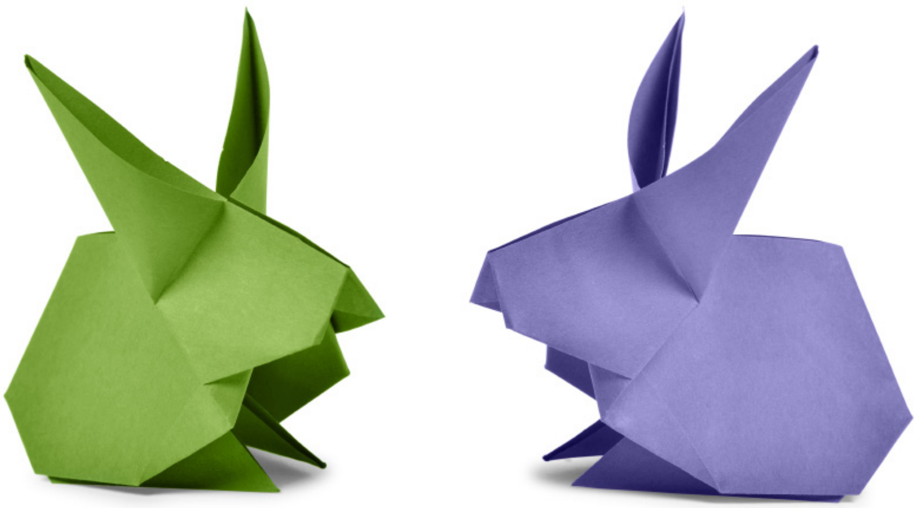
eValue
Investment Solutions

How to...
choose a growth risk questionnaire that is fit for purpose



How to Guide from eValue

Introduction

In the fifth of our ‘How To’ series we will consider the importance of a risk assessment questionnaire in helping advisers identify how much risk an investor is prepared to take. The questionnaire is normally completed during the fact finding stage of the advice process and forms a key part of discussions between client and adviser.

The questionnaire process lays the foundations for future discussions that are focussed on each individual’s capacity (or ability) to take investment risk, which is a vital ingredient in providing quality financial advice.

The purpose of this document is to help you select a risk assessment questionnaire that is robust, can be used with all your clients and ensures that your advice process remains compliant. There are many risk assessment questionnaires in the market place, which means choosing the best for your purposes is not straightforward.

Step 1: Familiarise yourself with best practice guidelines

First of all, you need to be sure that the questionnaire you use includes key factors that meet with best practice guidelines issued by the Financial Conduct Authority (FCA). The regulator and its predecessor, the FSA, have clearly stated that a fund recommendation must take into consideration the amount of risk an investor is willing and able to take, and that a robust questionnaire should play an integral role in that process.

The FCA has also said that good practice requires a company to use one process to assess their customer’s attitude to risk and a separate process to assess their capacity for loss, while ensuring both are appropriately considered as part of a suitability assessment.

Step 2: Understand how the risk questionnaire is constructed

When a new risk questionnaire is being put together there are several steps that should be taken by the provider before arriving at the final version:

1 - Obtain access to a large bank of questions

2 - Filter the questions to create a ‘test set’

3 - Carry out a trial with actual customers during a financial review

4 - Analyse the results for reliability and validity

5 - Select the best questions for the questionnaire

6 - Set the boundaries for the risk profiles

You should ask the following questions about a potential new risk assessment questionnaire:

Do the questions measure attitude to investment risk?
Questions need to be understood and have a sufficiently wide variation in responses to be able to successfully measure risk.

Do less obvious questions work as well as direct ones?
Questions need to include a number of different approaches so that they can differentiate between those with different characteristics.

Do they work across all types of client?
Regardless of age, sex, geography or experience, each question should work equally well.

