Behavioural Finance Biases in the Decisions of Pension Fund Trustees

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Private occupational pension schemes control a large share of financial assets around the world. The large investment choices made by these schemes can influence markets, and determine the quality of life of millions of pensioners. These are important decisions, which are concentrated in the hands of a few pension trustees. Despite their relative size, importance, and concentrated power, behavioural finance research has mostly ignored decisions made by pension trustees, instead focusing on lay individuals, who typically make smaller, more atomized, investment decisions primarily on their own behalf.

In a series of five online experiments, we investigate the relatively unexplored area of behavioural finance biases found with pension trustees. We show that trustees display a number of biases found in unsophisticated retail investors. In particular we focused on:

1. We replicated the naïve diversification effect: trustees allocated investments evenly across all funds, regardless of their relative risk, according to the 1/N rule;
2. We show that framing influences trustee decisions: The amount of risk taken by trustees is influenced by spurious labelling, such as labelling a mutual fund as “conservative” without changing any of its underlying risk characteristics;
3. We show that poor advice (recommendation of clearly inferior options) influences trustees’ decisions; moreover the influence of advice varies depending on whether advice is given before or after trustees consider their own independent views;
4. Judgments of ideal pension characteristics made by trustees on behalf of their members are highly correlated with, and influenced by, individual trustees’ personal preferences and personal pension circumstances;
5. Trustees’ information search when selecting mutual funds reveal the fund characteristics that they consider most important towards their choices. These priorities varied across different trustees and were more consistent for professional trustees than member-nominated trustees.

A common finding emerging from most of the experiments is that different types of trustees are differentially affected by such biases. We observed that more experienced trustees are less susceptible to biases than less experienced ones, highlighting the importance of training and experience to ensure better decision making.

Overall, our studies show that the risky financial decisions made by trustees on behalf of pension members are not firmly principled, but instead are influenced by irrelevant factors. Given the huge influence trustees’ decisions have on asset allocation, and by extension on financial markets, this is of some concern. Our findings raise questions about the efficiency of employing surrogate trustees to make critically important life decisions for pensioners. Exploring the decisions made within pension schemes may have wide ramifications for the pensions industry and the future sustainability of pension incomes.