



ABS Risk Profiling Questionnaire Manual

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Introduction

This manual outlines the methodology behind the Adviser Business Solutions (ABS) proprietary Risk Profiling Questionnaire. It is intended to act as a reference for the consultants and staff of ABS, and in addition may be used by Consultants and staff of other Professional Advisory Firms who are utilising ABS's back office investment services. The manual documents the background and development process, and outlines the principles and scoring mechanism that are comprised in the Questionnaire. It does not however, prescribe, instruct or take responsibility for how the questionnaire is used.

The ABS questionnaire is intended to complement the wider advice process that includes a thorough fact find. It is meant to assist the adviser in determining the most suitable investment strategy for a client and is not intended to replace the advice process.

The questionnaire is owned solely by ABS, and therefore the responsibility for the content of this manual, the methodology and subsequent use lies with ABS.

Background

ABS recognises the importance of incorporating a risk profiling tool as an integral and long established part of their advice process. To date, this has taken the form of a risk profile questionnaire which plays an important role in helping to determine the appropriate investment strategy to recommend to a client. As a reflection of its importance in the advice process, ABS are determined to gain a greater understanding of, and have greater input into the calculative processes that sit behind the profiling tool they use. This led us to the decision to develop our own proprietary risk profiling tool built on our own experience and knowledge. Through our input and involvement, in all aspects and stages of its development, ABS are confident that the process and the outcomes are a true reflection of our advice process.

Risk profiling questionnaires

Risk profiling has always been a part of the ABS advice process, setting out clearly and concisely, at the beginning of the process, the trade off between reward and risk. Establishing a client's tolerance for risk is deemed to be vital in ensuring the appropriate solution is found, and for a long lasting and profitable relationship between adviser and client to be established.

ABS has 6 established investor categories determined by objective and attitude to risk, and an investment strategy has been designed for each. In this way, ABS can ensure not only consistency of advice and investment recommendations across the board, but also make sure that all clients are treated fairly.

The questionnaire forms the basis and focal point of a wider fact find and is used as a tool to assist in making a more informed decision.

Risk profiling questionnaires – the market

Risk profiling is not an exact science. However, use of risk tolerance questionnaires is prevalent throughout the financial services industry, in a variety of forms, offering varying levels of quality and robustness.

What makes one risk tolerance questionnaire more robust and more accurate than another is difficult to quantify. There are no guidelines or regulations set down by the Financial Services Authority (FSA), nor are there any standard measures to gauge the accuracy or success of one questionnaire over another. Specialist company brands, academic research, and affiliations with institutions can lend some gravitas, but this in itself does not necessarily make for a more accurate tool. Importantly, the ultimate responsibility for the outcome will always lie with the adviser and adviser firm using the questionnaire.

As so many factors can influence a client's attitude and tolerance for risk, it can often be a difficult trait to measure conclusively due to its subjective nature. As most assessments and conclusions are invariably a snapshot of a specific moment in time, a questionnaire should always be a part of the advice process and is not to be considered as a replacement. It is for this reason that ABS believes the questionnaire we use should be borne directly out of our advice process, reflecting our fundamental beliefs and values. A thorough understanding of the workings of a questionnaire ensures greater control over the outcomes. If the adviser has to take responsibility for the outcome of a process, then it is prudent to take ownership of the tools that will lead to those outcomes.

The FSA research paper "Consumer Understanding of Financial Risk" states that attitudes towards risk are dependant upon an individual's personality, their circumstances, their level of financial knowledge and experience, and the extent of their financial product portfolio. It is subsequently pointed out that there is a flexibility in attitude and financial behaviour, dependent upon the prevailing market conditions.

The paper identified that there was a poor recollection of risk discussions with advisers, with accusations that in some instances the matter of risk was never raised. In such a scenario a risk tolerance questionnaire, as part of a larger fact find, provides a documented record of a discussion regarding risk.

Methodology

One of the key strengths of ABS is that it supports established Professional Advisory Firms, with experienced consultants advising a wide range of financial products.

ABS consultants have been using a simple risk profiling tool as part of their advice process for many years. The new questionnaire needed to be sympathetic to the existing advice process and sensitive to the current risk profiles attributed to existing clients. With this in mind, we have been fully involved in the process of developing our risk profiling tool, designed by advisers, to use with their clients.

