Index

academic behaviour 172–4
action
as component of behaviour 8
as decision theory problem 28
and mirror neurons 10–11
actionable knowledge 28–9
adaptive toolbox 42, 119
affect heuristic see heuristics: affect
affect, role of 7–10
Alemanni, B. 221
alternative dispute resolution (ADR) 166
anchoring 4–10, 145, 169
anticipated regret 7
armchair economics 22
“as if” concept 26, 72–4, 78, 130
asset management 216–17, 219–20
Attia, C. 15, 135, 156
austerity 145, 151–2
availability 9, 85–6, 120
aversion to loss see loss aversion
bank customers
bank-related behaviour 102
investment decisions 123–4
views of risk 122–3
banks
actions preceding financial crisis 67–70
and complexity 69, 128–30
cooperative 122–4
incentives 102, 105
regulation 102–7
stability 103–5
see also central banks
Behavioral Financial Regulation and Policy (BEFAIRLY) xvii–xix, 30, 47, 55
Behavioral Investor Types (BITs) 98
behavioural biases 97, 119, 159, 165, 168–9, 201–3, 232–4
behavioural economics
first generation 95–6
linking to monetary inertia 195–6, 201–3
pioneers 94–5
recent developments and lessons for policymakers 108–12
second generation 96–8
third generation 98–9
behavioural finance
adaptive toolbox in 119
for better prediction and regulation 14–17
call to rethink nature of 130
emergence of 96–7
financial organizations 12–14
future 99
incorrect forecasting 2–3
and investment process 228
neuroeconomics 10–12
original intention and end result 117
personalized 98–9
pioneers 95
regulation of bankers’ behaviour 102–7
reshaping financial consumer protection 183–92
role in pension fund investment 219–20
room for methodological principles in 120
semantic and pragmatic anchoring 4–10
versus traditional financial paradigm 227
behavioural finance preferences
architecture building 228–32, 234
behavioural chart 231
emotional behaviour 228, 230–33
growth dimension 228–9
inflation and investment needs dimension 228–9, 234

Riccardo Viale, Shabnam Mousavi, Barbara Alemanni and Umberto Filotto - 9781788973069
Downloaded from Elgar Online at 07/06/2019 11:08:17AM
via free access
The behavioural finance revolution

Innovator types 231–2
irrational behaviour bias 228, 232–3
leverage dimension 228–9
monetary policy dimension 228–9
recommendations 233
survey findings 232–3
behavioural insights (BIs) 37, 184–5, 187, 195–6
behavioural policymaking
and bounded rationality 24–30
dealing with internalities 39–43
economists and psychology 20–24
lessons for macroeconomics 108–12
more pragmatic approach to 36–9
pension fund investment
recommendations 221–2
potential for integrative approach 37, 44
spread of 33
terminology 33–4
versus traditional economic policy 33, 35–7, 40, 44
see also behaviourally-inspired policies
behavioural regulation see regulation
behaviourally-inspired policies
Consob’s steps towards 187–92
defining 34–6
European institutions 184–7
see also behavioural policymaking
Benartzi, S. xii, 88–9, 96–7, 111
Bendor, J. 24–5, 29
bias-variance dilemma 120–21, 129
Black–Scholes case 15, 139
Black–Scholes–Merton formula 126
bonuses see rewards
boosts
classes of 42
domain for use 43
motivational 43
risk literacy 43
as targeting competences 42
theoretical foundations 41–2
types of 42–3
uncertainty management 43
bounded rationality
basis for theory of 21, 75
definition of theory of 84
elements of 26–9
in political science 24–5, 29–30
two orientations of 24–5, 29–30
brain 10–12, 89–92
budge policies 37–8
capital asset pricing method (CAPM) 78, 116
Capital Markets Union (CMU)
focus on SME growth 215
personal pension market 221
recommendations for 222–3
casinos 118, 129
causal models 152–4
central banks
actions in presence of behavioural biases 201–3
beliefs in 65–6
communication and formation of expectations 59–63
doves, pigeons and hawks 201–2
as Econs 197, 199–201
effect of financial crisis 58
 governance 200–201
large-scale asset purchases 58
as lenders of last resort 103
loss aversion 195–7, 201–3
monetary inertia 195–6, 199–203
quantitative easing 3, 63–6
signalling with policy rates 61–3
use of committees 197–9
use of multiple models 66
see also banks
Cervellati, E.M. 98
chess 82–3
cognitive accessibility 11
cognitive biases 7, 30, 52, 83, 98, 117, 125, 144, 151–2, 167–9, 186–7, 207–8
cognitive components
of decision-making 15, 23, 83, 227
of organizational memory 17
“cognitive continuum” 8
cognitive control 43
cognitive economics 15, 17, 109–10
cognitive limitations 24, 26–8, 51–2, 110–11, 119
cognitive operations of mind 41
cognitive overload risk 208
cognitive processes 7–8, 83, 190
cognitive sciences
  application in Consob 187–91
  ascertaining role of 184–7, 191–2
  use in monetary policy analysis 203

