13. Reining in excessive risk - Instructions Risk Elicitation

Part 1 of the experiment consists in choices between lotteries. All the choices you make are **completely confidential** and cannot be traced back to you personally. Please consider each decision problem carefully before you indicate your decision, as your final payoff will depend on your choices in addition to chance.

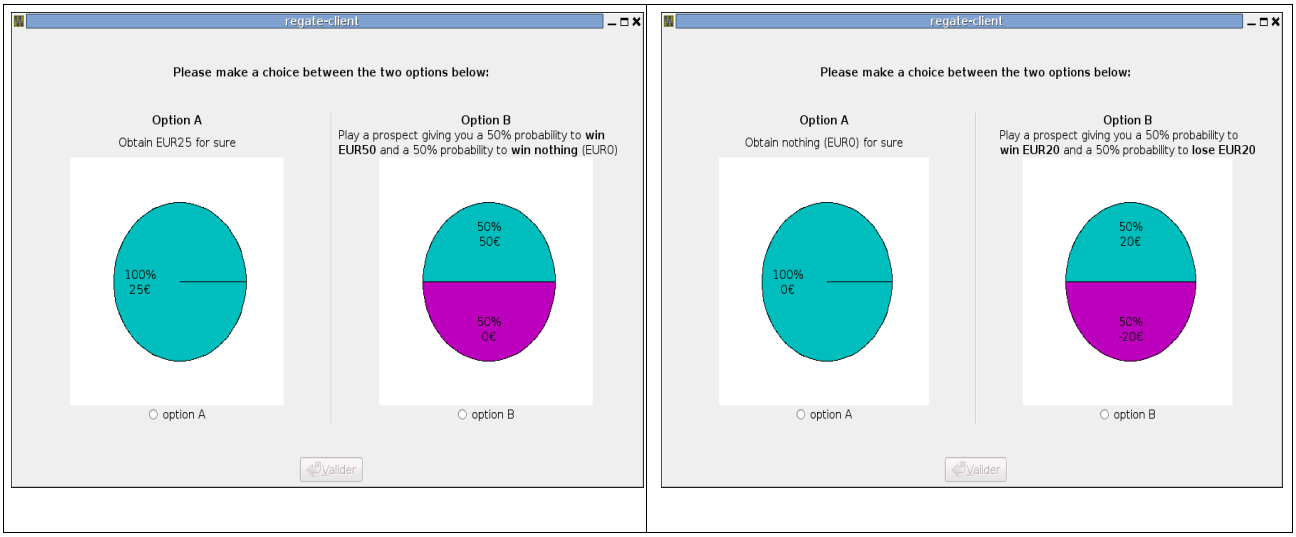
In the choice pairs involved in part 1, you will be called upon to make repeated choices between a sure amount of money and a lottery with two outcomes. As to the outcomes of the lottery, there are three basic types of lotteries: 1) lotteries giving you a certain probability to win an amount of money, and a complementary probability of winning nothing (*pure gain lottery*); 2) lotteries giving you a certain probability to lose an amount of money, and a complementary probability of losing nothing (*pure loss lottery*); and 3) lotteries giving you a probability of winning a certain amount of money and a complementary probability of losing a certain amount of money (*mixed lottery*). All the information necessary for you to take a decision will be displayed on the computer screen.

Given this setup of the lotteries, and given that the parameters of a decision change for each decision problem that is presented to you, it is crucial that you **pay close attention to both outcomes and probabilities**. Also, pay attention to the sign of the outcome as it may be positive or negative! While you can incur losses in this part of the experiment, the payoffs are calibrated in such a way that it is extremely unlikely for you to lose money over the course of the whole experiment.

For pure gain or pure loss lotteries, you will be asked to choose repeatedly between any given lottery and different certain amounts. According to your choices, the certain amount will be adjusted upwards or downwards for the subsequent decision. You will then be asked again to choose between the new certain amount and the lottery. After five choices, you will pass on to the next lottery.

For mixed lotteries, a procedure analogous to the one described above is used. The only difference is that for these lotteries what changes in subsequent iterations is not the sure

amount of money (which now stays always at 0), but rather the amount to be lost in the lottery. Below you find an example of a choice for a pure gain lottery and for a mixed lottery.



We next describe how your payoffs for this part of the experiment will be determined. Only some of the choices you make will be randomly drawn and played for real money. While the exact procedure is described in detail below, the most important thing for you to know is that **you will perform best if you make each decision as if it were the only one to be played for real**. In other words, there does not exist any way in which you can outsmart the system by choosing according to some predetermined strategy.

Three choices will be extracted for real play from the lotteries presented to you in part 1—one choice involving a pure gain lottery, one choice involving a mixed lottery, and one choice involving a pure loss lottery. All choices within the given domain have the same probability of being extracted.

Whatever choices are extracted will then be played out at the end of the experiment. If in the choice that is extracted you have chosen the sure amount, that amount will be added to (or subtracted from for loss lotteries) your total payoff. If you have chosen the lottery, a random draw will determine whether you have won or lost, and the corresponding amount will be

added or subtracted from your total payoffs.

The payoff will only be determined once the whole experiment is finished. When you are done with the questions in part 1, please wait for the other people in the experiment to finish as well. As soon as everybody has completed the first part, we will proceed to distributing the instructions for part 2.