Investment Trustee Checklist

Decision-making in defined benefit trustee meetings

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The reason you need this checklist is because you do not think you need this checklist

Making a decision — any decision — is hard. Making the right decision is even harder. But, if we have all the facts, expertise, and experience at our fingertips, we are fine — right? Perhaps not.

Along with Behave London, Aon trialled a checklist[1] to help reduce bias in investment decision-making for defined benefit pension trustees. These trustees (serving and ex) were asked questions common to their responsibility about investment decisions and asked for their response and confidence in their answer. The results are surprising.

- Without the checklist trustees were faster, less correct, and just as supremely confident in their ability compared with their checklist-using counterparts
- The checklist-using trustees were slower/more considerate, more correct, and still as supremely confident as their non-checklist counterparts

Not only have we helped DB trustees reduce their decision-making bias to a degree that now matches their *declared* confidence in their *ability*, we have proven that declared confidence is not related to ability to make less-biased decisions — and that is the reason why, even if you think you do not need this checklist, you do.

Why does this checklist work, and why is it needed?

Human decision-making is a clever trade-off between our energy-hogging, rule-governed, calculating, conscious thought, and our more intuitive, rapid, and non-conscious processing. This trade-off was of great benefit to humans as we evolved, helping us move day-to-day mental processes to the non-conscious. However, the trustee meeting was never part of our evolutionary influence, and, as a consequence, we sometimes apply decision-making strategies that were better suited to keeping us alive in the past years ago than keeping our scheme alive 20 years from now.

The good news is that knowing when and how mental shortcuts and biases influence our decision-making is the first step in distancing ourselves from their effects.

Common traps

Trustee meetings were certainly not part of early human existence, there are some conditions that trustees face today that would be familiar to our ancestors: decision-making under uncertainty, decision-making in a group, and decision-making with time horizons that could vary between a day and a lifetime.

More specifically, trustees are laden with the necessity of dealing with other people's money, and investing time and effort in that process. Both this bias towards others and a commitment that is endowed with responsibility, commonly generate strong feelings of loss and risk aversion. That in turn, often guides other subconscious mental shortcuts — for example, sticking to the status quo, delegating responsibility, conforming to groupthink, and protecting one's reputation. These common traps are why — even though we are confident in our abilities — we need help reducing our bias.

Downloading and using the Aon Trustee checklist is the first of many, many, more correct decisions you will make.

1 74 defined benefit pension trustees were sampled, and 254 'financially savvy' members of the public across two tests that measured bias in decision-making with and without a checklist designed to explain and minimise bias

The science bit: results and details

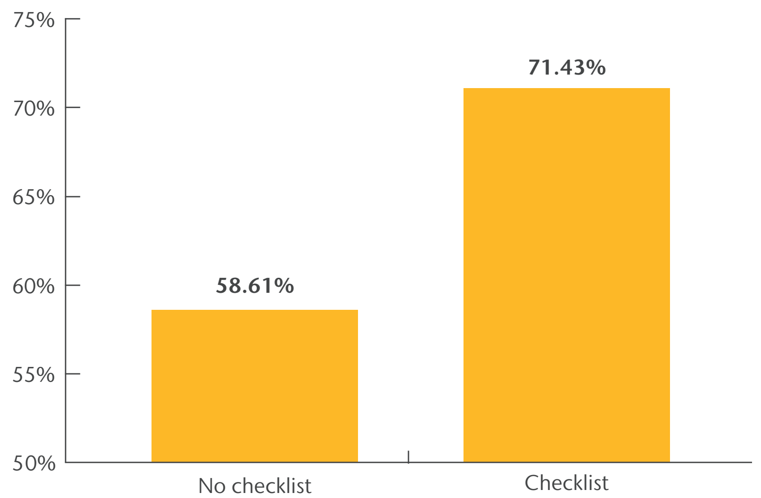
Time taken to answer questions

Trustees (n=74) using the checklist (n=35) took significantly longer[2] to answer the questions. The average time taken to answer five real life pension problems using the checklist was 88.65 seconds compared to 44.24 seconds for the group without checklist – twice as long. This suggests that we have managed to put a brake on quick, intuitive reasoning: using the checklist makes answering financial questions more deliberative. Some of the effect is also likely to derive from the trustees reading the checklist items.

Reduction in biased answers

The results indicate that the checklist can direct the decision-maker (n=35) towards a less biased choice as the proportion of less biased answers (deemed correct for the analysis) was significantly higher for the group using the checklist (71.43% as opposed to 58.61%). This effect was significant[3].

