Does Behavior Change When Perceived Risk Has Changed? - by Hugh Massie

It's easy to accept that markets are inherently unpredictable, however the past year has been the worst that most people in the market can remember. What implication does this have on the risk profile of your clients? Have your clients become more conservative and sceptical? Or are some clients on a buying spree? It is interesting to consider how your clients are reacting to market downturns, laced with corporate scandals and the threat of terrorism.

This raises an interesting question for Advisors: does behavior change when perceived risk has changed? And does clients' risk tolerance ever change? These questions ultimately boil down to one thing, the relationship between a client, their behavior and their investments.

According to Roget's, "Behavior" is the mode in which we conduct ourselves in the concerns of life. Behavior is influenced by your inherent personality, and by the impact of your environment. With this in mind, can a client's behavior change? In times of uncertainty people are more likely to revert to the behavior they feel most comfortable with, whether this be positive or negative. Therefore to understand how clients will react in a given set of circumstances, we need to understand what is most natural for that person – the 'core' of who they are.

This doesn't mean that people can't change – history and our own experience show us scores of people who have been able to do just that. The question is whether their choices in terms of behavior have addressed the 'intangibles' – issues like inherent fears, life experiences and core beliefs. The client also needs to address how these issues have affected their expectations towards their funds and their Advisor, and what aspects of investment they need education and mentoring in.

Risk profiling is widely used in the advisory context as a basis to allocate products to clients, but it captures only one facet of a client's financial behavior. But Advisors need to understand more than just one facet of a client's tendencies in order to manage them appropriately, which is where a deeper knowledge of the client's inherent behavior can be a powerful tool in client relationships.

Understanding your client's financial behavior is all about understanding their experience and their perception of that experience, and then understanding how it relates to the different aspects of investment.

With a deeper understanding, one can begin to understand how different clients may react at different times, and address clients' issues at their core. The realization of a client's full wealth-creation potential is achieved by uncovering their 'financial personality,' and then aligning it to their unique life plan. The starting point is for your clients to understand the core of who they are, then using this knowledge to make successful financial decisions.

Coddington's "Understanding People Before Numbers" approach to financial planning led in 2001 to the development of Financial DNA®, a web-enabled, non-threatening process for clients and Advisors to uncover their unique financial wiring. The Financial DNA® process begins with a simple, validated personality test, which gives an advisor information vital to the client relationship – for instance, how the client prefers to be communicated with, what level of detail they wish to see, their decision-making style and so forth. From there, clients undergo a more in-depth appraisal that measures the following aspects of a client's 'financial personality':

1. Need for control
2. Information requirements
3. Management Focus
4. Results Focus
5. Investment Confidence
6. Investment Knowledge & Aptitude
7. Risk
8. Loss Tolerance
9. Advice Style
10. Decision-making style
11. Goal orientation
12. Advisor Relationship
13. Communication Style
14. Financial Motivation
15. Asset Allocation
16. Values
17. Investment Propensity
18. Education Motivation

The client's Financial DNA® is then used as a basis upon which to make recommendations, structure advice, communicate with the client, and offer education and mentoring. For Advisors, it makes the financial planning process much more straightforward, because they can confidently address the issues at the core of a client's financial decisions, which otherwise may not have been apparent until years into the relationship.

A relevant and timely example may be a client whose funds under management have decreased in value due to market fluctuations, and not because of Advisor mismanagement. Their reactions to the downturn will depend heavily on their loss tolerance, acceptance of risk, investment confidence, financial astuteness, communication style and perhaps most importantly, the level of trust they feel towards their Advisor. By understanding that client's Financial DNA®, their Advisor will be able to address not just the financial issues involved, but the issues that are driving the client's attitudes, reactions and behavior, enabling the Advisor to educate and mentor them in the process.

Without this knowledge, Advisors may perceive a client's behavior to be linked to the perceived level of market risk. Whilst the Advisor perceives the client's behavior as having 'changed' due to fluctuations in the market, in reality it is actually a part of their wiring that has always existed, but lain dormant until their financial situation took an undesirable turn. The reality is that this unexpected behavior occurred because the Advisor did not really know their clients in the first place, creating an expectation gap between the Advisor and their client. Client's financial predispositions don't change, however their expectations and understanding can be managed through insight into what drives them most strongly, and addressing these core issues.

It is only through understanding the inherent financial wiring of clients that one can provide an improved platform to deliver advice and mitigate professional risk. Advisors need far more in-depth and holistic processes to uncover the financial personality and decision-making drivers of the client. This can potentially make the process of choosing asset classes and managing investment strategies more aligned to clients' real expectations.

Related to all of this is that financial markets are in a period of turbulence, a situation which may last for some time to come. This situation may test the commitment of many to their strategies. The key for investors in such times, more than ever, is to know their own Financial DNA®, and use this knowledge as a basis for financial decisions.

Now more than ever, the financial planning industry needs to place greater emphasis on delivering the least risky Advisor/Client relationships. The most profitable and respected financial planning businesses are those that foster understanding and mutuality in long-term, holistic client relationships.

These relationships become even stronger when the Advisor goes through the same self-discovery process and makes their unique Financial DNA® known to the client. The level of self-understanding that the Advisor has can impact how they interpret, manage and address their clients' needs and issues.

There is a responsibility for both Advisors and their clients to obtain a better understanding of one another in order to minimise the expectation gaps, enhancing their financial Advisory relationship.

The foundation to building outstanding client relationships and mitigating risk, regardless of the level of wealth, ultimately comes down to the level of trust between a client and Advisor. Many clients are guarded and hesitant to disclose certain information to their Advisor. This is very often, and quite realistically, due to the client's uncertainty with the Advisor and the relationship. The key to address this is for Advisors to adopt a "knowing me – knowing you" process, whereby both the Advisor and client reveal themselves to the same level. This is a business process that has been followed little, if ever, in the financial advisory industry but when practiced, achieves committed buy-in from clients who desire security and trust in the Advisory relationship above all else.

Ultimately, business and financial advisory success in the 21st Century will be attributable to the philosophy of "understanding people before numbers". This understanding needs to be practiced at the deepest levels. It is all very well raising problems and identifying issues, but these can cause even further confusion unless a remedy is clearly available.

The solution lies in revisiting the foundation of the planning process and uncovering a client's financial personality, and then understanding what impact that will have on their financial decisions. The end result for Advisors and Clients alike will be improved relationships and communication, forming a foundation of trust, enhanced decision-making and educational take-home value for the Client.

For further information on Financial DNA®, contact us at enquiries@financialdna.biz, visit our website at www.financialdna.biz.

About the Author:

Hugh Massie is the President of Financial DNA Resources. In his work as a Wealth Mentor, Hugh specializes in human behavioral discovery using the proprietary Financial DNA® Discovery Process to liberate and empower people, families and organizations internationally to implement committed wealth creation decisions aligned to the core of who they are. Hugh is the author of a book "Financial DNA® – Discover Your Unique Financial Personality for a Quality Life".