# 5 Step Guide to the New World of Risk Profiling.

Money Mind Profile

# Questions.

We ask you to start this guide by answering these 3 questions.

How much time do you spend explaining your risk profile to your clients?

- No time
- 30 Minutes
- 1+ Hours

Do your clients enjoy your risk profiling experience?

- Yes
- No

Have you ever had that one client panic and cash out when markets hit a low point?

- Yes
- No

# Risk Profiling - the Importance & Pitfalls.

Did you know that you could be spending a minimum of **2,970 minutes*** per year explaining risk profiles to your clients.

Your clients are also likely to be disengaged from this important step of your advice process, and you may be missing important psychological insights of how their decision-making framework (like self-control) affects the advice you provide.

*Average number of active clients seen annually per advisers is 99.

The most persistent and continued misconception in financial planning is that a client's risk tolerance determines their investment strategy, independent of their financial circumstances, needs and psychological framework.

Risk profiling is a fundamental step in delivering responsible, ethical, and effective financial advice, however, it has been plagued with many obvious pitfalls.

The role of risk profiling was designed to help financial advisers understand their client's ability and willingness to take on different levels of risk. This understanding is essential for several reasons:

1. **Personalise advice:** Tailor investment portfolios to match client's risk appetite and preferences.
2. **Informed Decision-Making:** Help clients make better-informed decisions about money and investments.
3. **Risk management:** Avoid recommending unsuitable high-risk investments to risk-averse clients, reducing potential stress and dissatisfaction.
4. **Achieving goals:** Ensure investment strategies support clients' long-term financial objectives while managing potential downside risks.
5. **Regulatory compliance:** Meet industry standards and legal requirements for suitability and client protection.
6. **Building trust:** Demonstrate professionalism and understanding, foster stronger client-adviser relationships.
7. **Behavioural Alignment:** Help align investment choices with a client's comfort level, reducing emotional reactions to market fluctuations and promoting disciplined investing.

*MoneyMind Poll survey on 279 advisers.

# More than just Risk Profiling.

The historical practice of a risk profile questionnaire is to assess a clients 'attitude toward risk', without consideration of the client's circumstances, needs, experience, and decision-making framework.

This outdated form of risk profiling has unfortunately become an industry norm, and falls contrary to the intent of the law. A client's 'attitude toward risk' should not be the primary determinant for your investment recommendations.

If your firm has been using the same risk tolerance questions, copied, and compiled over the decades from various questionnaires or outdated tools, you may find they lack scientific rigour and don't necessarily meet regulatory standards - they may, in fact, be a serious risk to your firm.

Regulators across the globe identified a number of key risks that wealth management firms face, these risks have been highlighted in various reports.

**Key Risks:**

1. **Risk profiling process:** Firms fail to have a robust and consistent risk profiling process.
2. **Risk capacity & loss:** Most advisers consider a client's attitude to risk, however, many fail to take appropriate account of their risk capacity and capacity for loss.
3. **Risk need:** Many advisers fail to take sufficient account of a client's other needs, objectives and circumstances (Risk Need for Goals - RRR)
4. **Poor questions & answers:** Many Risk Profile Questionnaires (RPQ) use poor questions and answers to establish the risk a customer is willing and able to take; with over-sensitive scoring or inappropriate weighting to answers, resulting in inappropriate conflation or interpretation of customer responses (noting that some risk profiles use benchmark data over direct responses).
5. **Cognitive difficulty for clients:** Clients lack of understanding of the risk profile questions; the use of vague, unclear or misleading descriptions or illustrations.
6. **Articulate variability:** Many advisers fail to articulate the 'shape' and 'variability' of returns over a period to determine a client's comfort level of gain & loss associated with the level of risk.
7. **Biases and anomalies:** Many clients fail to complete a RPQ unassisted, creating adviser bias and introducing anomalies that can affect how clients answer questions independently.

Along with the above risks, a **client's financial experience, understanding, decision-making framework,** and **personal priorities** tend to be overlooked when it comes to the traditional approach to risk profiling. How your clients react to certain life events or market conditions is derived from human emotion, and for advisers, recognising and addressing their psychological traits is a key role in supporting clients.

Source: https://www.fca.org.uk/publication/finalised-guidance/fsa-fg11-05.pdf
Financial Ombudsman Service: "Risk profiling in Financial Advice disputes"

# The New Frontier of Risk Profiling.

There is a new frontier of risk profiling that introduces a new way to look at clients through an intuitive, comprehensive, bias-free, and AI-powered discovery process.

