Financial DNA®

## Risk Profiling – An Incomplete Solution to the 'Know Your Client' Rules? – by Hugh Massie

Why have "Risk Profiling" processes come into existence? Quite simply, they have been developed primarily as a tool to be used, and in some cases relied on, by Advisors to meet the regulatory requirements of the 'Know Your Client' rules.

The 'Know Your Client' rules provide a statutory responsibility for Advisors to know as much as possible about their clients so that they can assist and guide them to making informed investment decisions. Among clients, there are significant differences in the levels of financial knowledge, capacity and importantly, individual financial personalities in a holistic sense.

Product disclosure and recommending the most suitable product is a fundamental requirement of Advisors. Clients must understand recommended products and their features, as no one likes unexpected surprises. There is generally a huge responsibility on Advisors to educate clients on financial matters and explain the impact and outcomes of specific recommendations. If this responsibility is not managed and the investment or relationship goes sour, the Advisor's wisdom is immediately questioned. This is how client-advisor relationship issues quickly translate into professional liability issues.

Risk profiles have historically been designed to mitigate professional liability risks by providing Advisors with the following insights into their client's preferences:

- Liquidity
- Investment Time Horizon
- Asset Class
- Risk/Return trade off
- Risk Tolerance
- Growth/Income preference

This process ultimately provides a quantitative output that forms a foundation for the Advisor's Asset Allocation and consequently investment product recommendations. Traditionally, when this risk profiling process is complete the Advisor will be seen to have taken a compliance step towards justifying the making of investment product recommendations that meet both the client's goals and the legislative requirements around the 'Know Your Client' rules.

The biggest risk with using a traditional risk profiling process is the superficial "cookie cutter'" approach. Not everyone can be placed into pre-defined categories that largely dictate a linear financial planning process. The events and turning points that take place in the journey of the client's life cannot be ignored. In our experience many clients are dissatisfied with the risk profiling process, and often refuse to participate, if it is used as the cornerstone of understanding them. Further, the client is not educated or wiser for having completed the risk profiling process. There is little value in the process if the client gets no take home value that will lead to a more discerning pattern of decision-making. Accordingly, in these situations there is generally little client buy-in and that is ultimately very dangerous particularly in turbulent investment markets.

We would therefore argue that traditional risk profiling tools have been designed to allow planners to meet the 'Know Your Client' rules only on a rudimentary level. The core of truly understanding the client and

Copyright 2015 Financial DNA Resources

comprehensively addressing the ‘Know Your Client’ rules must also include understanding such qualitative factors as:

- Financial attitudes of clients and Advisors
- Understanding how financial decisions are made
- Requirements for control, research and communication styles
- How and when will a client commit to an investment strategy
- A person’s core values
- Inherent Investment aptitudes

It is only through understanding the inherent wiring of clients and the impact of environmental influences, which involves uncovering how and why they make decisions, 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 of the client. This will potentially make the process of choosing asset classes and managing investment strategies more understandable.

Related to all of this is that we are experiencing substantial turbulence in the financial markets which could last for an extended period. This will test the commitment of many to their strategies. The key for investors in such times, more than ever, is in our view to know their own core self as a foundation to decision-making.

There needs to be greater emphasis on how to deliver the least risky Advisory relationship. The more profitable and respected financial planning businesses are those that foster understanding and mutuality in a long term and holistic client relationship model.

One would also recommend that the Advisor should go through the same process and make it transparent to the client. The level of understanding that the Advisor has of him/her self may impact how the client’s needs are interpreted and managed.

In today’s world it is a reality that expectation gaps exist between financial Advisors and their clients. There is a responsibility for both Advisors and their clients to obtain a better understanding of one another in order to have an enhanced financial Advisory relationship.

We believe the key to building outstanding client relationships and mitigating risk, regardless of the level of wealth, comes down to trust. Many clients are private and unlikely to reveal what is truly needed in a short period to properly advise them. This is very often, and quite realistically, because they do not know with whom they are dealing. We know that the key is to adopt a “knowing me – knowing you” process of both the Advisor and client revealing themselves to the same level. This is a business process that has been followed little, if ever, in the financial advisory industry but in our experience will achieve committed buy-in.

Ultimately, business and financial advisory success in the 21st Century will be attributable to “understanding people before numbers”. This philosophy needs to be practiced at the deepest levels. It is all very well raising problems and identifying issues, but what is the remedy?

The solution goes back to revisiting the core of the planning process and finding a comprehensive solution to uncovering a person’s financial personality and the environmental impact. Importantly, the process must be made systemised with technology support, practical for advisors and clients, non-threatening, limit the feel of psychology invasion, be decision-making focused and provide high educational take-home value.

**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".