cognitive skills 112

cognitive system 42–3

committees (monetary policy) 197–202
complexity 16–17, 69, 128–30, 188–9
Consob (Italian Authority for Securities Markets)
  application of cognitive sciences in 187–91
  demand for financial advice 189–90
  financial disclosure 188–9
  future steps 191–2
  investor education 190–91
  research into behaviourally informed policies 184
  rules of conduct 189–90
  suitability assessment 189

conversational maxims 5

credit standards 149–51
Cruciani, C. 207, 210

cultural cognition 24–5

culture of risk 148–9, 155

data
  case of flawed 152
  experiential 84
  fitting 120
  framing effect 6
  order of 5–6
  presentation of 4
  quantity of 9
  selection of 4
  undersampled 140–43, 155

databases 146

debiasing 16, 25, 169
decision process 41, 168–9, 183
Delphic policy 61–2
disclosure
  for behavioural finance 17
  Consob 188–9
  educative nudges 41
  regulation 38–9, 165, 185–6
  response to information asymmetry 164

disposition effect 7, 89–90
diversification
  causes behind lack of 216

improving portfolio 223

recommendations for pension fund
  216–17
  risk 221–2
“dotcom effect” 9
dual model of mind 7–8

ecological rationality 12, 41–2, 119–22, 125, 128

economics
  armchair 22
  mathematics and logic 21–2
  versus psychology 20–24, 73, 82, 169
  reunion with psychology 81–9, 110–11
  stress on optimization theory 22–3
Econs 197, 199–201

efficient market hypothesis (EMH)
  74–82, 155
emotional salience 9
emotions 7–8, 17, 52, 83, 122–3, 187, 191, 228, 230–33
endowment effect 8, 110
equity premium puzzle 77–8, 88–9
European Commission (EC)
  Capital Markets Union project 215, 221
  financial disclosure 185–6
  interest in behavioural approach 185
  Joint Research Centre 184–5
  Key Investor Information Document 185–6, 189
  personal pension products proposal 221
  rules of conduct 186–7
European Securities Markets Authority (ESMA) 187, 189
European Supervisory Authorities (ESAs) 186
Eurozone crisis 135, 145, 151–2

expectations
  as driving behaviours 107
  and efficient markets 74–8
  formation of 59–63
  fully rational 64, 70, 74
  and “irrational” operators 79
  regulators and bankers 102–3, 106–7
  role in financial planning 71

see also rational expectations theory
expected utility theory (EUT) 40, 82–3, 130, 227

finance
analyzing heuristics in 122–30
judgmental overconfidence in 136–9
mathematical tools of 116–17, 119
psychological blind spot in 117
role of uncertainty 115, 118, 130
towards systematic study of heuristics in 130

financial advice
demand for 189–90
non-monetary benefit 208
transparency of cost 206

financial advisory industry
exchange dimension of service 210–13
framework to understand trust in 210–13
as money doctors 207, 209–10, 212–13
as more than money managers 207, 213
new normative requirements for 206
relationship and exchange dimensions 210–13
trust models in 207–10
financial advisory models evolution 234

financial analyses and forecasts
anchoring and adjustment heuristic 4
behavioural sciences for improved 14–17
causal models for 152–4
correcting errors in 152–4
emotional salience 9
groupthink in 145–8
misprediction in US housing market 140–43, 155
overconfidence in 136–9
quantity of data 9
subservience to rating agencies 15–16
unreliable 2–3, 109

