An Experimental Investigation of how Financial Complexity Affects Asset Pricing and Risk Sharing in Complete Markets

Bachelor's Thesis in Banking and Finance

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Abstract

An experimental study to investigate the impact of financial complexity on asset pricing and risk sharing in complete markets was conducted. The findings are that adding financial complexity to the description of a share's outcome increases price volatility and decreases trade efficiency. Furthermore inducing financial complexity was found to enhance supply and reduce demand. The change in the subjects' behaviour resulted in lower market prices and therefore higher risk premia. Furthermore, an increase in risk sharing could be observed. These effects can possibly be explained trough adverse selection, overconfidence and wrong computations by the subjects. However in this study, complexity had no influence on liquidity. The experimental results do not provide an explanation for why complexity had no influence on the individual risk sharing of the subjects.

Keywords:
Financial Complexity; Framing; Trading Behaviour; Risk Premium; Risk Sharing; Asset Pricing; Experimental Finance

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C91, D81, D83, G12