

QuickStart Guide

Contents

1. About Your Trial and This Guide	Page 2
2. FinaMetrica Methodology Flow Chart	Page 3
3. Your First Risk Tolerance Profile	Page 4
❖ Client Registration	
❖ The Risk Tolerance and Demographic Questionnaire	
❖ The Risk Tolerance Report	
4. Using FinaMetrica in Your Advising Process	Page 8
❖ Knowing The Client	
❖ Developing Recommendations	
❖ Obtaining Informed Consent and Commitment	
5. Discussing Your Client's Risk Tolerance Profile	Page 11
❖ Must Do	
❖ Should Do	
❖ Could Do	
❖ Adjusting The Score	
❖ Gap Analysis With An Adjusted Score	
6. Obtaining Your Client's Informed Consent and Commitment	Page 14
❖ Risk Management	
❖ Practice Development	
7. Appendix	Page 16

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About Your Trial and This Guide

Your Trial

Your 30-day trial gives you unlimited use of the FinaMetrica system. We recommend you use the system with 5-10 clients in order to realise and appreciate the system's benefits, namely:

<p>Improved Productivity</p> <p>Using best-of-breed risk profiling gives you a marketing edge, allows you to quickly come to grips with one of the most problematic aspects of the planning process - your clients' risk tolerance, and expedites client decision-making.</p>	<p>Better Advice</p> <p>Needs-based planning serves both emotional and financial needs. The desire to feel safe is a very strong emotional need, which the FinaMetrica toolkit addresses objectively and transparently.</p>
<p>Better Client Relationships</p> <p>Build a more in-depth understanding of your clients and demonstrate objectivity in managing risk tolerance issues, including differences within couples, facilitating client acceptance and trust.</p>	<p>Stronger Compliance</p> <p>The key to compliance is obtaining your client's informed consent and commitment. FinaMetrica provides a provable, best-practice solution for managing risk tolerance to that end.</p>

About This Guide

Our aim is to quickly introduce you to the FinaMetrica system so you can be using it appropriately with as little effort as possible. The Guide comprises:

- ❖ The FinaMetrica Toolkit Flow Chart, one-page summary of all the material presented in the guide.
- ❖ Three core sections;
 - Your First Risk Tolerance Questionnaire: step-by-step on how to set up a questionnaire.
 - The Risk Tolerance Report: explains how the report is structured and where its contents come from.
 - Your Advising Process: shows where and how FinaMetrica's unique features can be used to advantage.
- ❖ Two additional sections, Discussing Your Client's Risk Tolerance Report and Obtaining Your Client's Informed Consent and Commitment, which expand on critical topics introduced in the core sections.

Other Documents

Two documents below supplement the Guide they can be downloaded under [System Resources](#).

- ❖ Asset Allocation Mappings & Guide, the spreadsheet enables you to link FinaMetrica risk tolerance scores to investment risk, and the guide explains how to use the spreadsheet.
- ❖ Risk and Return Reports & Guide, relates FinaMetrica risk tolerance scores to historical investment performance as an aid to managing clients' risk and return expectations.

Cautions

FinaMetrica does not produce investment strategy recommendations. In particular, we do not suggest asset allocations, model portfolios or the like. We assume you already have the means to determine the strategies that would be required to achieve your client's goals (in the absence of any consideration of risk tolerance) and techniques for constructing portfolios.

FinaMetrica tests risk tolerance and then enables you to make an apples-to-apples comparison between the questionnaire results and the risk inherent in the strategies required to achieve your client's goals. If there is a 'gap', the FinaMetrica methodology allows it to be resolved in a manner that your client can understand and to which they can give their informed consent and commitment.

Enjoy!

Finally, clients react very positively to the FinaMetrica experience. We all want to know more about ourselves ... and how we compare to others! FinaMetrica can be presented to your clients as an enjoyable exercise with a serious purpose.