ABS wrote the initial pool of questions, built on our wealth of experience in giving investment advice and using similar tools to assist in the assessment of an individual's tolerance for risk.

The Questionnaire is tested on an ongoing basis. The responses and resultant outcomes from these tests are benchmarked against existing client risk profiles, and individually cross referenced with the personal knowledge and experience of the adviser.

The questionnaire consists of a set of twelve questions designed to determine:

- Time horizon
- Capacity for risk
- Return expectations
- Experience
- Attitude to risk

These are the five fundamental influencing factors that the questionnaire is looking to identify to help determine the appropriate investment strategy.

Time horizon

Equities have consistently proved to be the long-term driver of portfolio returns, but equity markets clearly experience dramatic periods of short-term volatility along the way. Time has the ability to mitigate the short-term risk inherent in equity markets and it is crucial to establish a client's willingness to consider their investment a long-term one. A client unwilling or unprepared to consider investing for the long-term should not be directed towards equities.

ABS take a firm view that a client with a time horizon of less than five years should not have a significant exposure to equities. Five years is considered to be a short term timeframe, with five to ten years considered as medium term and over ten years considered as long term. Equity investment is generally reserved for those with a medium to long term timeframe.

Capacity for risk

Having assessed a client's willingness to consider an investment time horizon as long-term the next stage is to gauge their ability to meet their objectives.

Willingness + Ability = Capacity

The factors that combine to build a picture of a client's ability to meet their time frame (cash savings + income expectations + breadth of savings portfolio), are used as measures to assess how likely a client is to need access to this long term savings strategy in times of emergency.

Time is the investor's friend and the more time a client can generate the greater their capacity for risk.

Return expectations

A client's return expectations provide a good indicator of the type of investment strategy required; the higher the expected returns the greater the risk required and vice versa.

This factor is also about meeting client expectations and ensuring a successful long-term relationship. If a client has only conservative expectations they will be happy if those are met. There is no requirement to expose them to unnecessary risk in pursuit of levels of return they don't require.

Experience

An experienced investor is likely to be more resilient to risk and perhaps less likely to expose themselves to it. Paradoxically it is likely, from FSA research, that more experienced investors are likely to consider themselves less experienced and knowledgeable. A lower degree of sophistication amongst clients can result in less focus on the downside and more emphasis on potential benefits.

Experience brings its own rewards and experienced investors are less likely to react negatively to short term volatility due to their ability to look to the long term, therefore making them more tolerant of risk.

Attitude to risk

A client's attitude to risk and capacity for loss is measured through an assessment of their reactions to specific situations. This is where a client outlines how they feel about taking risks with their savings, with risk in this context defined as the possibility of losing money. This definition of risk should create focus in the mind of the client and prompt a more honest response.

Each question is followed by five potential responses, each of which adopts a personalised, engaged tone. Each of the questions is consciously different

from one another, designed to prevent fatigue, repetition or easy pattern establishment that can occur in questionnaires that adopt a more linear, structured approach (e.g. strongly agree, agree, disagree or strongly disagree).

The responses are descriptive and aligned to the characteristics displayed in the following Risk Profile categories.

RISK PROFILES

Profile 1- Safe Investor

The answers that you have provided to our risk profiling questionnaire lead us to categorise you as a "Safe Investor". Your main priority is preserving your capital and you demonstrate no tolerance for investment risk. You should consider focusing on paying off any debts or loans before building up your cash deposits.

The detailed characteristics for clients falling into this risk profile are provided below:

Time	<ul style="list-style-type: none">• Very low time horizon• Access to savings required in less than 2 years
Return expectation	<ul style="list-style-type: none">• Capital preservation is essential• Low return expectations, in line with High Street savings accounts
Experience	<ul style="list-style-type: none">• Little or no experience• Not financially aware• Low levels of savings• Cash savings preferred• No desire for equity exposure
Attitude to risk	<ul style="list-style-type: none">• Completely risk averse• Capital preservation paramount• Short-termist view• Likely to panic with any short term volatility
Capacity for risk	<ul style="list-style-type: none">• No capacity for risk• No savings cushion• Possibly low or decreasing income

Profile 2 – Very Cautious Investor

The answers that you have provided to our risk profiling questionnaire lead us to categorise you as a "very cautious Investor". You are concerned with preserving your capital and your appetite for investment risk is low. However, you appreciate that to achieve better returns than you can from cash deposits, you need to invest a proportion of your capital in other investments including equities and this could lead to some short term volatility.

