Determinants of the Use of Heuristic Choice Rules in the Swedish Premium Pension Scheme: an Internet-Based Survey

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Results of analyses of citizens’ choices in the Swedish premium pension scheme (Hedesstrom et al. 2004) were replicated in an Internet-based survey of fictitious choices among fund categories. Findings indicated the prevalence of a default bias, use of a diversification heuristic, a home bias, and use of the 1/n heuristic. Involvement in the scheme increased with amount to invest but decreased with age. Involvement was positively correlated with number of chosen funds, and being more involved decreased the likelihood of choosing the default fund. Naive risk diversification, home bias, and use of the 1/n heuristic were however unaffected by involvement.

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EXTENDED ABSTRACT

In many countries public retirement schemes are being reformed, as citizens are expected to take more responsibility for their own future pension. In the premium pension scheme, Swedish citizens can choose which stock and/or interest funds 2.5% of their income will be invested in. A brochure describing the 655 available funds is sent out to all eligible citizens, who are then required to make a sequence of choices: whether to invest in the default stock fund or in other funds, how many (one to five) and which funds to select, and how to divide the investment across the selected funds.

In analyzing people’s choices of premium pension funds at the introduction of the scheme in 2000, Hedesström, Svedsäter, and Gärling (2004) found indications of the following heuristic-driven biases: a tendency to select the default option (default bias, Johnson et al. 1992); a tendency to choose many funds seeking maximal variety (diversification heuristic, Read and Loewenstein 1995); a tendency to avoid funds with extreme low and high risk (extremeness aversion, Simonson and Tversky 1992); a tendency to choose domestic funds (home bias, Kilka and Weber 2000); and a tendency to divide investments evenly across the chosen funds (1/n heuristic, Benartzi and Thaler 2001).

The aims of the present follow-up study were twofold. Firstly, as heuristic-driven biases may depend on the complexity of the choice task (Payne, Bettman, and Johnson 1993), we wanted to investigate whether the results would be replicated in a simplified controlled experimental setting. A second aim was to disentangle possible individual determinants of heuristic-driven biases. A particular focus was on the role of involvement, since highly involved individuals may use more sophisticated decision processes (Verplanken and Svenson 1997).

A sample of 392 employees at Göteborg University from all levels and areas of duty completed an Internet survey. They were asked to make a fictitious choice of premium pension funds as if for the first time. The same fund categories as in the brochure were presented. However, instead of specifying particular funds, respondents made a choice among the categories of funds, selecting one to five unspecified funds in each chosen category. Information about social demographics, savings, and level of involvement was included in a series of regression analyses. Level of involvement was measured on three self-report rating scales (not important–important; requires no deliberation–requires deliberation; nothing to lose–much to lose) that were averaged (α=.734).

Having a larger amount to invest, being young, and owning stocks was shown to increase involvement.

The default stock fund was chosen by 56.0% (224) of the respondents compared to 32.9% in the previous study. This increase may be attributable to participants’ awareness of the fact that so far (the Internet survey was carried out in 2003) the default fund had performed better than the average actively selected fund portfolio. Being more involved, having a larger amount to invest, and owning stocks showed independent effects of reducing the tendency to choose the default fund.

Replicating the results of the previous study, the typical choice among respondents who did not choose the default fund was to include the maximal number of five funds in the portfolio. More involved individuals included a larger number of funds than did less involved individuals. A majority selected funds all belonging to different categories. Men and stockowners tended to choose fund portfolios with a higher average risk.

Also mirroring the results of the previous study, the proportion of choices of stock funds investing only or predominantly in Sweden was larger than the relative availability of such fund categories, thus indicating a home bias. As in the previous study, and in accordance with the 1/n heuristic, the most popular investment allocation was to divide the total amount evenly across the chosen funds. Neither involvement nor any of the background variables were found to affect the proportion of Swedish stock funds included in the portfolio or the use of the 1/n heuristic, except that older people tended to use the 1/n heuristic to a larger extent.

To summarize, although the choice task was simplified, the results largely replicated those of the previous study. Being more involved had an effect in reducing choice of the default fund, and this effect was independent of amount invested. However, no other effect of involvement was observed, except that being more involved meant including a larger number of funds in the portfolio. Thus, raising people’s level of involvement in the premium pension scheme is likely to decrease choices of the default fund and increase diversification, but not to reduce the home bias or use of the 1/n heuristic. It cannot be excluded that simplifying the choice task even further would reduce heuristic-driven biases, but informing and educating scheme participants may be of greater importance.

REFERENCES