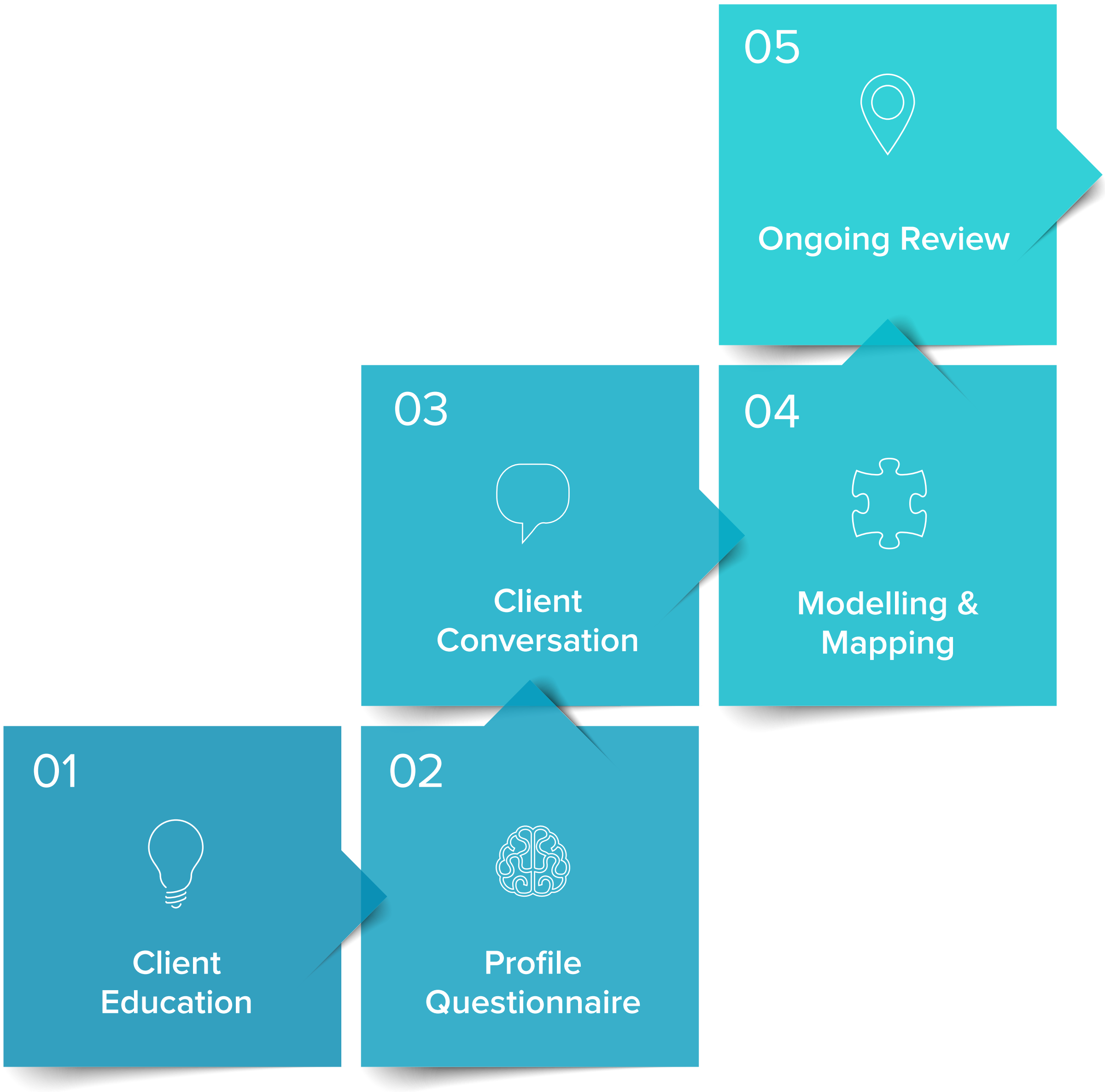
It draws from decades of science and datasets that fuse economics with psychology, taking a multidimensional approach to profiling, rather than the narrow view that derives from older-styled risk tolerance tools.

# Best Practice for Determining Your Client's Risk Profile.

Investment advice is built on the foundation of an adviser's solid understanding of their client's financial knowledge and experience, their decision-making framework, and the four pillars of risk (risk need, risk tolerance, risk capacity & risk comfort).