The detailed characteristics for clients falling into this risk profile are provided below:

Time	<ul style="list-style-type: none">• Low time horizon• Access to savings required in around 5 years
Return expectation	<ul style="list-style-type: none">• Low return expectations but looking for returns in excess of cash• Possible income seeker• Conservative, steady return sought• Emphasis on risk management over return
Experience	<ul style="list-style-type: none">• Limited experience• Aware of need to invest in order to exceed cash returns• Possibly wealthy with no need to speculate to accumulate
Attitude to risk	<ul style="list-style-type: none">• Conscious of losing money• Low tolerance to capital loss• Likely to react badly to any short term volatility• Wary of international investment
Capacity for risk	<ul style="list-style-type: none">• Low capacity for risk• Possibly low, fluctuating or decreasing income

Profile 3 –Cautious Investor

The answers that you have provided to our risk profiling questionnaire lead us to categorise you as a "Cautious Investor". You are prepared to accept some short term volatility in order to achieve a return on your capital over the long term. Whilst you are looking for low risk growth you are prepared to accept that some equity exposure is necessary to achieve your investment objectives.

The detailed characteristics for clients falling into this risk profile are provided below:

Time	<ul style="list-style-type: none">• Medium term time horizon• Access to savings required in around 7-10 years
Return expectation	<ul style="list-style-type: none">• Seeking low risk growth• Higher return expectations than a Very Cautious Investor• Conservative, steady returns sought• Looking for growth over income
Experience	<ul style="list-style-type: none">• Experienced but may not consider themselves to be so• Better investment experience than the Very Cautious Investor
Attitude to risk	<ul style="list-style-type: none">• Willing to accept some short-term volatility• More aware of the likelihood of short term falls and therefore less prone to react negatively• Aware of the need to access more risky assets in pursuit of growth• Prepared to consider international investment
Capacity for risk	<ul style="list-style-type: none">• Sufficient savings cushion• Longer time horizon

4 – Moderate Investor

The answers that you have provided to our risk profiling questionnaire lead us to categorise you as a "Moderate Investor". You understand that short term volatility is inevitable if you are to achieve an attractive level of growth from your investments over the long term. You understand that you need to invest a proportion of your capital in equities to achieve your objectives and are comfortable with international investment.

The detailed characteristics for clients falling into this risk profile are provided below:

Time	<ul style="list-style-type: none">• Medium to high time horizon• Access to savings not required for 10 years
Return expectation	<ul style="list-style-type: none">• Capital growth objective• Greater emphasis on reward over risk
Experience	<ul style="list-style-type: none">• Some experience• Prepared to acknowledge their experience• May already have some investments• Likely to be more financially aware
Attitude to risk	<ul style="list-style-type: none">• Aware of the potential for short term losses and comfortable with that• More aware that short term losses can be recovered over the longer term• Maybe prepared to expose a small percentage of savings to more speculative investments• Comfortable with international investment• Comfortable with short term risk in pursuit of longer term returns
Capacity for risk	<ul style="list-style-type: none">• Greater capacity for risk• Longer term time horizon• Sufficient savings cushion

5 – Aggressive Investor

The answers that you have provided to our risk profiling questionnaire lead us to categorise you as an "Aggressive Investor". Your priority is capital growth and you have a high tolerance for investment risk. You are an experienced investor who accepts short term volatility is inevitable in order to achieve an attractive level of growth from your investments over the long term. You accept that a considerable proportion of your capital may be invested in equities in order to achieve your objectives and are comfortable with significant exposure to international investments.

