



Pension Trustee Checklist

Decision-making in trustee meetings

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

Further reading

Authority effects

Authorities have a subtle but powerful effect on decision-making, often not explicitly acknowledged (Milgram, 1974). In particularly risk-heavy or uncertain situations, deferring decision-making or aligning one's decision with that of an authority (eg, someone more senior, experienced, or perceived to be more competent) can relieve the emotional burden. However, people are often fooled into thinking someone is an authority, and excessively conform to their opinions (Cialdini, 2001).

Herding and groupthink

Evolutionarily, belonging to a group provided greater chances of survival than being alone. Due to this, in risky and uncertain situations, people often follow the group in what is also known as herd behaviour – a tendency to follow the actions of other group members, rational or irrational (Raafat, Chater and Frith, 2009). In terms of decision-making, this can lead to groupthink – aligning your opinions with those of other group members, more or less consciously. In the famous Asch (1955) conformity experiments, participants overwhelmingly followed group judgments on the length of lines presented on a blackboard, even when the majority of the group were confederates and their judgments purposefully wrong.

Loss aversion

For the human brain, losses loom larger than gains (approximately twice). According to Prospect Theory (Kahneman and Tversky, 1979), people are more sensitive to avoiding losses than to pursuing gains, even if their value is equal. Decision-making is inherently skewed towards averting loss and the risks linked to it. It is especially so if the mental accounting frame of decisions is narrow, leading to frequent evaluations and shorter-term choices (Haigh & List, 2005). This is because volatile investments (eg, stocks) create the impression of greater loss compared to steadier investments (eg, bonds).

Status quo bias

Driven by loss aversion and ambiguity aversion, people are reluctant to switch from an option provided by default – for example chosen in the past, or already in place (Samuelson and Zeckhauser, 1988). This reluctance increases even more if the number of alternative choices rises (Ren, 2014).

In a number of experiments, it was easier for people to make an unbiased decision when the situation was framed like that: “You inherit £75,000. You can choose between investing in government bonds, stocks, or put the money in your savings account”, as opposed to a status-quo option: “You inherit £75,000 in government bonds. You can choose to switch to stocks or put the money in your savings account. Do you?”

Endowment effect

Driven by loss aversion, people are reluctant to give up what is already theirs, even in the presence of perfect information, even if they should, and even if they can make a gain (Kahneman, Knetsch and Thaler, 1990). This could be everything from an object, to an idea, to an existing investment strategy.

Ownership can have a strong but subtle effect. In a study of an Italian telecoms company, customers who were credited 100 free calls when phoning to quit the service were much less likely to resign than those who were merely offered 100 free calls (Welch, 2010).

Responsibility and reputation

Reputation maintenance is born of a self-interested motive that increases the chance of future support or decreases the chance of ostracisation and abandonment (Bateson, 2003). Often an intuitive, rapid, and associative effort, it is one of the evolutionary drivers of behaviour that can explain co-operation between individuals in the absence of direct return, as well as conformity. This is particularly relevant in large groups where first-hand knowledge is missing because potential co-operating partners can only act on knowledge about each other's reputation.

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