We developed this best practice guide and the MoneyMind Profiling tool to integrate with your advice process, and ensure that you have a robust framework around your compliance obligations.

The below process is designed to provide standardisation and consistency across your risk profiling assessment process. It helps you to understand and manage your client's mindset, whist meeting your obligations around your client's risk profile.



# Step 1.
# Client Education.

## Did you know that knowing your client’s financial knowledge and experience is a regulatory requirement?

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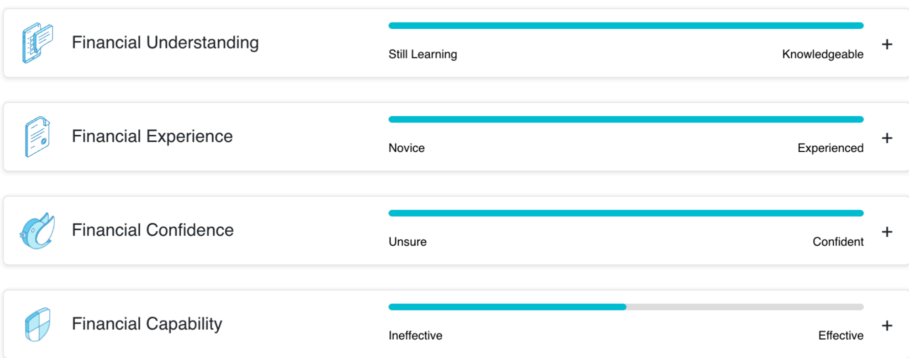
Not only is it a compliance tick, it can also help you to meet your clients or potential clients at their level - significantly improving connection and engagement.

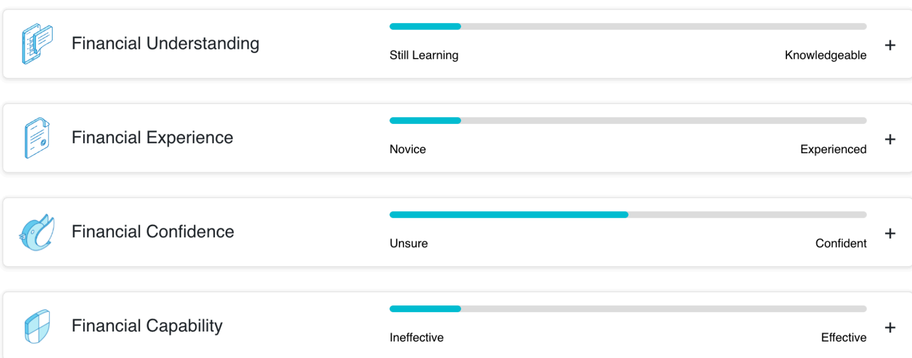
Knowing your clients or potential client’s financial knowledge, understanding, and experience, can influence ‘what’ you say and ‘how’ you say it.

If your client’s financial literacy level is ‘knowledgeable’, ‘experienced’, and ‘confident’, then it’s easy to meet them there, discuss more complex financial strategies, as opposed to a client that is at a level of ‘still learning’, ‘novice’, and ‘unsure’, then they may require more education around financial concepts.

