

Abstract

This paper assesses the sophistication of pension funds' investment policies using data on 748 Dutch pension funds during the 1999–2006 period. We develop three indicators of sophistication: gross rounding of investment choices, investments in alternative sophisticated asset classes and 'home bias'. We find that pension funds' strategic portfolio choices are often based on coarse and possibly less sophisticated approaches. Most pension funds, particularly the medium-sized and smaller ones, round strategic asset allocations to the nearest multiple of 5%, similar to age heaping in demographic and historical studies. Second, many pension funds invest little or nothing in alternative asset classes besides equities and bonds, resulting in limited asset diversification. Third, medium-sized and smaller pension funds favor regional investments and as such not fully employ the opportunities of international diversification. Finally, we show that pension funds using less sophisticated asset allocation rules tend to opt for investment strategies with a lower risk-return profile.