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Identifying your client's attitude to risk

Standard Life has developed two Risk Assessment Questionnaires in conjunction with Oxford Risk Research and Analysis (ORRA). These questionnaires are provided to enable a wider conversation about risk with your client as part of your end-to-end advice process. To support your assessing suitability requirements, this document explains the benefits of risk questionnaires, who ORRA are and how to use the risk questionnaires.

Why use a Risk Questionnaire?

Understanding your client's attitude to investment risk is an important factor in making decisions about their investments. Risk questionnaires are a recognised way of assessing attitudes to investment risk.

The ORRA questionnaires have been designed to measure attitude to investment risk, i.e. your client's emotional response to changes in the value of their investments. Your client's attitude to investment risk is just one factor you should take into account – it is essential to have a discussion with your client to consider, amongst other things, your client's actual ability to withstand changes in the value of their investments (capacity for loss), your client's financial goals and risks other than investment risk. The outcome of this conversation should be documented along with the output from the risk questionnaire itself.

The ORRA risk questionnaires are suitable for use with a wide range of clients, however, all of the output categories produced by the questionnaire assume that the client is willing to take at least some investment risk. If a client falls into the lowest risk category it is therefore necessary to use the subsequent conversation to assess whether or not investment is appropriate for them or whether they would be more comfortable with leaving their money on deposit.

FCA Guidance

The FSA's March 2011 guidance paper *'Assessing Suitability: Establishing the risk a customer is willing and able to take and making a suitable investment selection'* emphasised the importance of assessing capacity for loss. This is something that can best be established by the adviser as part of the fact find process and discussion with the client as it will depend very much on an individual's personal financial situation. Capacity for loss may also vary with financial goal.

Risk need considers risk in relation to the client's goals. If a client already has nearly enough assets to meet their goals, they may not need to invest in risky assets to meet their goals even if they are willing and able to do so. At the other end of the spectrum, a client's goals may not be achievable without accepting a level of investment risk above their risk appetite – the FCA focussed on the importance of discussing and agreeing whether this is appropriate/acceptable for the client before proceeding. Again, any decisions to take on more or less risk for a particular goal should be documented as part of the advice process.

The paper also made the important point about volatility/risk of capital loss not being the only risk to consider. Inflation risk is also key for many investors and is something that should be made particularly clear to clients who have indicated that they would prefer to leave their money on deposit. Liquidity risk and accessibility are other important factors.

Attitude to risk is something that can change over time, for example as family circumstances change, so it is important to revisit this subject regularly to ensure that any previous recommendations remain appropriate.

Who are Oxford Risk?

Oxford Risk Research & Analysis Ltd is an independent company, linked to the University of Oxford, who are acknowledged experts in risk profiling. Their risk analysis expertise and tools are utilised by a wide range of financial services companies and in the UK alone over 1500 assessments are conducted each day using Oxford Risk questionnaires.

Which questionnaire should you use?

ORRA have produced two risk assessment questionnaires for Standard Life. One has 17 questions and the other has 10 questions.

Both the 17Q and 10Q questionnaires are suitable for a wide range of clients, having been tested on a broad population of users. The key differences between the two questionnaires are:

17Q Questionnaire:

- Provides 5 extra risk metrics
- Provides a personalised risk report

10Q Questionnaire

- Is shorter and easier to complete

The ORRA questionnaires have been designed to measure attitude to risk i.e. your client's emotional response to changes in the value of their investments.

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How should you use the Risk Questionnaires?

The risk questionnaires are provided to enable a wider conversation about risk between you and your client.

You can pass your client the PDF to complete with their answers or you can complete the questionnaire with them. You can then enter the results into the online tool on **Adviserzone**, which will analyse your client's risk preferences.

The questionnaires provide your client with their risk score and calculated risk level. In addition, the 17 Question Risk Questionnaire provides a personal output covering the client's risk preferences, including an overall risk level and score and 5 extra risk metrics. These provide the basis for discussion with your client about their risk preferences. The questionnaires are not a replacement for a conversation with your client about risk.

Following discussion of the results with your client, they can then select their risk level. Your client does not necessarily need to select the same level as indicated by the risk questionnaire if, for example, other factors such as your client's capacity for loss indicate that another category is more appropriate for them. Additionally, the questionnaire is designed to assess your client's overall attitude to investment risk. Your client may decide to take more or less investment risk for a particular investment.

What are the limitations of the Risk Questionnaires?

The questionnaires will help you to understand your client's attitude to investment risk but it is important to understand that there are some limitations.

- Education, not advice – these tools are a guide for illustrative purposes only
- Limits – these tools don't look at other factors such as your client's stage of life, their financial goals or the size of financial loss your client is able to withstand
- Think bigger – risk is just one of the things your client needs to consider when making investment decisions. For example, the term of their investment and whether they might want to access their investments before the end of this term are also important
- Discussion –talk about the results with your client before taking action

How did ORRA develop the questionnaires?

ORRA composed the questions and algorithms for producing the risk levels used in the questionnaires. A similar process was followed for producing each of the questionnaires.

ORRA started each process by conducting a review of literature and research related to financial risk taking. These analyses resulted in initial lists of questions that were all assessed for ease of understanding and clarity. These questions were evaluated for simplicity, comprehension and consistent interpretation.

For each questionnaire, the list was narrowed down by a panel of experts and then reduced further by qualitative and quantitative analysis. The questions were ranked for reliability and relevance and a final set of questions was determined for each questionnaire.

How can I access the risk questionnaires?

Both the 10Q and 17Q questionnaires can be found in the Online Services section on: **www.adviserzone.com**

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