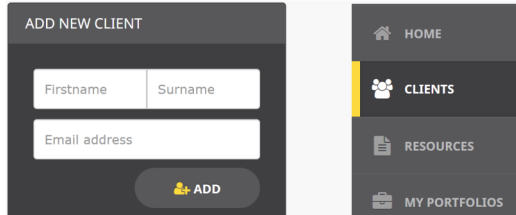
FinaMetrica Toolkit Flow Chart

PROCESS	
Step 1 Complete Questionnaire	<ul style="list-style-type: none"> • Register client/s and allow them to complete the questionnaire at their own convenience - ideally before the first meeting or early on in the planning process to avoid indirectly introducing bias into the result (p. 4). • For couples, each person should complete their own questionnaire.
Step 2 Discuss Risk Tolerance Report	<ul style="list-style-type: none"> • Ask client if report is accurate and to point out any ‘inaccuracies’. If ‘inaccuracies’, go back to completed questionnaire and look at actual answer with client. If one mistake made, note it and use score. If multiple mistakes re-do questionnaire (p. 11). • Explore the Investment section and any differences (identified by italics in the report). Look at the client’s preferred portfolio, downside comfort zone and expected 10 year investment returns and compare what actually has happened to their preferred portfolio in the Risk and Return Reports with the client.. This begins the education/managing expectations process (p.11 -12). • Explore any other answers that differ from those typically given for their risk group. • Make notes on the discussion, if necessary adjust the score and sign off with the client on the report and notes as accurate (p.12 - 13).
Step 3 Develop Recommendations	<ul style="list-style-type: none"> • Put risk tolerance to one side and explore (using your modelling software) what is required to achieve the client’s financial goals having regard to risk capacity. • Use Gap Analysis tool to identify any gap between the level of risk client would normally choose to take and investment risk associated with the return required to achieve their goals (within their risk capacity) (p.9 - 10). • Assist client to resolve any gap by suggesting alternatives and illustrating resulting outcomes: Take more or less risk, invest more or less, and or ease or increase goals (p. 9). • Consider alternatives, coach and guide, but not decide – the client owns the problem and decision. Your role is to identify the need for decisions, the alternatives and their consequences.
Step 4 Manage Expectations	<ul style="list-style-type: none"> • Reintroduce the Risk and Return Reports to educate the client and help them work through the trade-off process. Show how their chosen portfolio would have performed and how this compares with their risk and return expectations (p.10).
Step 5 Obtain Informed Consent	<ul style="list-style-type: none"> • If compromises and trade-offs were required because of risk tolerance mismatches within a couple or as a result of the gap analysis, document and sign off on: <ul style="list-style-type: none"> ❖ The client’s goals required a level of risk that were not consistent with risk tolerance; ❖ The gap between risk required and risk tolerance was disclosed to the client; ❖ The pros and cons of alternatives were discussed and made clear; ❖ The client chose an alternative that involved a departure from their risk tolerance.
Step 6 Re-Do Risk Test	<ul style="list-style-type: none"> • Reassess after a significant life or financial event, positive or negative, otherwise, every two to three years to capture changes over time. (p. 8) • Can be used to trigger a review meeting or prior to a scheduled review.

Your First Risk Tolerance Questionnaire and Report

Client Registration

- Once logged in, you can use the 'Add New Client' box on the right of your dashboard or click on Clients (left side menu) then New Client.



- Fill in your details, select either the 25 or 10 question questionnaire*, leave "Send Registration E-mail"*** checked and click the **Save & Close** button. You will be taken back to the **Clients** screen, which confirms your registration. While this was happening, the system will have sent you an email confirming your registration.

▲ FIRST NAME	▲ LAST NAME	▲ ADVISOR	▲ LAST COMPLETED	TOTAL	EMAIL
+ Jean	Sample	John Smith		2	jean@sample.com

- Now you can start doing your FinaMetrica questionnaire by clicking on the plus symbol next to your name then under the Actions column, click Complete. Note that when a client completes the questionnaire online, the advisor will be notified by e-mail.

▲ CREATED	▲ COMPLETED	VERSION	LENGTH	SCORE	AGREED SCORE	ACTIONS
02/14/2018		s3.0	10			Select ^ Complete

- The **Clients** page, is where you manage information about the clients you have registered. When you register a Client their **Last Completed** date will be blank until their risk tolerance questionnaire has been completed. Once the risk tolerance questionnaire has been completed, the date completed is shown under **Last Completed**. To view the Risk Tolerance report, go to the Actions column and click on **Latest Report**.

▲ CREATED	▲ COMPLETED	VERSION	LENGTH	SCORE	AGREED SCORE	ACTIONS
02/14/2018	02/14/2018	s3.0	10	50		Select ^ Resend Invite Save PDF Add Note View Report

* Advisors who are providing a comprehensive service may want to use the 25 question version with the more detailed report. Whereas, those providing limited advice (i.e. for a particular sum of money rather than a comprehensive plan) may want to use the 10 question version instead. You can view samples of the 25 and 10 question risk tolerance reports on pp.5-8.

*** "Send Registration E-mail (Client)" - if checked, the client will get an email. "Send Registration E-mail (Advisor)" - if checked, the advisor will get a copy of the client's email.

Your First Risk Tolerance Questionnaire and Report

The Risk Tolerance and Demographic Questionnaire

There are 25 or 10 plain language questions in the risk tolerance questionnaire. All must be answered. The 25 questions cover a wide range of financial issues, not just investment issues. The 10 questions are a subset of the 25 which focuses more on investment issues. All questions have been tested for Understandability and Answerability, and their statistical significance. See Psychometrics in the Appendix for details regarding the validity and reliability of FinaMetrica’s risk tolerance test.

There are eight demographic questions. Answering these is recommended but optional. The demographic data is not used in preparing the Risk Tolerance report. It is used anonymously in research studies.

The Risk Tolerance Report

Both the 10 and 25 question Risk Tolerance report comprise,

- ❖ An individually specific section, which summarises and assesses the answers given and
- ❖ A general section, which provides information about risk tolerance and the FinaMetrica questionnaire.

For the balance of this Guide, Jean Sample will be used as an illustrative example.

Sample 10 Question Risk Tolerance Report

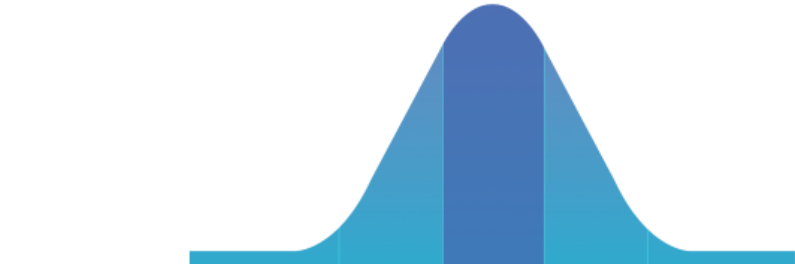
— YOUR RISK TOLERANCE SCORE

Jean’s score is 50, this is the average score.

Your risk tolerance score enables you to compare yourself to a representative sample of the adult population. Your score is **50**. This is the average score.

When scores are graphed they form a bell-curve as shown below. To make the scores more meaningful, the 0 to 100 scale has been divided into five risk groups. Your score places you in the **Average** risk group.