Is each question reliable?
Inserting a good question improves reliability of the questionnaire

Step 3: Check that your questionnaire clearly measures attitude to risk

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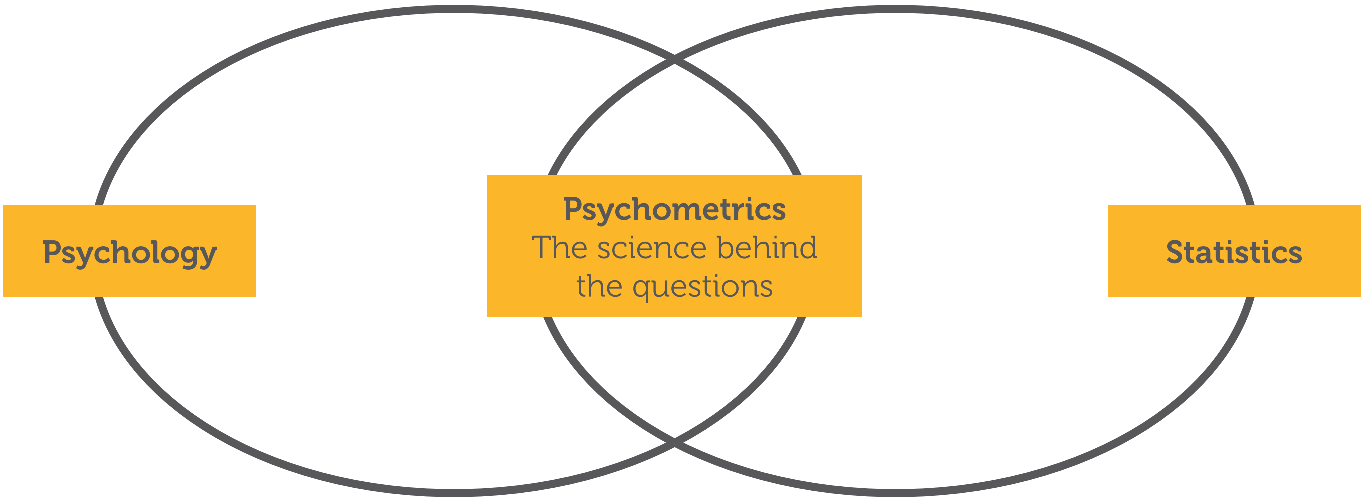


Questionnaires should be tested carefully using statistical techniques to ensure their validity, reliability and accuracy.

Risk profile descriptions used to summarise the results from a risk-profiling process should be clear and succeed in communicating the levels of risk involved. A comparison between different risk levels should not be made but a good questionnaire will also show the 'bumpiness' of the investment journey.

As an adviser, you need to ensure that your risk profiles are sufficient to avoid clients with very different risk profiles ending up in the same risk profile. A good questionnaire will show the location of a client's risk profile on the risk scale and the probability of the customer being in the next risk category.

A well-constructed questionnaire should put individuals in the right risk category almost all the time. Or, to put it another way, a risk questionnaire will allocate people into the same categories over and over if it were filled out by the same person repeatedly.

All questions should be trialled with target investors before being used in a questionnaire to ensure that they are easily understood and unambiguous. For example, we should not use questions that are vague, use double negatives or complex language.

Likewise, the options given to answer a question should not be vague, as this can be misinterpreted by customers, leading to poor outcomes. A “middle” answer can often be selected by the customer due to a lack of understanding. We should not assume that an investor has any level of mathematical ability to help them calculate a response, so questions that refer to percentage figures should not be included.

Ask yourself, if you had no prior investment experience, would you be able to answer the questions? If the answer is no, then they are unlikely to meet with FCA best practice.

Step 4: Check that the questionnaire includes different types of questions that work for all clients

A questionnaire should combine a number of different approaches such as:

Emotional questions
Focus on how the individuals feel about taking risks

Self-assessment questions
Encourage individuals to judge their own appetite for risk

Past behaviour questions
Ask what previous investments an individual has made

Scenario setting questions
Aim to establish what an individual’s reaction is in a given situation

A varied approach as outlined above means that a questionnaire as a whole can be used to accurately establish attitudes to risk whatever the characteristics or tendencies of a particular individual might be.

Additional questions should also be incorporated into the questionnaire process to reduce sensitivity to answers given to any one question.

