brookings.edu/bpea-articles/the-age-of-reason-financial-decisions-over-the-life-cycle-and-implications-for-regulation.
12. Ibid.
13. See “Cognitive Function as a Proxy of Financial Decision Making in Older Primary Care Adults,” by Anthony Weiner et al. in the July 2017 issue of *Alzheimer’s and Dementia*.
14. See the 2015 *Consumer Reports* article, “Financial Elder Abuse Costs \$3 Billion a Year. Or Is It \$36 Billion?” Available at consumerreports.org/cro/consumer-protection/financial-elder-abuse-costs-3-billion-or-is-it-30-billion-
15. See the “True Link Financial Report on Elder Financial Abuse 2015.” Available at truelink-wordpress-assets.s3.amazonaws.com/wp-content/uploads/True-Link-Report-On-Elder-Financial-Abuse-012815.pdf.
16. See the September 2017 *Harvard Business Review* article, “Work and the Loneliness Epidemic,” by Vivek Murthy.
17. See the 2020 Consensus Study Report from the National Academies of Sciences, Engineering, and Medicine, “Social Isolation and Loneliness in Older Adults: Opportunities for the Health Care System.” Available at nap.edu/catalog/25663/social-isolation-and-loneliness-in-older-adults-opportunities-for-the



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