Jean’s score is in the Average Risk Group.



Risk Group	Very Low	Low	Average	High	Very High
Score Range	Less than 35	35-44	45-54	55-64	65 or more
No in group	7%	24%	38%	24%	7%

— YOUR RISK GROUP

Description of the Jean’s Risk Group.

Investors in the **Average** risk group are prepared to take a small to medium degree of risk with their financial decisions, more likely medium. When faced with a major financial decision, some are usually more concerned about the possible losses while others are usually more concerned about the possible gains. It is somewhat more important that the value of their investments retains its purchasing power than that it does not fall. For some, a fall of 10% in the total value of their investments would make them feel uncomfortable but for most it would take a fall of 20%. Given the portfolio choices below, they prefer Portfolio 3 or 4, more likely Portfolio 4.

Mix of Investments in Portfolio

Medium Risk /

	Very Low	Low	Avg.	High	Very High
DIFFERENCES					
Shows where Jean differs from her Risk Group to the five key investment questions.	It is not uncommon for some of the answers given in the risk tolerance questionnaire to differ from those typically given by people with similar risk tolerance. Sometimes the answer indicates more risk tolerance and sometimes less. The table below shows one difference in your responses to the five key investment risk questions.				
LOSSES V GAINS Q4			✓		
CURRENT RISK-TAKING Q5			✓		
DOWNSIDE COMFORT Q7			✓		
PREFERRED PORTFOLIO Q8			✓		
FACE VS REAL VALUE Q9	✓				

Variation

- ❖ Adjusted Risk Score
If Jean’s responses to any of the five key investment questions differ from her Risk Group, then the system will calculate an adjusted risk score, and Risk Group where applicable and will display the adjustment below the differences. See Adjusting The Score on page 13 for more details.
- ❖ Inconsistency Alert
If Jean’s responses were too inconsistent, the Differences Overview chart would show where Jean differs from her Risk Group on all 10 questions. There would also be an Inconsistency Alert. See Adjusting The Score on page 13 for more details.

Sample 25 Question Risk Tolerance Report

YOUR RISK TOLERANCE SCORE - JEAN							
Jean’s score is 54, this is higher than 64% of all scores.	Your risk tolerance score enables you to compare yourself to a representative sample of the adult population. Your score is 54 . This is a slightly-higher-than-average score, higher than 64% of all scores.						
Jean’s score is in Risk Group 4.	When scores are graphed they form a bell-curve as shown below. To make the scores more meaningful, the 0 to 100 scale has been divided into seven risk groups. Your score places you in risk group 4 .						
Jean over-estimated her score.	In answer to the last question, you estimated your score would be 60. Most people underestimate their score by a few points. However, yours was an over-estimate. When compared to others you are somewhat less risk tolerant than you thought you were.						
Risk Group	1	2	3	4	5	6	7
Score Range	Less than 25	25-34	35-44	45-54	55-64	65-74	75 or more
No in group	1%	6%	24%	38%	24%	6%	1%

— YOUR RISK GROUP

Investment

Description of the Jean's Risk Group.

It is somewhat more important that the value of their investments retains its purchasing power than that it does not fall (Q18). For some, a fall of 10% in the total value of their investments would make them feel uncomfortable but for most it would take a fall of 20% (Q14). In recent years, for most there have been no changes in the risk of their personal investments but for those that have changed, the changes have been mostly towards lower risk (Q19). Over ten years they expect an investment portfolio to earn, on average, about two to two and a half times the rate from term deposits, more likely two times (Q21). Given the portfolio choices below, they prefer Portfolios 3 or 4, more likely Portfolio 4 (Q16).

Mix of Investments in Portfolio

Portfolio	High Risk / Return	Medium Risk / Return	Low Risk / Return
1	0%	0%	100%
2	0%	30%	70%
3	10%	40%	50%
4	30%	40%	30%
5	50%	40%	10%
6	70%	30%	0%
7	100%	0%	0%

Jean's difference.

With these portfolio choices, you would choose Portfolio 5.

The Risk Group description, as modified by the reported differences, is a verbatim statement by the client about themselves in relation to risk. Jean Sample is saying,

I think of "risk" as "uncertainty". I have a reasonable amount of confidence in my ability to make good financial decisions. I usually feel somewhat optimistic about my major financial decisions after I make them...

— DIFFERENCES

Financial Past

RISK TAKING?	Q9				✓			
THRILL INVESTING	Q4				✓			

Investment

FACE VS REAL VALUE	Q18				✓			
DOWNSIDE COMFORT	Q14				✓			
RISK CHANGES?	Q19				✓			
10-YEAR RETURNS	Q21				✓			
PREFERRED PORTFOLIO	Q16						✓	

Shows where Jean differs from her Risk Group.

Government Benefits and Tax Advantages

TAKE A RISK?	Q22				✓			
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The balance of the Risk Tolerance report (not shown) explains to the client how the report should be used and provides footnoted information about risk, risk tolerance and the FinaMetrica system (for your 'engineer' clients.)

Using FinaMetrica in Your Advising Process

Advising processes vary from advisor to advisor but all will have some essential elements in common:

1. Knowing The Client
2. Developing Suitable Advice
3. Obtaining Informed Consent and Commitment

Knowing The Client

Developing an understanding of your client's goals, needs and priorities is a critical early step. Your interaction with your client during this discovery stage lays the foundations for your ongoing relationship.

When and How to assess Your Client's Risk Tolerance?