The detailed characteristics for clients falling into this risk profile are provided below:

Time	<ul style="list-style-type: none">• Comfortable with the longer term time horizon• Prepared to lock savings away for over 10 years• May consider extending time horizon if required
Return expectation	<ul style="list-style-type: none">• Driven by desire for capital growth• High growth expectations• Pursuit of growth over risk, more emphasis on gains than losses• Less keen on small, steady incremental returns
Experience	<ul style="list-style-type: none">• Experienced and confident• More up to date with financial matters and global markets• More interested in overseas markets• Has some investments already
Attitude to risk	<ul style="list-style-type: none">• Less risk sensitive• Aware and comfortable with the idea of taking risks for greater potential gains• Unlikely to react negatively to short term falls
Capacity for risk	<ul style="list-style-type: none">• Greater capacity for risk• Sufficient savings cushion• Increasing income expectations• Other investments

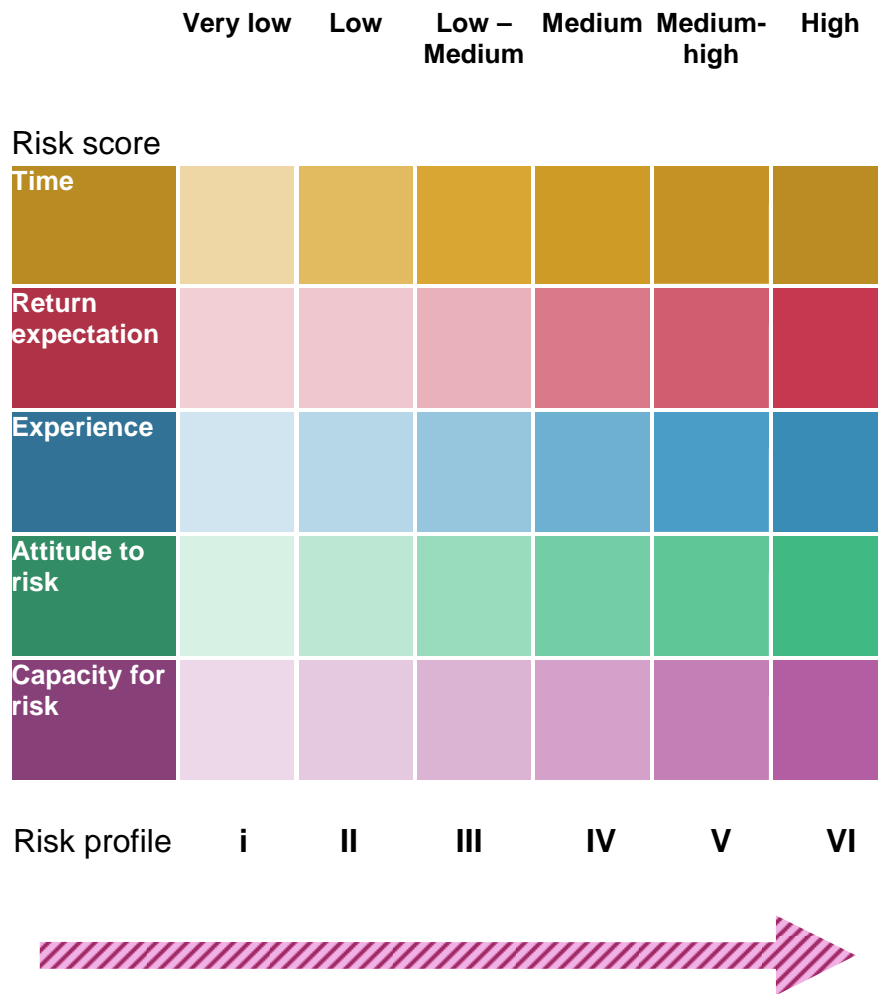
6 - Very Aggressive Investor

The answers that you have provided to our risk profiling questionnaire lead us to categorise you as a "Very Aggressive Investor". Your objective is to achieve high levels of capital growth over the medium to long term and you have a very high tolerance for investment risk. You are an experienced and confident investor who is comfortable taking a high level of risk in order to achieve your objectives. You are looking for considerable exposure to equity markets and are extremely comfortable with having significant exposure to international investments.

The detailed characteristics for clients falling into this risk profile are provided below:

Time	<ul style="list-style-type: none">• Comfortable with the longer term time horizon• Prepared to lock savings away for over 10 years• Prepared to embrace and even extend time horizons if it enhanced opportunity for returns
Return expectation	<ul style="list-style-type: none">• Driven by desire for extremely high levels of capital growth• Extremely high growth expectations• High octane wealth accumulation
Experience	<ul style="list-style-type: none">• Experienced and confident• Likely to be up to date with financial matters and global markets• Interested in overseas markets• Has an established and diversified savings strategy in place• Looking specifically for considerable exposure to high risk, speculative vehicles
Attitude to risk	<ul style="list-style-type: none">• Highly likely to be speculating with only a portion of savings• Likely to have a target in mind and therefore relatively uninterested in short term volatility
Capacity for risk	<ul style="list-style-type: none">• A relatively high risk taker• Investment likely to be only a small part of a much wider portfolio• Experienced in riding out short term fluctuations