Financial Conduct Authority (FCA) 37, 168, 184

financial consumer protection
behavioural finance reshaping 183–92
consumer behavioural weakness 164–5
financial education for 167–9
necessity of 163–4
need for multi-disciplinary approach 169
private enforcement 166–7
public enforcement 165–6
regulation 165

financial crisis
and availability heuristic 86
bank regulation preceding 104
catching institutional investors by surprise 220
challenging paradigm underlying financial regulation 183
as combination of myopia and herd behaviour 60
and financial heuristic 124
financial market preceding 67–70
impact on central banks 58
and MiFID II Directive 206, 209
and psychological biases 135–6, 151–2, 154–6

financial disclosure
Consob’s study on 188–9
European Commission’s report on 185–6
regulation 185–6

financial education
campaigns 183
for empowering financial consumers 167, 183
for investors 190–91
issues for consideration 98–9
low level in Italy 221
need for portfolio of approaches 167–9
as not limited to financial literacy 16
traditional 190–91
financial education programs 98–9, 167

financial incompetence
aims of study 135–6
asymmetric rewards and risk culture 148–9, 155
client psychology 143–5, 155
cognitive biases 151–2
correcting errors in statistical thinking 152–4
groupthink 145–8, 151–2, 154–5
judgmental overconfidence 136–9
relaxing credit standards and mispricing risk 149–51, 154–5
undersampling 139–43, 155
understanding of and recommendations for 155–6
financial intermediaries in period preceding subprime crisis 67–70
and trust 208–9
financial literacy of bank customers 122–4
behavioural aspects 159–62
definitions 122, 124
dimensions of 158–9
financial knowledge 159–61, 163, 181
gender differences 161, 163
initiatives to raise awareness of relevance 168
versus nudging 125–6
overconfidence 159, 161–2
questions used to measure 179
role of parents 163
solutions for general public 124–5
statistics on 181, 221
financial markets see markets
financial organizations 12–14
financial regulation see regulation
forecasts see financial analyses and forecasts
forgetfulness 9, 14, 52
forward guidance 59–63, 65, 105–6
fractal markets 80–81, 140
framing bias 43, 52, 117, 164
framing effect 4, 6, 82, 87–8, 169, 185–7, 221
Franceschi, F. 163
free will 11
Friedman, M. 72–3, 83, 96, 108, 118, 120
full rationality 26–8, 110–11
gains versus losses 6–7, 87–8
game theory 20, 22, 96
Gaussian curve 15, 80–81
Gigerenzer, G. 7–9, 12, 20, 24–5, 27–9, 41–3, 48, 50, 55, 86, 116–17, 119–20, 124–9, 192
Giorgiantonio, C. 217–18
goal-orientation 26–8
governance central banks 200–201
of pension funds 216–19, 222–3
governance inertia 196, 200–201
groupthink among US securitization professionals and financial analysts 145–8
in Eurozone crisis 151–2
as exacerbating shared delusions 155
as often exacerbating errors 154
gut feelings 9
harm principle 51
Hayek, F. von 51, 73, 118, 155
herd behaviour 3, 52, 60, 219–20
heuristics affect 8, 120, 136, 149–51
anchoring and adjustment 4
availability 9, 85–6, 120
and bounded rationality 24–5, 28–30, 84
ecological rationality of 12, 41–2, 119–22, 125, 128
empirical questions on 13
fast and frugal 9, 24–5, 42–3, 116, 119, 125, 129
in finance, study of 130
gaze 115, 129
ground-based 106
impacting on information processing and evaluation 169
for investment 126–8
“local” 12
one-reason 13
prototype 9
relevance 9, 84–5, 120
for regulation 128–30
representativeness 9, 84–5, 120
satisficing 126–7
simple 9, 12–14, 23, 41–3, 84, 119
“skin in the game” 130
terminology and description 115
use in human decisions 227
white-coat 124
The behavioural finance revolution