With new clients, the earlier the better, even before the first meeting. The plain language questionnaire is designed to be completed at the client's convenience without the aid of an advisor, saving both your and their time, and avoiding the possibility that your explanation might bias the result.

New clients react positively to the risk tolerance assessment process - a bright spot in the sometimes dreary fact-find, and you have created a good first impression. With existing clients, FinaMetrica can be the trigger for a review meeting or it can be a value-adding extra done prior to a scheduled review. Remember, with couples, each does their own questionnaire.

When to Re-Do a Risk Questionnaire?

Risk tolerance is a stable attribute but it is not set in concrete. If a client has experienced a significant life or financial event, positive or negative, the risk questionnaire should be re-done. Otherwise, every two or three years in order to capture changes over time. Think of it as monitoring your client's financial blood pressure.

When and How to Discuss the Risk Tolerance Report with Your Client?

The risk tolerance report does not replace discussion with your client but rather provides an objective, information-rich starting point for a more in-depth interaction. It is best tackled early in the discovery process. What you learn here will inform the balance of the discussion. There are detailed notes in *Discussing Your Client's Risk Tolerance Report* (pp. 11-13).

In brief, you start by confirming that your client accepts the accuracy of the report ... or not. You explore any answers that the client gave which differ from those typically given by others in their Risk Group. With couples, you will find the comparisons provided by the joint report particularly illuminating for them and you.

How to Obtain Sign-Off on Risk Tolerance?

The Risk Tolerance report is input to your discussion with your client about their risk tolerance and may occasionally be amended as a result of that discussion, see *Discussing Your Client's Risk Tolerance Report* (pp. 11-13).

You can decide whether to use the Risk Tolerance report itself for the notes and sign-off, or append it to the proposal/financial plan/Investment Policy Statement, making the notes there and then having your client sign-off on it. Either way, the sign-off constitutes your client's instructions to you about the level of risk they would normally choose to take.

Developing Suitable Advice

The process of developing suitable advice is based upon obtaining your client's properly informed commitment to a set of trade-offs between conflicting alternatives. Effective trade-off decisions can only be made when the elements of the trade-off have been separated, and can be clearly understood and compared. A key trade-off decision commonly confronted by clients is between risk tolerance and the risk required to achieve goals.

Gap Analysis

There is often a gap between the level of risk which your client would normally choose to take, their risk tolerance, and the risk associated with the return required to achieve their goals, their risk required. To identify that such a gap exists and then assist your client to resolve it, requires that you can make an apples-to-apples comparison between risk tolerance and investment risk.

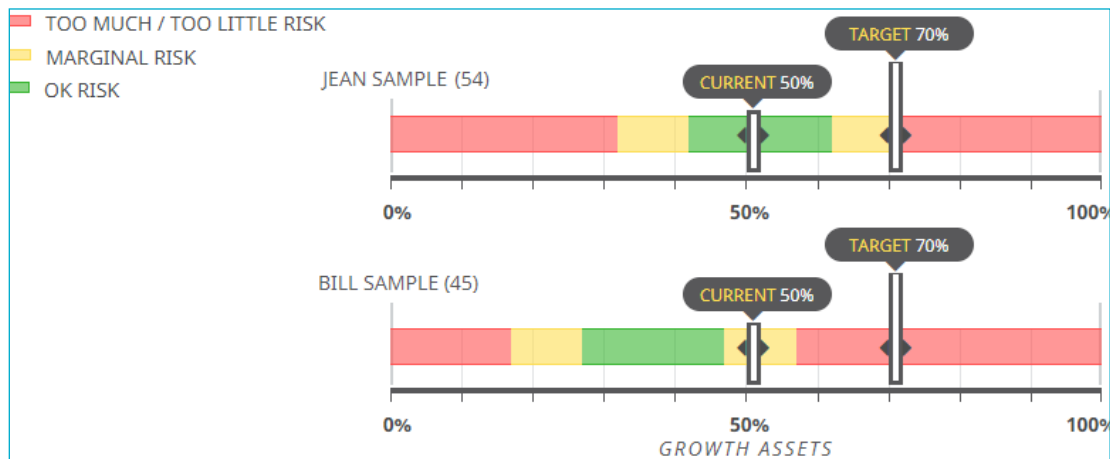
You can compare risk tolerance to investment risk in the Gap Analysis section of the Risk Tolerance report, it is also contained in the Excel file, **Asset Allocation Mappings**, and explained in its accompanying guide.

Let's explore with a simplified example:

Assume you have a set of five portfolios, A to E, where risk and return increase progressively. Enter the portfolios under My Portfolios to divide the 0 - 100 score range across the five portfolios on a best-fit basis. So, on a risk tolerance basis, Portfolio A suits clients with scores of 0 - 24, Portfolio B suits clients with scores of 25 - 43, etc.

	Growth Assets	Best Fit	Too Much Risk	Marginal	OK Risk	Marginal	Too Little Risk
A	0%	0 - 24	n.a.	n.a.	0 - 25	26 - 33	> 33
B	20%	25 - 43	< 14	14 - 25	26 - 40	41 - 46	> 46
C	50%	44 - 59	< 41	41 - 46	47 - 58	59 - 64	> 64
D	70%	60 - 79	< 53	53 - 58	59 - 71	72 - 79	> 79
E	100%	80 - 100	< 72	72 - 79	80 - 100	n.a.	n.a.

Bill and Jean Sample, with risk tolerance scores of 45 and 54 respectively, currently have Portfolio C. Your analysis shows that they need to move to Portfolio D to best achieve their long term goals. Both are likely to find that the volatility of Portfolio D is outside their comfort zone, Bill more than Jean. Below are Bill and Jean's risk tolerance comfort zones and current and target portfolios.



