



The benefits of personal financial planning

by Otto Lucius, Chair,
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It's just a fact of life: some people possess more knowledge and information than others. While this simple truth may be benign in many areas, it can lead to severe distortions in financial markets. When certain people have more knowledge, superior analysis or faster

access to information than others, we call it information asymmetry. Exploiting information asymmetry can give one actor in the marketplace an unfair advantage over others by enabling insider trading and market manipulation.

Lawmakers all over the world have enacted regulations to prevent or minimize information asymmetry. Examples include the European Union's market abuse directive and the markets in financial instruments directive (MiFID). And of course, information asymmetry is an important contributing factor to our current global economic crisis.

Times like these make it even more important to limit information asymmetry. A deep financial crisis leaves investors shaken, disappointed and even betrayed. What started as a relatively narrow loss

of faith – the so-called subprime crisis – expanded quickly during 2008 into a full-blown financial meltdown that left Wall Street in shambles.

In 2009, the crisis reached the real economy. Huge fortunes were devastated literally overnight. For a number of reasons, investor psychology now ranges from disappointment to complete lack of faith in financial intermediaries – and this mistrust is perhaps most acute in regard to financial advisors.

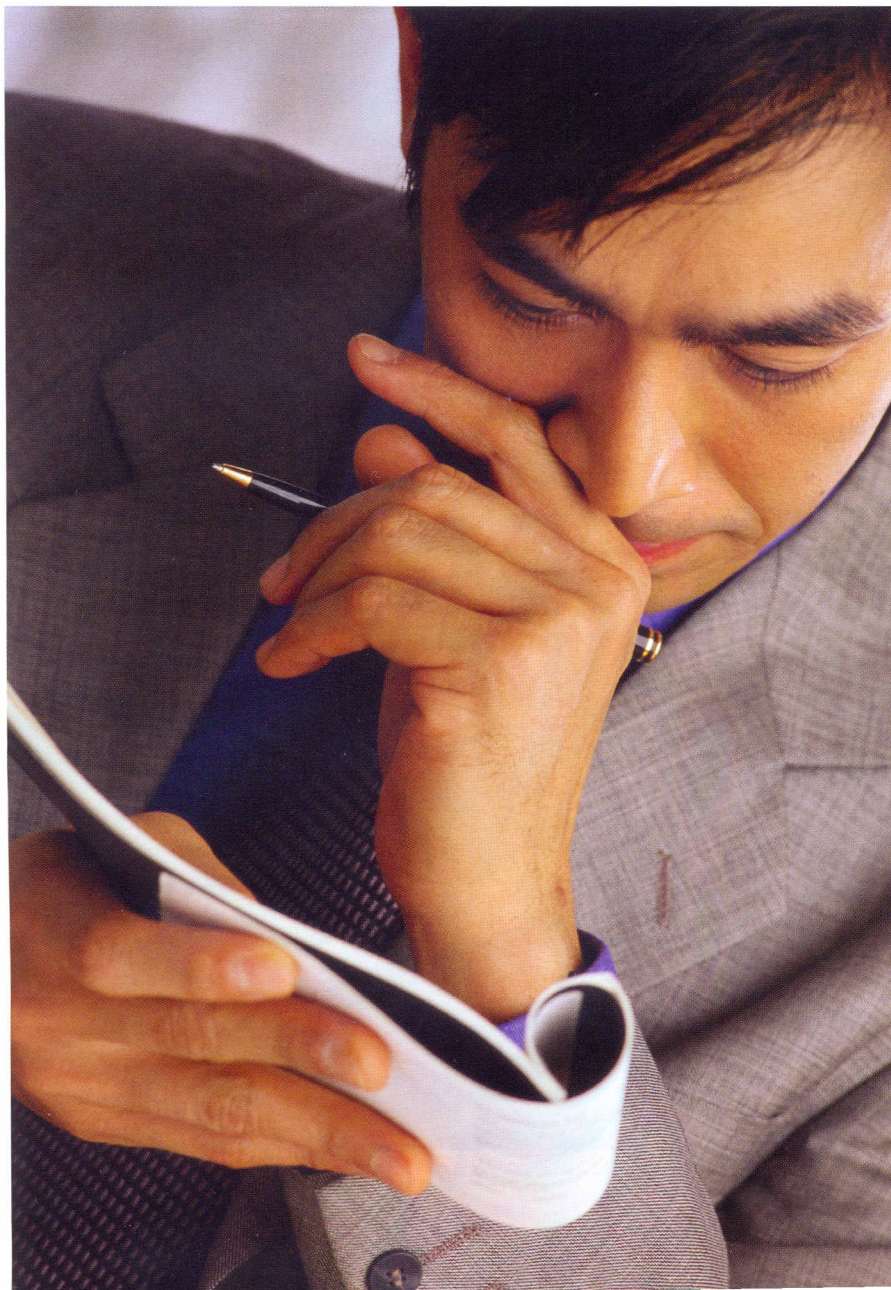
Myopic loss aversion

Investors generally tend to think in very short time frames and show very low tolerance for short-term losses. This means that they may focus, for instance, on the risk of loss over a one-year time frame even when investing for retirement in 30 years. In behavioural finance, such behaviour is called "myopic loss aversion."

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Investments are made not only to make money per se, but also to reach certain goals. This was once fairly straightforward. With or without insights from modern portfolio theory, investors could trust that asset management achieved returns at least equivalent to those of a market portfolio. But now this simple truth is in doubt, leaving investors uncertain.