heuristics-and-biases 24–5, 41–2, 84
heuristics revolution
study of adaptive toolbox 119
study of ecological rationality 119–22
taking uncertainty seriously 118
Hilton, D. 15, 135–6, 138, 144, 156
House Price Appreciation (HPA) 140–43
household behaviour analysis 225–7, 234
housing market (US)
“predatory” mortgages 144–5
undersampling and misprediction in 140–43, 155
incentives
bankers driven by strong market 105
fiscal 174–5
for managers, and herding 219–20
and nudges 40, 50
and regulation 37–9, 155, 165
trader 64
see also rewards
incrementalism 24–5, 109
information inertia 196
information, role of 183–4
innovation
Italian anomaly 171–3
valuation criteria of universities 172, 174
“institutional herding” 220
insurance-lottery framework 96
intellectual arrogance 52–3
interest rate inertia
loss aversion triggering 195–6
when central bankers are Econs 199–201
when central bankers become humans 201–2
internalities
in classifications of public policies 35–6
dealing with 39–43
investment
heuristics for 126–8
Italian attitudes towards 177–81
investment knowledge 216, 221–2
investment process 228, 234
investment rules 221–2
investor behaviour 174–5, 177–81, 234
investor education 190–91
Italy
attitudes toward investment 177–81
Consob’s steps toward behaviourally informed policy 187–92
financial attitude 227–34
financial literacy 122–4, 158–63, 169, 179, 181, 221
households’ financial portfolio 225–7
innovation 171–5
low capitalization of SMEs 215
pension funds 215–18, 222–3
Joint Research Centre (JRC) 184–5
judgmental overconfidence 136–9
Key Investor Information Document (KIID) 185–6, 189
Keynes, J.M. 73, 95
King, M. 106, 118, 129–30
Knight, F. 28–9, 115–16
knowledge
and financial literacy 122, 124, 159–61, 163, 167–9
generated from information processes 28–9
investment 216, 221–2
in Italian innovation anomaly 173
and organizational memory 13
“pretense of” 118
study on consumers’ financial
188–92
large-scale asset purchases 58–9
law of small numbers 140
less-is-more principle 9, 13–14
libertarian paternalism 16, 97, 125
Linciano, N. 189, 191, 221–2
linguistic transparency 17
Loewenstein, G. 33, 35–7, 39
logic 21–2
logical consistency 5
loss aversion 6–8, 88–90, 94, 112, 164, 169, 187, 195–7, 201–3
Riccardo Viale, Shabnam Mousavi, Barbara Alemanni and Umberto Filotto - 9781788973069
Downloaded from Elgar Online at 07/06/2019 11:08:17AM
via free access
Index

losses versus gains 6–7, 87–8
LTCM (Long Term Capital Management) case 15, 139–40

mapping 17
markets
“beating the” 71–6
behavioural sciences for improved prediction and regulation 14–17
efficient 74–8
fractal 80–81, 140
limits of efficiency 79–81
as prone to myopia 60, 67–70
Markets in Financial Instruments Directive see MiFID II Directive
Markowitz, H. 95–6, 115–16, 119
Masciandaro, D. 195–7, 199, 201
mathematics 21–2, 116–17, 119
mean-variance approach 95, 116, 119, 121
memory
in bounded rationality 84
in chess game 83
consumption behaviour 110
market 80–81
organizational 13–14
in stock selection 86
“traditional” 14
in undersampling 139
MiFID II Directive
direct and secondary effects 209–11, 213
establishment 206
financial consumer protection regulation 165, 225
purpose and focus 206–9
mirror neurons 10–11
mis-selling 166, 187–8
misprediction in US housing market 140–43
mispricing
risk 149–51, 154–5
stock 73–7
Mojon, B. 69
monetary policy
committees 197–202
doves, pigeons and hawks 199, 201–2
effect of beliefs on 65–6
forward guidance 59–63
interest rate inertia 199–203
large-scale asset purchases 58–9
loss aversion shaping decisions on 195–7, 201–3
principal–agent perspective 201
quantitative easing 63–5
recommendations for 203
zero lower bound 58, 61–2, 196
money doctors 207, 209–10, 212–13
money managers 207, 213
monkeys
brain mechanisms experiment 10
“dart-throwing” 3, 76
Mousavi, S. 20, 28–9, 117
“muddling through” 24–5