Resolving the Gap

There are three alternatives to consider, individually or in combination:

- Take More Risk**, they could decide to take the additional risk knowing that they may be uncomfortable from time to time, Bill more than Jean.
- Invest More**, perhaps they could spend less and save more. There may be personal-use assets that could be sold (or down-sized) with the proceeds being invested. Alternatively, it may be possible to increase personal-exertion income.
- Ease Goals**, they could delay, reduce or forgo goals.

Bill and Jean own the problem. You can suggest and illustrate solutions, coach and guide ... but not decide. There is nothing wrong with Bill and Jean deciding to take more risk than they would normally choose providing this is done knowingly, alternatives have been considered and it is not so much risk that one or both of them are likely to panic in a major downturn.

If your analysis had showed that they were on target to achieving their goals with their current portfolio, then there is no gap to be resolved.

If your analysis had showed that with Portfolio C they were expected to do considerably better than was required to achieve their goals - a 'good' gap rather than a 'bad' gap? In this happy situation, there are again three alternatives to consider, individually or in combination:

1. **Take Less Risk**, they could take lower risk, assuming that this increased the likelihood of their achieving their goals.
2. **Invest Less**, they could apply some of their savings and investments to other purposes - personal, family, charity, etc. Alternatively, they may choose to reduce the effort going into earning personal-exertion income.
3. **Increase Goals**, they could accelerate or raise existing goals, or add new goals.

Gap analysis actually involves risk capacity as well as risk required and risk tolerance. Risk capacity is the level of risk the client can afford to take without putting their goals at risk. Risk capacity is an absolute limit. It is best dealt with when using your planning software to calculate risk required. If the 'worst case' outcome for a risk required investment strategy would derail your client's goals, then an investment strategy that would fall within risk capacity becomes the starting point for comparison with risk tolerance. For a more detailed discussion of risk capacity, see [Risk Profiling: Art and Science](#).

If you discover a 'bad' gap, i.e. your client cannot be expected to achieve their goals given their financial resources and their risk tolerance, remember that this does not have to be fully resolved at the very beginning of a long-term plan. In a long-term plan, if history is any guide, very little is lost by going slowly for the first year or two.

Remember also that a new client can feel somewhat anxious, even threatened, by the strangeness and complexity of what to you are everyday issues ... but may be reluctant to tell you for fear of appearing inadequate. If a 'big' decision can be safely deferred temporarily, a new client may see that as a very attractive alternative.

Existing Clients

Gap Analysis will come into play with an existing client if there has been a change in their circumstances, goals or risk tolerance, or if their investments have significantly over or under performed.

As noted earlier, risk tolerance can be changed by major life events and does generally decrease with age. Clients should be retested after a major life event and otherwise every two to three years. Unless nothing has changed and investments have performed as expected, Gap Analysis will be part of the annual review.

Managing Expectations

Most clients start with unrealistic expectations about risk and return. Unrealistic expectations can quickly become unfulfilled expectations and unfulfilled expectations tend to cause grief for all concerned ... except the lawyers.

A good time to start educating (new) clients about risk and return is during Gap Analysis discussions. The Risk Tolerance report gives plain-English details of their risk and return expectations based on their answers to the risk tolerance questionnaire.

FinaMetrica's Risk and Return Reports and Guide are a valuable resource. In plain language they link analysis of our risk tests database to month-by-month back-testing of historical portfolio performance. At a glance, you can show clients how representative sample portfolios would have performed against their risk and return expectations, as stated in their answers to Q14 and Q21.

Obtaining Informed Consent and Commitment

Your compliance procedures will be aimed at satisfying your duty of care to your client by ensuring that you have their informed consent before implementing the plan. Not only does FinaMetrica help you meet this legal obligation but it also makes it easy to prove that you did, should proof be necessary.

The Risk Tolerance report is an objective, robust, plain language assessment of your client's risk tolerance which they sign-off on as constituting their instructions to you about the level of risk they would normally choose to take. If, in developing recommendations, trade-offs were required because of risk tolerance mismatches within couples or as a result of gap analysis,

- ❖ these will have been made knowingly by your client,
- ❖ the pros and cons of the alternatives will have been made clear, and
- ❖ the decisions themselves are readily documented for sign-off.

If you think about compliance as quality control, then the corollary is that you obtain informed commitment. Your client more fully owns their plan. They understand better how the strategies relate to their goals. And, any trade-off decisions are theirs, because they made them.

Discussing Your Client's Risk Tolerance Report

The primary purpose of the Risk Profiling process, including discussion of the Risk Tolerance report, is to identify an investment strategy which best fits your client's circumstances, aspirations, risk capacity and risk tolerance.

In this context there are things you must do to ensure that you have instructions upon which you can rely (Must Do). Further discussion will help you quickly develop an in-depth understanding of your client and accelerate the establishment of a relationship of trust (should Do and Could Do).

Must Do

Confirm Report Accuracy

You must ask your client whether the report is accurate (because you will treat it as their instructions to you about the level of risk they would normally choose to take.) Some clients will be surprised by their scores and may question the accuracy of the report. You should ask them to go through the Risk Group description, as modified by any differences reported, and point out any 'inaccuracies'. Remember that the report is a literal summary of the answers they gave.

If they identify something they consider inaccurate, go back to the completed questionnaire and look at the actual answer with them. It is possible that they made a mechanical mistake in selecting an answer option. One such mistake will not affect the risk tolerance score by more than a couple of points. The mistake should be noted and the score can be used as it stands. If there are multiple mistakes, the questionnaire should be done again.