Grading the clients according to the fundamental influencing factors



The Questionnaire

	Time Questions	Characteristic
1	It is important to be clear about when you plan to sell your investment. When do you foresee needing this money?	Time
2	Do you have cash savings available to cover any unforeseen expenses and events?	Capacity for risk
3	Without including your home, what percentage of your overall assets is this investment likely to represent?	Capacity for risk
	Risk Questions	Characteristic
1	How would you describe your investment experience?	Experience
2	The security of your capital is your priority even if that means that the value of your investment may not go up as much when investment markets perform strongly.	Attitude to risk
3	The chart below shows the maximum percentage of gain and loss suffered in a single year by investors in ten different investment strategies, over a ten year period. Looking at the potential gains you could have made, and the losses you might experience, which portfolio would you feel most comfortable investing in?	Return expectations
4	The chart below shows the fluctuations of the UK stock market over the last twenty years. As you can see the market has risen and fallen many times, often quite dramatically. As an investor, growing your capital is your main aim. You are prepared to see the value of your investment fall when markets fall and you will hold on to your investments until they recover.	Attitude to risk
	Question	Characteristic
5	It is likely that there will be periods when events in the economy and the stockmarket result in the value of your investment falling. If you did not need your capital for a period of ten years or more, how long would you be prepared to see the value of your capital fall before you would sell your investments?	Return expectations
6	The chart below shows how much you would have made in percentage terms, from three different investments over a period of twenty years. Given the potential gain an investor could have made, and the way in which the investment acted and behaved during that period, which investment would you select?	Return expectations
7	It is likely that as an investor you will see short term ups and downs in the value of your investments. If your investment fell as a result of market conditions rather than fund management, how much of a fall would you be prepared to accept before selling your investment?	Return expectations

8	Given your response to the previous question, what would your response be if your investments fell in excess of the level you selected over a twelve month period?	Attitude to risk
9	All Investments carry the potential to make money and the possibility of losing it. The higher the return you are looking for, the greater the risk you will need to take to achieve that goal and the more significant the falls in the value of your capital you can expect to experience. Which of the following statements best describes your feelings about this?	Attitude to risk

Effecting the Time Horizon

The questionnaire attempts to identify two aspects of a client's time horizon; willingness and ability. The willingness of a client to consider their investment as a long-term strategy is measured by asking the client when they are likely to need access to their money. The ability of the client to meet their stated time horizon is then measured by the level of protection they have in place to cover possible unforeseen circumstances.

ABS take a firm view that an investor with a time-horizon of less than five years should not have a significant exposure to equities, as such a time-horizon shows a lack of understanding about the characteristics of the asset class.

The questionnaire asks for the client to state their time horizon; revealing their willingness to consider investment as a long term commitment. The next measure is the client's ability to meet their stated timeframe. A client's ability is affected by their financial circumstances; the levels of cash savings they have, their future income expectations and the size of their broader savings portfolio. These measures of circumstance create a picture of how likely a client is to need to access these savings quickly, and thereby, invalidate their stated timeframe. The greater the cushion, in terms of other liquid assets accessible to cover unforeseen circumstances, the greater the client's ability to match their willingness to investments, and the greater their capacity for risk.

Cash

ABS would expect a client to have an emergency fund of at least 3 months' expenditure, which would be held in deposit accounts with little or no notice period, in order to fall back on if required. Clients with savings of less than 3 months' worth of expenditure would be encouraged to build an emergency fund, and discouraged from investing until such a fund is in place. The less a client has in their cash reserves, the more likely they are to have to resort to drawing on their investment portfolio in times of emergency.

All factors present a measurement of the client's ability to extend their stated time horizon if required. If they are able to extend their time horizon then they have a greater capacity for risk.