naïve diversification bias 119
Neapolitan Republic story 46
neuroeconomics 10–12, 89–90, 96
neurofinance 89–92
no-trade theorem 79, 87
Nobel Prize winners xi, 15, 21, 94–6, 98–9, 108, 115, 139
noise traders 79–80
nuclear power 149–50
nudges
automatism 40–41
as behavioural intervention 36, 39
behavioural policy tilting towards 222
as behavioural regulation tool 49–51
benefits of 49–50
versus boosts 41–3
in bounded rationality 25
as “choice architects” 50–51, 53–4
from decision analysis perspective 41
definition 39
disciplines impacting on 97–8
discomfort 40
educative 41–3
definition 39
examples 16
versus financial literacy 125–6
indifference 40
limitations of 49–50, 112
versus mandatory rules 53
against mortgage deals 155
as policy information tool 39
probability 40–41
as prompted choice 227
social 111
The behavioural finance revolution

soft, manipulative approach 49–50, 54–5
taxonomy of 40–41

Odyssean policy 61–2
OECD-INFE survey 159–61
one-size-fits-all approach 167–8, 189, 221
organizational dyscrasia 15–16
overconfidence
  and demand for financial advice 189–90
  impact of financial decisions 86–7
  impacting on information processing and evaluation 169
judgmental 136–9
  as psychological bias 117, 227
  in self 143–4
Smith’s description 94
survey assessment of 159–62

Pareto, V.F.D. 22, 81, 94–5
“patient” capital 215, 223
pension funds
  Europe’s investment in 215–16, 221–2
  governance of 216–19
  herding behaviour 219–20
  investment rules and behavioural policy recommendations 221–2
  national barriers restricting investment in 222
  need for consortium of investment 223
  role of behavioural finance 219–20
  as source of SME long-term financing 215–16, 223
  personal liability 130
  personal pension products (PEPPs) 221–2
  personality theories 98–9
policymaking
  cognitive biases in 151
  financial consumer protection
    challenges 163–7
  financial education 167–9
  monetary 197–9, 201–2
see also behavioural policymaking
political economics
  evaluation of monetary policy through board composition 197–9
  evolution 195
  foundation as psychological 94
  political science
    bounded rationality in 24–5, 29–30
    rational choice theory in 29
  portfolio theory
    behavioural 95–6
    mean-variance 95
    mental accounting 96
    risk-averse 96, 158
  positive illusions 143–4
  priority effect 5
  private enforcement 166–7
  probabilistic revolution 116–17
  probability
    affect’s role in 8
    and availability 85–6
    of events for US equities 230–31
    and framing 88
    Knightian 29, 115
    miscalibration measures 136
    and overconfidence 86–7, 161
    and representativeness 84–5
    in situations of risk 115–16
    versus utility 40–41
  probability distribution 141–2
  problem-solving orientation 24–5, 28, 84
  prospect theory 6–7, 83, 88, 90, 96, 227
  prototype heuristics 9
  prudential regulation 104–5
  psychological biases 38, 135, 154–5
see also groupthink; heuristics:
  affect; judgmental overconfidence; positive illusions; risk aversion;
  temporal discounting; undersampling
psychology
  behaviour modeling 23–4
  bias explaining subprime borrowers’ behaviour 143–5
  client 143–5
  cognitive 7, 185, 188, 203
  versus economists 20–24, 73, 82, 169
explaining mispricing risk 149–51
Index