Sometimes your client will confirm that the report is an accurate summary of the answers they gave but will still have difficulty accepting their score. You should explain that the score is simply the result of an objective, statistical comparison between their answers and the answers given by a sample of the adult population.

If their score is lower than expected, that's because they under-estimate the risk tolerance of the adult population - vice versa if their score is higher than expected. In either case, ask them to talk about how they formed their views about other people's risk tolerance. Who are they comparing themselves to?

Explore Investment Choices

Once you have dealt with the accuracy of the report, you should explore the Investment section and, in particular, any differences reported there. Such differences will occur in virtually all tests. Now is a good time to begin educating your client about risk and return, managing their expectations and laying the groundwork

for obtaining their informed consent. FinaMetrica's [Risk and Return Reports](#) and Guide will be helpful here. This document links the plain language of the client's Risk Tolerance report to the risk and return characteristics of investment portfolios.

In our 25 question example, Jean Sample chose Portfolio 5, reported as a difference, as her preferred portfolio (Q16). Her downside comfort zone is a fall of 20% (Q14) and she expects her investments to earn twice the 'risk free' rate (Q21). The Risk and Return Reports show, historically, the reasonableness or otherwise of her expectations.

However, suppose Jean Sample had chosen a fall of 10% or less as her downside comfort zone limit. Is she willing to feel uncomfortable from time to time? If a fall was, say, minus 20%, how much more uncomfortable would she feel? Would such a fall ever be acceptable? Some people will be willing to bear sustained periods of significant discomfort and some will not. In most cases, your clients will be happy to sign-off on their risk tolerance reports as presented.

However, following the discussion outlined above (and those suggested below, if done) they and you may agree that an adjusted risk tolerance score is more appropriate. In which case, the adjusted score and the reasons for the adjustment should be noted for sign-off, and the adjusted score should be used in calculations.

The 10 question version automatically takes into account any differences in the five key investment questions and provides an adjusted risk tolerance score and group where applicable.

Should Do

"Should" is used in the sense that effort spent here will invariably be worthwhile. There are no hard and fast rules. If there is a very inaccurate self-impression or some particularly significant difference reported, you may start with that. Alternatively, you may begin with general questions about (recent) financial experiences, attitudes to risk and return, etc., which can then lead to opening up discussion on the topics below.

Check Risk Groups

On average, male clients are at the high end of Risk Group 4 (Average) and female clients are at the low end of Risk Group 4 (Average). Where a client is two or more Risk Groups away from these averages, they are 'outliers' and this should be discussed.

Check Self-Impression (25 question version only)

If your client's estimate of their risk tolerance is ten or more points away from their actual score you should certainly discuss this with them. It is likely that the issue will have already been raised under Report Accuracy above. But, if it hasn't, you should raise it, following the explanation outlined previously. Even if the difference is only five points, there should be some benefit in a brief discussion.

Check Number of Differences

Typically, there will be from two to five (25 question version) or one to three (10 question version) differences. Differences occur because, while those within a Risk Group are similar, they are not clones. Clients whose scores fall at either end of a Risk Group tend to have more differences than those in the middle. The number of differences is an indication of the client's consistency when it comes to financial issues. Occasionally, a client will have many differences – eight or more, indicating a lack of consistency in financial matters. Of itself, this is not a negative characteristic - some people are just less consistent than others. However, it is helpful to both client and advisor for this to have been identified openly at the very start of the relationship.

Explore Differences

Differences provide an opportunity to open up discussion. Each represents an aspect of your client where they differ from those with whom they are otherwise similar. Differences will be either low or high, i.e. your client's answer indicates less (low) or more (high) risk tolerance than is typical for their Risk Group.

All of Jean's differences are high differences – as you might expect given that her score, 54, is at the top end of Risk Group 4's range of 45 to 54. Obviously, differences that are significantly outside the range are more important than those just outside. Jean's preference of Portfolio 5 is just outside the Group 4 range, but Jean's score is close to Group 5 anyway. However, if it had been Portfolio 1, which is typical of Group 1, that would have been a significant difference.

For any difference, low or high, it is appropriate to ask why your client thinks it might be that they chose a lower/higher option than is typical of their Risk Group. But it's important not to make too much of any particular difference. Remember, these are real people not clones. However, you should look for any difference between the level of risk your client is now willing to take, in Making Financial Decisions and the level they've taken previously, in Financial Past. If there's been a change, you'll want to know why.

Could Do

There are many possible applications for the information contained in the Risk Tolerance Report. For examples:

Q4. "Thrill" Investments (25 question version only)

Whatever the client's answer, exploring this issue - Why? Why not? What results? Would you do it now?

Q11. Borrowed to Invest? (25 question version only)

If "Yes", it will be informative to ask, Why? How? Results? Do again? Similarly, if "No", try asking "Why not"? Would you now? ... but remember that older females may never have had the opportunity.

Q22. Government Benefits & Tax Advantages (25 question version only)

Many advisors' value-add involves arbitraging the Social Security and/or Taxation systems. But there are risks here and quite extreme differences in clients' attitudes. Some clients have a strong aversion to paying tax and/or will do almost anything to obtain a government benefit. Others are deeply concerned about being seen, or seeing themselves, as tax or social security cheats.