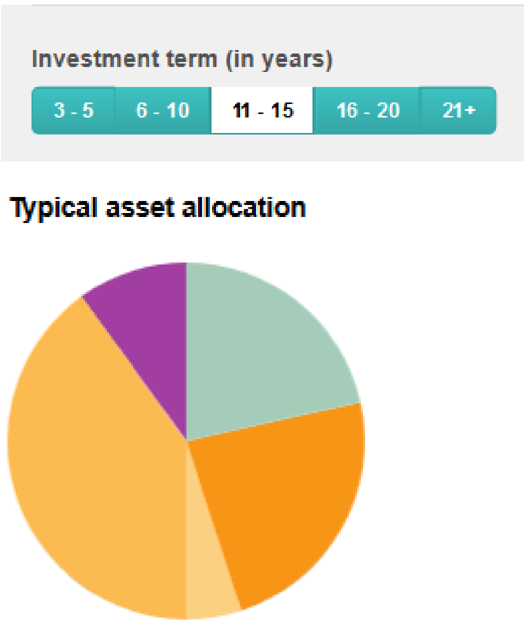
You are likely to have a wide range of clients with very different backgrounds and ranges of investment experience. The questionnaire should, consequently, be suitable to be used with your entire client bank in order to demonstrate a consistent approach to your risk profiling process.

Step 5: Ensure the length of the questionnaire is appropriate

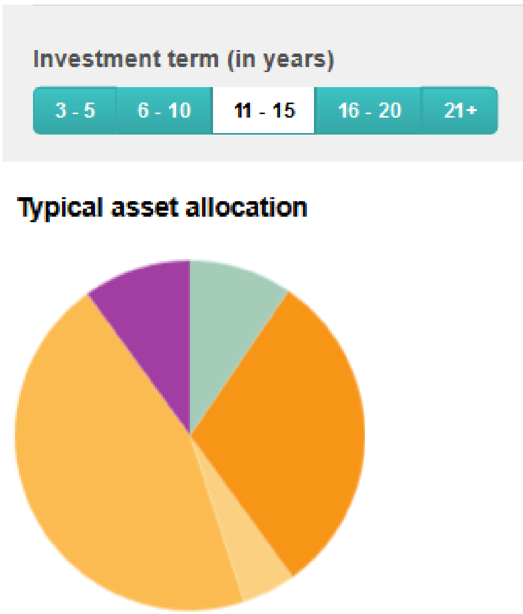
It is important that the length of the questionnaire has the right balance of being long enough for reliable results and short enough to ensure a good customer experience. It should not become tedious for your clients to complete.

On the other hand, if the questionnaire is too short, it can lead to undue weighting being placed on a particular question. A useful rule of thumb for this is that a questionnaire should have at least 1.5 questions for each risk rating.

Step 6: Consider whether investment term is taken into account



	Corporate Bonds	21.5 %
	UK Equity	23.5 %
	Specialist Equity	5.0 %
	Overseas Equity	40.0 %
	Property	10.0 %



	Corporate Bonds	9.5 %
	UK Equity	30.5 %
	Specialist Equity	5.0 %
	Overseas Equity	45.0 %
	Property	10.0 %

Each investor will have a different investment term for their investment goals, therefore investment term and asset allocation cannot be fixed for everyone. A good questionnaire will incorporate the term of the investment in the assessment of an investor’s risk profile and the goals can be set to see potential outcomes.

Step 7: Confirm how the risk assessment questionnaire is maintained

A good questionnaire will be regularly tested and updated to maintain its quality. Therefore, it would be good to find out how regularly your questionnaire is being reviewed. Responses should be analysed to ensure that the pattern of responses is as widespread as anticipated.

Also, you should want to know that the questions are working in the way that they are expected to and meet any additional statutory requirements requested by the regulatory body. You could perhaps ask the provider if any changes have been made to the questions in the last five years.

Step 8: Test the flexibility of the risk assessment questionnaire

You may want the option of having different risk scales. Is this an option with your provider? The FCA is happy for you to use different risk scales, as long as you can clearly define why it is appropriate to use different risk scales for certain segments of your client bank.

The eValue approach

This guide has highlighted the importance of working with a questionnaire that genuinely identifies a client's attitude to investment risk. This is the first part of a process that will ultimately ensure they receive an appropriate fund recommendation, which takes account of their attitude to, and capacity for, risk. These actions are a requirement of the FCA whenever investment advice is being given.

The eValue risk questionnaire has been constructed in conjunction with specialists in the field of psychometric question writing. It meets the requirements set out in this guide and is regularly reviewed to ensure that all questions remain valid and effective.

We hope you found this eValue 'How To' Guide helpful. Look out for others appearing on our website at evalueis.com, including our upcoming guide, *How to choose a income risk questionnaire that is fit for purpose.*

If there is a subject you'd like to know more about, then we'd love to hear from you. Please email us directly.

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