as foundation of political economy 94–5
and heuristics 23–5, 30
and market responses 38
portrayed as source of irrationality 117
reunion with economics 81–9, 110–11
of thinking 23
public enforcement 165–6
public policymaking
behavioural classification 34–6
dealing with internalities 39–43
new integrative approach 44
pragmatic classification 36–9
traditional 33, 44
quantitative easing (QE) 3, 62–6
randomized controlled trials (RCT) 34–5
rating agencies 15–16, 142–3, 146, 149
rational behaviour 74–5, 227, 230–33
rational choice theory 25, 29, 110
rational expectations theory 74–6, 81–2, 117, 200–201
rationality
broad definition 108
deviations from 111
ecological 12, 41–2, 119–22, 125, 128
in research strands of behavioural economics 110–11
rationality hypothesis 183–4
recency effect 5
recognition heuristic see heuristics
recognition portfolios 128
reflection effect 6
regret 7–8, 134
regulation
bank 102–7
behavioural sciences for improved 14–17
disclosure 38–9, 165, 185–6
educative nudges 41
experimental approach to 34
financial consumer protection 165
herding possibly driven by 220
heuristics for 128–30
of investment behaviour 216–17
investment rules 221–2
of pension fund governance 218–19
policy interventions 35–9, 41
as prescriptive 48
resistance to ‘being led to the good’ 46–7
rules for designing 47–8
rules and scoring 38–9
soft versus hard approaches 48–56
regulators
accountability of 49, 54–5
competence of 49, 51–2
nudgers 48–51, 53–4
representativeness 9, 84–5, 120
rewards
asymmetric, in finance industry 148–9
bonus culture 148, 155
and miscalibrated traders 138–9
for those performing well 72
risk
bank customers’ views of 122–3
banks’ estimation of 128–9
and behavioural finance 117
comprehension of 179, 181
to consumers 161–2, 164
culture of 148–9, 155
and heuristics 116
and investment decisions 123–4
mispricing 149–51, 154–5
nuclear power 149–50
and personal liability 130
theory behind 115–17
and uncertainty 118
and utility 8–9
risk aversion 52, 77–8, 90, 177, 227, 230–34
robo advice 190
Rossi, S. 112, 215
Rotondi, Z. 200
rules of conduct
Consob 189–90
for empowering financial consumers 183
ESMA 187
European Commission’s report on 186–7
reliance on information flows 184
salience 9, 17, 85–6, 164, 166
satisficing 24, 115, 126–8
Savage, L.J. 28, 82, 96, 115–16, 227
Save More Tomorrow (SMART) program 97
securitization professionals 145–8
self-interest 108
Selten, R. 27, 116, 129
shadow banking 104–5
Shefrin, H. 20, 43, 95–6, 99, 125
Simon’s ant 23
simplicity 13, 16–17, 221
“skin in the game” 130
SME long-term financing 215–16, 223
Soccorso, P. 189, 191, 221–2
social dyscrasia 16
start-ups
and academic research 172
legal framework for 171–2
performance 174–5
recommendations for 175
success factors 171
university initiatives 174
statistical literacy 41–3
statistical thinking, errors in 152–4
Statman, M. 20, 95–6, 98, 209
stock
in fractal markets 80–81, 140
methods of valuation 71–8
mispricing 73–7
in “no-trade theorem” 79
noise traders 79
trader reaction to news regarding 78
“story model” 5–6
structural equation model (SEM) 210–13
structure–conduct–performance paradigm 103–4
Subjective Expected Utility (SEU) 227
subprime mortgage crisis 16, 67–70, 124, 135–6, 140–46, 148–9, 153–5
suitability assessment
Consob 189
ESMA’s guidelines 187
Sunstein, C.R. 16, 24–5, 39–42, 48–50, 96, 125, 222, 234
swine flu 153–4
“teasers” 16–17, 37, 144–5, 155
temporal discounting 144–5, 155
Thaler, R.H. xi–xii, 12, 16, 24–5, 39–41, 43, 48–9, 78, 85, 88–9, 94–9, 108, 111, 117, 125, 222, 234
teaching of mind (ToM) 90
trust
avenues of future research 213
as complex phenomenon 207
as crucial element in provision of financial advisory services 207
methodological framework for understanding 210–12
models in financial advisory industry 207–10
no single definition of 212
relationship and exchange dimensions 210–13
Trust Game 209
Tversky, A. 4, 6, 24–5, 82–4, 95–6, 140, 227
uncertainty
allowing for profit 116
approach to rationality under 12
and boosts 43
cognitive-based 26–8
and forecasters 4
heuristics as solution to 13, 42, 116, 118, 121–2, 128
and information perception 168
and information quantity 183–4
inherent 26–8
less-is-more principle 9
mean-variance portfolio under 119–21
and organizational memory 14
and risk 28, 106, 115–17
satisficing for decision-making under 115, 126–8
taking seriously 118
theory of decision-making under 130
and value of stocks 71, 73
undersampling
historical examples 139–40
and misprediction in US housing market 140–43, 155
universities 172, 174
utility and risk 8–9
utility theory 8, 74, 82, 87
value at risk (VAR) 128–9, 139–40, 145, 153

Venture Capital finance
at centre of attention 171
incentives for 174–5
Italy’s position 172
recommendations for 175

start-ups requiring easy access to 171

Viale, R. 2, 8, 16, 175

Weltanschauung 48, 52, 54

zero lower bound (ZLB) 58, 61–2, 196