Financial Preparedness




Financial Preparedness



# Step 2.
# Profile Questionnaire.

**Risk is not just about numbers.
It's about your client's mindset.**

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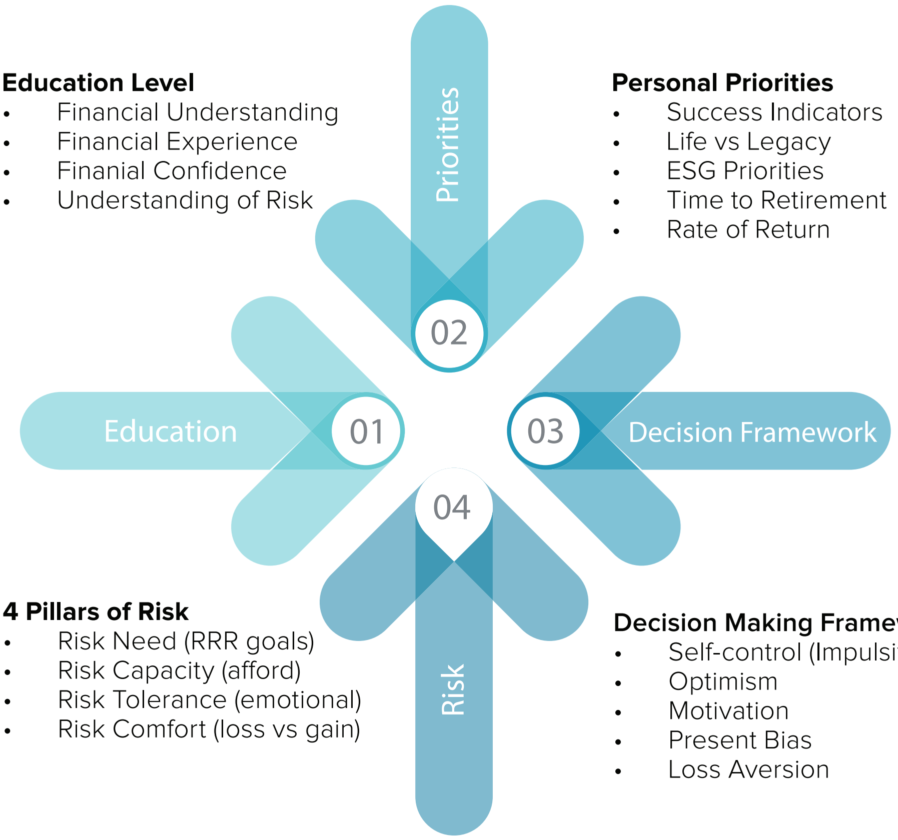
Your profile questionnaire should cover more than just a client's risk tolerance. It should look into your client's psychological traits, their decision-making framework, priorities, their comfort level around risk, the risk they need to take in order to achieve their goals, and the risk they can afford to take. After all, your client's 'decision-making' away from your office, can reinforce, or sabotage, their financial future.

Risk Profile Questionnaires must also be designed in a simple, visual language your clients can understand and interpret - delivered to them in a way that is digital and convenient.

We've designed the below best practice 'profiling framework' to help advisers mitigate risks when it comes to profiling clients. It takes a broader approach by assessing four key areas that includes your client's:

**Education Level**
- Financial Understanding
- Financial Experience
- Finanial Confidence
- Understanding of Risk

**Personal Priorities**
- Success Indicators
- Life vs Legacy
- ESG Priorities
- Time to Retirement
- Rate of Return




**4 Pillars of Risk**
- Risk Need (RRR goals)
- Risk Capacity (afford)
- Risk Tolerance (emotional)
- Risk Comfort (loss vs gain)

**Decision Making Framework**
- Self-control (Impulsivity)
- Optimism
- Motivation
- Present Bias
- Loss Aversion

# Step 3.
# Client Conversation.

**Too often, risk tolerance is assessed in isolation to a client's specific needs, capacity, situation, behaviours, and experience.**

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We began this guide by asking; have you ever had that one client panic and cash out when markets hit a low point? Or did you have that one client who sabotaged their own plan by spending set aside cash?

Most advisers have experienced these type of client situations, but what if you could have pre-empted how your client's were going to act and react by simply knowing their psychology from the beginning.

What if your client's 'impulsive' reaction could have been avoided? What if you had a gauge to indicate how likely they'll stick to their plan?

Tools that support governance around your client's behaviours, especially in times of market volatility, allows you to have pre-emptive conversations rather than reactive ones. Knowing a client's nuances and characteristics can equip you with the intel and insights that enable you to master the narrative.

What if your client conversations were tailored to be a little more like this... based on their traits...

| Self control | Impulsive | Disciplined |
|---|---|---|
| | "We know that your level of self control sits a little on the impulsive scale, this may trigger an impulsive reaction when markets have inevitable downturn periods, you may panic or want to shift asset allocations. When this happens, we are going to have you focus on the longer term objectives of your investments and stick to the plan..." | "We know that your level of self control sits on the disciplined scale, so when markets have inevitable downturns, you will stay the course and stick to the plan..." |

