

Using Monetary Loss Aversion to Assess Risk Tolerance Questionnaires

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Abstract

A variety of risk tolerance questionnaires are used within the financial planning industry to assess client risk tolerance. Many of these questionnaires focus on validity and reliability or psychometric testing to justify the inclusion of questions. However, no risk tolerance questions have been tested to see how well they correlate with aversion to monetary loss. In this study, participants filled out several risk tolerance questionnaires and two weeks later their coefficients of loss aversion were measured using monetary gain and loss scenarios. No statistically significant correlation was found between loss aversion and the risk tolerance questionnaire scores. The individual risk tolerance questions were placed into categories (expected utility theory, prospect theory and self-assessment) and composite measures were created for each group. Statistically significant correlations were found between loss aversion and all three composite measures. Implications for risk tolerance assessment are discussed.

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