Proportion of correct answers



Jargon busting

n = the number of people we've asked or number of data points we have.

p = measure of statistical significance where <0.05 indicates strong evidence or a statistically significant result (e.g. <0.05 = less than 5% chance we're wrong, <0.007 = less than 0.7% chance we're wrong).

df = degrees of freedom (the number of independent variables).

t = probability distribution inputs used to calculate 'p' which judges how robust the result is (as above).

Confidence in the answer being correct

Overall, confidence remained relatively high for those with and without a checklist; however, this effect between groups was not statistically significant[4]. This suggests that using the checklist, the trustees were slightly more confident of their answer – most likely, the checklist affirmed their worries or concerns about the situations. But it also means that the trustees were quite confident of their more biased choices made without using the checklist.

The results for financially savvy people who answered similar general money questions were similar in that time taken with checklist was slower (and we hypothesise more considerate) and answers were less biased, although not as statistically significant. It was trustees who really felt the benefit.

[2] From the probability distribution of the data ($t = 2.80$) and the number of independent values (degree of freedom, $df = 48.29$) there is strong evidence that there is a significant difference between the time taken by the Trustees when consulting a checklist ($p < 0.007$). [3] From the probability distribution of the data ($t = 3.92$) and the number of independent values (degree of freedom, $df = 72$) there is strong evidence that there is a significant difference between the answers given by the Trustees when consulting a checklist versus without ($p < 0.001$). [4] From the probability distribution of the data ($t = .57$) and the number of independent values (degree of freedom, $df = 72$) there is strong evidence that there is a significant difference between the time taken by the Trustees when consulting a checklist ($p < 0.573$).

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If these effects drive your decision-making unchecked, the best you can hope for is to be 'right for the wrong reasons'.

Decision-making in a group

1. Authority

"I am not allowing a person's experience from a different domain to unduly influence me in this domain."

Why this is important: We all like experts to assist with decision-making; it is important to have the facts. However, even though we correctly tend to bow to someone else's experience and authority on a subject in which they are knowledgeable, we also tend to lend these people's opinions more weight in subject areas in which they're not an 'authority'.

Bottom line: This is a dangerous situation if an influential figure is out of their domain, and wrong (and that includes you).

2. Herding and groupthink

"I have listened to my 'gut', and spoken without censoring myself. If I agree with others, it is because I have consciously and effortfully made that choice."

Why this is important: 100,000 years ago, sticking with the group provided a greater chance of survival than being alone. Today, life is not so trepidatious – even so, our non-conscious herding instinct still remains even when wearing a suit and drinking a latte.

Bottom line: Decisions shaped by groupthink have a low probability of achieving successful outcomes for trustees.

Evaluation of assets, investments, and strategy

3. Loss aversion

"I evaluate loss and gain by using calculations and logic — my feelings about either are not important."

Why this is important: Decision-making is inherently skewed towards averting loss and the risks linked to it, because the pain of realising a loss is greater than the pleasure of realising a gain of equal size.

Bottom line: Decisions shaped by averting loss often 'feel' correct when they are likely logically incorrect.

4. Status quo

"Should I wish to leave an option as it is, I make an active choice to do so – nothing I do is 'by default'."

Why this is important: Our reluctance to switch from a default can be the product of effects such as our aversions to losses and ambiguity, cultural norms, and authority. In a very real sense, our rapid automatic thinking either fears the downside of change or accepts the implied 'stamp of approval' of the default. The real trapdoor is the misconception that doing nothing is the absence of a decision; it is not.

Bottom line: Whether through fear or implied approval, doing nothing is not a 'free pass' – it is an active decision.

5. Endowment

"I have made this decision 'as if' I were not involved previously, 'as if' I were giving advice on someone else's problem."

Why this is important: Driven by aversion to loss, we are reluctant to give up what is already 'ours', even in the presence of perfect information that clearly tells us we should. That which is 'ours' exists in many forms: an object, an idea, an existing investment strategy. A bird in the hand is not necessarily worth two in the bush.

Bottom line: If you let the endowment effect drive your decision-making, you simply will not make many decisions at all (if any).

6. Reputation and responsibility

"I have made a choice in favour of the best outcome, irrespective of what others may think of me."

Why this is important: Reputation maintenance is born of a self-interested motive to increase the chance of gifts and decrease the chance of ostracisation and abandonment from peers or other groups. Often an intuitive, rapid, and automatic tendency, it can affect us unknowingly.

Bottom line: When the needs of the fund are not aligned with the needs of the trustees, fund performance is at risk.

Notes

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