3

| | | |
|---|---|---|
| Psychological Tolerance for Risk | **High Psychological Tolerance for Risk:**<br><br>“You’ve weathered storms like this before, both in investments, and in life, I know this can feel a little unsettling...” | **Low Psychological Tolerance for Risk:**<br><br>“We know you aren’t comfortable with investment markets being front page news. You’re likely feeling quite a bit of worry....” |
| Risk Capacity | **Very High Risk Capacity:**<br><br>“You are in a situation where you have the financial capital and ability to weather this storm...” | **Low Risk Capacity:**<br><br>“We are keeping a close eye of any drastic changes and will act where we need to protect what you have...” |
| Risk Comfort | **Very High Risk Comfort:**<br><br>“The lure of positive investment returns is enough for you to endure negative returns as a trade off....” | **Low Risk Comfort:**<br><br>“The lure positive investment returns is not enough for you to endure negative returns...” |
| Risk Need | “To achieve your retirement goal, you require a 7% rate of return over the next 15 years...” | |

Tailoring your communication to match your client’s style will render context for them, by framing information based on their personal characteristics, sensitivities, and emotions, helping you to build a more meaningful connection.

# Step 4.
# Modelling & Mapping.

## Asset allocation in alignment with 4 pillars of risk.

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Cashflow modelling in financial advice involves detailed projections of your client's inflows and outflows. It is the process of goals planning and investment recommendations.

Mapping asset allocation to a risk profile involves aligning your investment portfolio's composition with your client's overall risk profile, which should include the 4 pillars of risk;

- **Risk Tolerance** - psychological tolerance for risk
- **Risk Capacity** - financial capital & human capital
- **Risk Comfort -** gain vs loss
- **Risk Need** - Required Rate of Return for goals

Other factors to consider are:

- **Time Horizon:** Longer-term vs short-term.
- **Liquidity Needs:** Higher cash allocations for short-term needs.
- **Market Conditions and Personal Priorities:** Tailor allocations accordingly.

Based on a client's risk profile, typical asset allocations are split:

| Risk Profile | Defensive Assets (%) | Growth Assets (%) |
|---|---|---|
| **Conservative** | 70-100% | 0-30% |
| **Moderate** | 50-70% | 30-50% |
| **Balanced** | 30-50% | 50-70% |
| **Growth** | 10-30% | 70-90% |
| **High Growth** | 0-20% | 80-100% |

# Step 5.
# Ongoing Review.

**A client's portfolio should be regularly adapted to changes to their situation, needs and preferences.**

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The view of the regulators and decades of academia is that a client's risk preferences are contextual and experiential, they will move and change over time.

The communication and management of "risk" is an ongoing responsibility; it requires you to regularly review your client's 4 pillars of risk (tolerance, capacity, comfort & need) through annual assessment.

What if you could make more of an impact by measuring improvements around your client's financial knowledge, experience, and understanding, or their level of self-control and motivation.

The unique mindset insights produced by MoneyMind Profile enables you to benchmark clients, so you can see real impacts from your advice and coaching.

The ongoing review process:

1. **Regular Updates:** Scheduled profile questionnaires (annually).
2. **Monitoring Progress:** Monitor your client's behavioural & mindset changes, alongside risk tolerance, capacity & need.
3. **Reassessing Risk:** Ensure your client's risk tolerance, capacity & need remains appropriate based on their circumstances.
4. **Documentation:** Keeping records of reviews, decisions, and any adjustments made.

Gain back your time, elevate your risk profiling experience, and gain deeper insights that unlock the psychology of your clients.

See how MoneyMind Profile has become a new frontier of risk profiling.

Book a Demo

# Checklist.

We've put together a helpful checklist for profiling your clients.

This focuses on 'best practice assessment criteria 'required to effectively profile client's and mittigate risk. It is structured around the foundational components of regulation.

Assess your client's **Financial Preparedness**
- Financial Understanding
- Financial Experience
- Financial Confidence

Assess your client's **Understanding of Risk**
- Risk vs Return
- Shape & variability of returns over a period

Assess your client's **Personal Priorities**
- Personal Priorities
- Success Indicators
- Life vs Legacy
- Time to Retirement
- Rate of Return Expectations

Assess your client's **ESG Priorities**
- Environmental
- Social
- Governance

Assess your client's **4 Pillars of Risk**
- Risk Tolerance - psychological tolerance for risk
- Risk Capacity - financial capital & human capital
- Risk Comfort - gain vs loss
- Risk Need - Required Rate of Return for goals

Assess your client's **Decision Making Framework**
- Fixed vs Growth Mindset
- Deliberation vs Action
- Limiting vs Liberating Beliefs
- Openness
- Self-control (Impulsivity)
- Optimism
- Motivation
- Present Bias
- Loss Aversion

# See beyond risk.

**Get in Touch**

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