The Impact of the Time Horizon

In the ABS Questionnaire, the Time Horizon (willingness + ability) may impact the risk profile of a client. The Adviser will review a client's answers to the Time questions with them, and make an assessment of their Time Horizon. For example, if a client is investing for less than five years or for more than ten years or has a limited capacity for risk, the adviser has the ability to override the recommendation of the questionnaire. This may occur if both the Adviser and the client believe a lower or indeed higher profile or strategy to be more appropriate given the client's Time Horizon. Any override to the

recommendation of the questionnaire will be thoroughly documented by the Adviser.

Time scoring

A client's time horizon is an important consideration in determining the risk category outcome for a client. A client's risk profile is measured independently and as a result a client may have a high propensity for risk but a short time horizon.

A realistic and accurate assessment of a client's time horizon can be made by first assessing a client's willingness (question 1) and then offsetting against their ability (questions 2-5).

Question 1: Willingness is measured by asking a client the straightforward question of how long they intend to remain invested. For the purposes of clarity, the question is intended to gain a picture of how long the client is prepared to lock the sum away without touching it.

The client's willingness is then cross-referenced against a number of influencing factors that may enhance or undermine the ability to meet the stated time horizon. These are addressed in questions 2-5.

Questions 2 & 3 assess capacity for risk. If a client has cash savings, a wider savings portfolio or rising income expectations, they are less likely to find themselves forced to access this savings pool. As a result of this, positive responses to these questions may move the client up the time horizon spectrum and vice versa. If a client needs to access a part of their savings within their stated timeframe, for reasons such as drawdown or multiple savings objectives, then their overall portfolio becomes more time sensitive and is therefore likely to require less risk exposure. As a result, a response in the affirmative to the question of mid term access will impact their initial willingness and subsequently result in the possibility of moving down the time horizon spectrum.

Risk scoring

Questions 1 through to 9 aim to measure risk by quantifying a client's attitude to risk, their experience and return expectations. Each question is given the same weighting in the overall risk score, however greater emphasis is placed on attitude to risk in the form of additional questions.

Each response carries a score, with the total score placing the client in one of six risk bands. Those bands present an overall picture of the client's risk profile and reflect the profile characteristics outlined earlier within this document.

Incorporating the advice process

The ABS Questionnaire has been designed to be used as an integral part of a wider advice process that will, by its nature, include a detailed fact find and discussion with the client. The outcomes and subsequent risk profiles generated by the questionnaire are not prescriptive. They provide an insight into a client's tolerance for investment risk, with the intention of supporting the advice process through promoting further discussion. The client profiles are borne out of experience but are, by necessity, generic and standardised. Not all client profiles will sit comfortably within the stated categories, however, detailed conversation with a client will draw out the additional information required. In this instance, the adviser has the ability to override the recommendations if both they and the client believe another profile or strategy to be more appropriate.

Each of the profile outcomes generated by the ABS Risk Tolerance Questionnaire is aligned with the ABS proprietary Strategic Allocation Policy. This policy is reviewed on an annual basis and is actively adjusted to suit the prevailing market conditions.

Overriding the Questionnaire Outcome

The adviser has the ability to override the recommendations if both they and the client believe another profile or strategy to be more appropriate. The adviser may override the risk profile recommended by the questionnaire for a number of reasons:

If a client is investing for less than five years or for more than ten years or has limited capacity for risk, the adviser has the ability to override the recommendation of the questionnaire. This may occur if both they and the client believe a lower or indeed higher profile or strategy to be more appropriate given the client's Time Horizon.

If after conducting a detailed fact find and discussion with the client, the Adviser believes a lower or higher profile or strategy is more appropriate given the client's attitude and objectives.

If after conducting a detailed fact find, the Adviser believes that the client's capacity for risk warrants either a lower or higher profile.

The outcomes and subsequent risk profiles generated by the ABS questionnaire are not prescriptive. If the Adviser does decide to override the risk profile recommended by the questionnaire then this should be noted on the results page, as should a clear rationale for the new risk profile that has been selected.

Documentation

The ABS Questionnaire will be an online tool. Client risk profiles will be recorded and filed by client name, date and outcome, as will each completed questionnaire. The responses to all questions and subsequent outcomes will be recorded and stored securely, and ABS will comply fully with the requirements of the Data Protection Act. The last completed questionnaire will be used by the individual adviser, at the next client meeting, as a starting point for future client reviews. However we will complete a new questionnaire with the client if the existing one is more than two years old or if their circumstances have changed. Any overrides will be recorded, alongside a requirement to record the rationale.