Adjusting The Score

The FinaMetrica risk profiling system is based on a psychometric questionnaire of personal financial risk tolerance. It is a principle of a psychometric assessment that the questionnaire results are discussed with the client before arriving at a final assessment. The risk tolerance score represents an overall evaluation of the answers the respondent gave to the questionnaire. These answers will not necessarily be consistent. An inconsistent answer will be identified as a "difference" in italics under the appropriate section of the Risk Group description in the Risk Tolerance report, e.g. in Jean Sample's report (pp.7-8) there are two inconsistencies highlighted as differences.

In some cases the differences are material and in some cases not. With experience you will become familiar with the Risk Group descriptions and be quickly able to identify a material difference.

Returning to Jean Sample whose score of 54 put her in Risk Group 4 (25 question version), suppose that her downside comfort limit was 10% (Q14), her preferred portfolio was Portfolio 2 (Q16) and it was somewhat more important that the value of her investments not fall than that they retain their purchasing power (Q18). These three answers would have been identified as differences.

Looking at the Differences section, her answers to Q14 and Q18 are those typically given by Risk Group 3 and her answer to Q16 fits Risk Group 2. Admittedly, this is an extreme example. Jean would have to be very inconsistent indeed to obtain a score of 54 given her answers to Q14, 16 and 18. Some of her other answers would have to have been answers typically given by Risk Groups 6 and 7. Nonetheless, it is useful as an illustration.

After discussion with Jean, which would probably have included comparing the downside volatility of

Portfolios 2, 3 and 4 in the Risk and Return Reports, you and she agree that for selecting an investment strategy it would be more appropriate to treat her as a Risk Group 3 with a score of 38.

You would need to document this discussion and decision with a file note by clicking on the Save button next to the score in the report, and include reference to it in the client’s financial plan and/or investment policy statement.

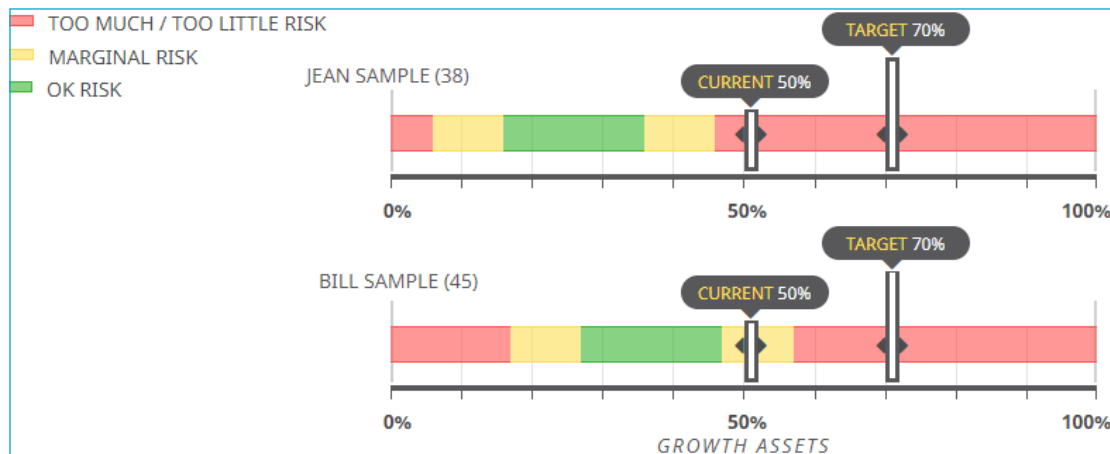
The key difference between the 25 question and 10 question version is that it has been designed so that a risk tolerance assessment can be made without an advisor involved. Where an advisor would normally be required to resolve inconsistencies in the client’s answers, the 10 question version uses an adjustment algorithm to adjust the Risk Group where necessary.

Some sets of answers are so inconsistent as to make algorithmic adjustment too difficult/dangerous. To deal with this there is a consistency algorithm which is applied before the adjustment algorithm. If the answers are too inconsistent an Inconsistency Alert is included in the report. If they are not too inconsistent the adjustment algorithm is used to determine whether there should be an Adjusted Risk Score which may lead to an Adjusted Risk Group. As mentioned earlier, inconsistencies is not a negative characteristic - some people are just less consistent than others.

While the 10-question version is designed for situations where an advisor is not needed, it can still be used with an advisor in the same manner as the 25-question version. Advisors who would like to provide a more comprehensive service may want to use the 25 question version with the more detailed report. Whereas, those providing limited advice (i.e. for a particular sum of money) may want to use the 10-question version instead.

Gap Analysis With An Adjusted Score

Bill and Jean's comfort zones are shown below (with Jean’s adjusted score from 54 to 38).



Clearly, with Jean’s adjusted score the gap between the 70% growth assets required to achieve their goals and the % growth assets consistent with their comfort zones has become much wider. However, it should still be addressed using the process described in Resolving the Gap, page 10. While the choices Bill and Jean face are now more challenging they do present you with the opportunity to demonstrate the value of your skills in helping them make optimal decisions in a difficult situation.

Obtaining Your Client’s Informed Consent and Commitment

Risk Management

All practices are likely to have dissatisfied clients sooner or later. Even a practice with perfect processes can fall foul of an impossible-to-please, irrational or dishonest client. Sensible risk management will aim, firstly, at minimising the incidence of dissatisfied clients and, secondly, at maximising the practice’s ability to defend itself. Most commonly, the dissatisfied client will have lost money.

The key elements of their claim will be that:

- ❖ In formulating your advice you didn't understand the level of risk they were willing to take, and/or
- ❖ In presenting your advice you didn't explain the risks involved in the strategy you recommended.