Most advisors – and commentators – tend to forget that investors normally hold more than the asset class of securities and/or derivatives. Clients are invested in assets such as commodities, real estate, art and antiquities. They are looking for solutions for certain needs, such as personal risk analysis to deal with potential illness, disability or death, or they are in search of estate solutions.





How financial planning helps

The current financial crisis strains clients' emotional and financial well-being as they plan for financial and life goals – which is of course, the central aim of financial planning. This requires a long-term strategic approach. Conditions of extreme market volatility and upheaval force clients to take a long-term view and to stay focused on a plan – assuming they have one.

This is where a financial planning expert is an essential resource. A qualified financial planner is firmly committed to the value of the process, which means that he or she offers advice based on a comprehensive strategic scenario featuring well-considered

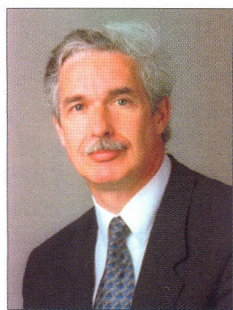
assumptions focusing on the needs and goals of the client.

The core of this process is an integrated approach including investment, tax, retirement, risk and estate planning. Only certified financial planners (CFP®) can provide the necessary relationship of trust, in particular, those certified to ISO 22222:2005, *Personal financial planning – Requirements for personal financial planners*.

Financial planners certified against ISO 22222 will never look for quick return, but will instead strive to put the client's interest first in every respect. Personal financial planning is built on trust and confidence between the planner and the client.

The planner has an important fiduciary duty towards the client, which implies focusing on long-term considerations. Planning horizons tend to be at least 10 years, but may stretch to 25 years or more. An overarching principle is that all elements of financial planning – from financial management to asset management and retirement and estate planning – are treated holistically. This approach accentuates the true value of financial planning. And only planners with comprehensive education and experience are able to provide the value and security that consumers require. ■

About the author



Professor Otto Lucius is Chair of the Austrian national committee ON-K 244, *Personal financial Planning*, and actively participated in the development of

the ISO 22222 standard. He is CEO of a research society in banking and finance, and teaches at the Department Banking and Finance, University of Graz, Austria, on financial planning and consulting. He is a founding member of Austrian Financial Planners.