You will need to be able to prove that you did both. In particular, you must be able to defend a situation where the plan's recommended investment strategy involved risk beyond that which they would normally choose to take, i.e. beyond their risk tolerance. You must be able to establish that:

- ❖ The clients' stated goals required a plan whose inherent risk was greater than their risk tolerance.
- ❖ This gap between risk required and risk tolerance was disclosed to the client.
- ❖ Alternatives (invest more, lower goals, increase risk) were discussed.
- ❖ The client chose an alternative that involved increased risk.

This is the meaning of obtaining informed consent. If you do this you will have minimised the incidence of dissatisfied clients. If you can prove that you did, you will have maximised your ability to defend yourself. For most professional advisors, nothing is more damaging, emotionally and financially, than having to defend a negligence/incompetence claim. By using the FinaMetrica risk tolerance test and following the FinaMetrica methodology, you will obtain informed consent and be able to prove that you did.

Clearly, obtaining provable informed consent is critical in 'avoiding sickness' but the corollary, obtaining informed commitment, is equally effective in 'promoting health'.

Practice Development

Many new clients' expectations are unrealistic. It's often simply not feasible to achieve their goals given their present and anticipated financial circumstances, and the level of risk they are willing to take. Compromises and trade-offs will be required.

The process of obtaining informed consent and commitment demonstrates to clients that their needs are being fully considered. If compromises and trade-offs are required, they are identified and resolved in a manner clients can understand and accept. In fact, informed consent and commitment puts the client in the driver's seat. The client makes the decisions. Your role is to identify the need for decisions, the alternatives and their consequences. You are responsible for your advice but the decisions are the clients.

To the extent that your value-adding promise includes identifying and resolving problems, your client will have had an early demonstration of your ability to deliver on that promise. Your relationship with your client is off to a good start. Clients have much greater understanding of and commitment to plans arrived at through the informed consent and commitment process. You won't find yourself repeatedly explaining the strategies or defending them. You will have happier clients. Happy clients are much more enjoyable to deal with for you and your team. Happy clients refer more.

Where a client subsequently has doubts or concerns, it is a simple task to revisit the documentation of the original process. This will either confirm that the client wants to stay with the original decisions or, if there has been a change in circumstances or goals, will identify that a review is needed. Reviews become an extension of planning. Obtaining informed consent and commitment is a logical, transparent framework for both.

Of all the information required as an input to the informed consent and commitment process, the client's risk tolerance used to be the most problematic. It was difficult and time-consuming for an advisor to make a quantified, objective assessment in a manner that was meaningful to the client, easily documented and readily expressed in terms of financial parameters, particularly those of portfolio construction. The FinaMetrica system solves this problem in a manner that clients can understand and appreciate. It is a significant step forward in best practice for obtaining provable informed consent. By using FinaMetrica you can more effectively discharge your responsibility for risk tolerance assessment. By following an informed consent and commitment process you empower your client and in doing so ensure that they accept their responsibility for the high-level planning decisions.

Appendix

What About The Confidentiality Of My Data?

FinaMetrica safeguards your data. All the data you enter is confidential. We use a password system to ensure that only you, or others in your organisation with access rights, are able to access the data. The information collected by the FinaMetrica system is kept securely on our server and we use industry-standard security measures. The FinaMetrica server is protected and fire-walled.

The Scoring Algorithm

Risk Tolerance is Normally distributed. Your client's answers are scored against statistical Norms for the clients of advisors population. The distribution of each question's answer options has been calculated. Each answer option is scored in terms of Standard Deviations above or below the Mean for that question. A composite score is calculated, taking into account covariance between questions. This composite score is then scaled to have a Mean of 50 and a Standard Deviation of 10.

Psychometrics

Over the past 100 years considerable effort has been devoted to establishing standards for measuring value-expressive attributes, such as risk tolerance. The research was done by psychologists and statisticians, and the discipline they developed is known as psychometrics.

Psychometric standards can be applied to questionnaires ranging from opinion polls and market surveys, through to tests of IQ, personality, aptitude, etc.

A robust questionnaire is, in psychometric terms, one that is valid and reliable, where,

- ❖ Valid means that it measures what it purports to, and
- ❖ Reliable means that it does so consistently, with a known level of accuracy.

A psychometric test must go through a rigorous development process comprising Usability Trials and Norming Trials, and must meet an internationally accepted set of psychometric standards.

- ❖ In Usability Trials, a large pool of questions is tested for understandability and answerability. This can involve researchers sitting with subjects who are encouraged to verbalise their thoughts as they examine the questions. Questions which seem straightforward are often revealed to have poor understandability and/or answerability.
- ❖ In Norming Trials, questionnaires comprising questions with high Usability are tested on representative samples to determine the statistical value of the questions and the scoring algorithm. Questions which appear insightful often have little or no statistical value in differentiating one respondent from another.

Typically, development requires multiple loops through both trial processes. The FinaMetrica system has been through four such loops.

A detailed discussion of the application of psychometrics in risk tolerance testing can be found in "Insights on Measuring Risk Tolerance from Psychology and Psychometrics", Geoff Davey, Michael J. Roszkowski and John E. Grable, Journal of Financial Planning, April 2005, pp 66 - 77, a copy of which can be downloaded at <http://www.onefpa.org/journal/Pages/Insights%20from%20Psychology%20and%20Psychometrics%20on%20Measuring%20Risk%20Tolerance.aspx>.

Certification by the University of New South Wales' Applied Psychology Unit that FinaMetrica meets international psychometric standards can be found at <http://www.riskprofiling.com/Downloads/UNSWFinaMetricaCertification.pdf>.



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