



Webinar:

Client risk profiling and managing investment risk

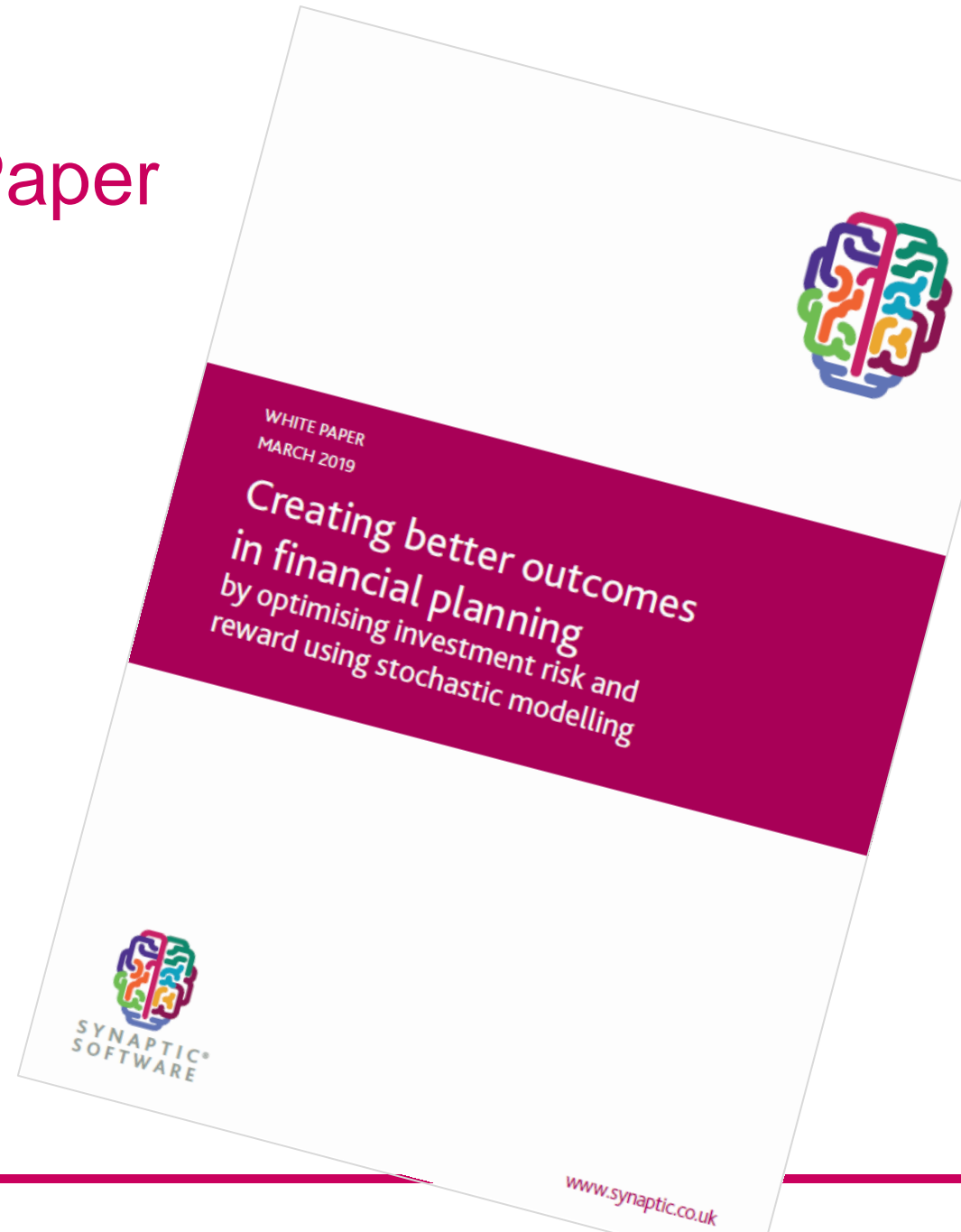


Eric Armstrong
15 July 2019

It's all covered in **Synaptic White Paper**

White paper: Creating better outcomes in financial planning by optimising investment risk and reward using stochastic modelling.

Downloadable from Adviser Home site and Synaptic website



How important is risk?

‘The revolutionary idea that defines the boundary between modern times and the past is the mastery of risk’.

Peter L. Bernstein. *Against the Gods*

By defining a ‘rational process of risk-taking’ the true nature of modern progress was revealed.



The essence of risk management lies in maximizing the areas where we have some control over the outcome while minimizing the areas where we have absolutely no control over the outcome.

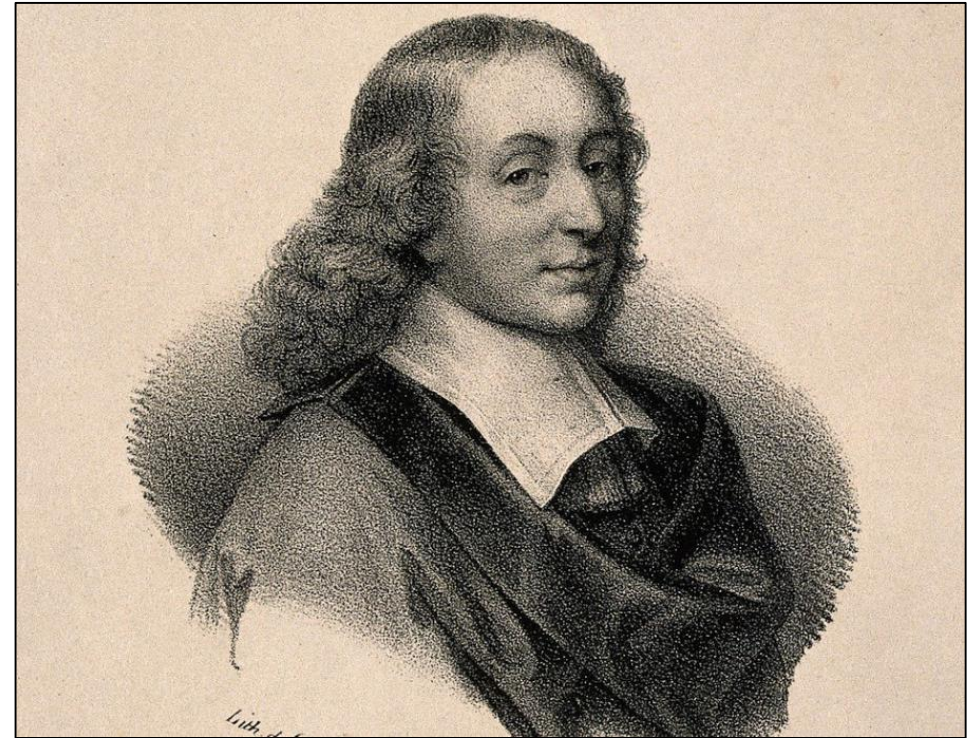
— Peter L. Bernstein —

AZ QUOTES



Some **milestones** in the consideration of risk

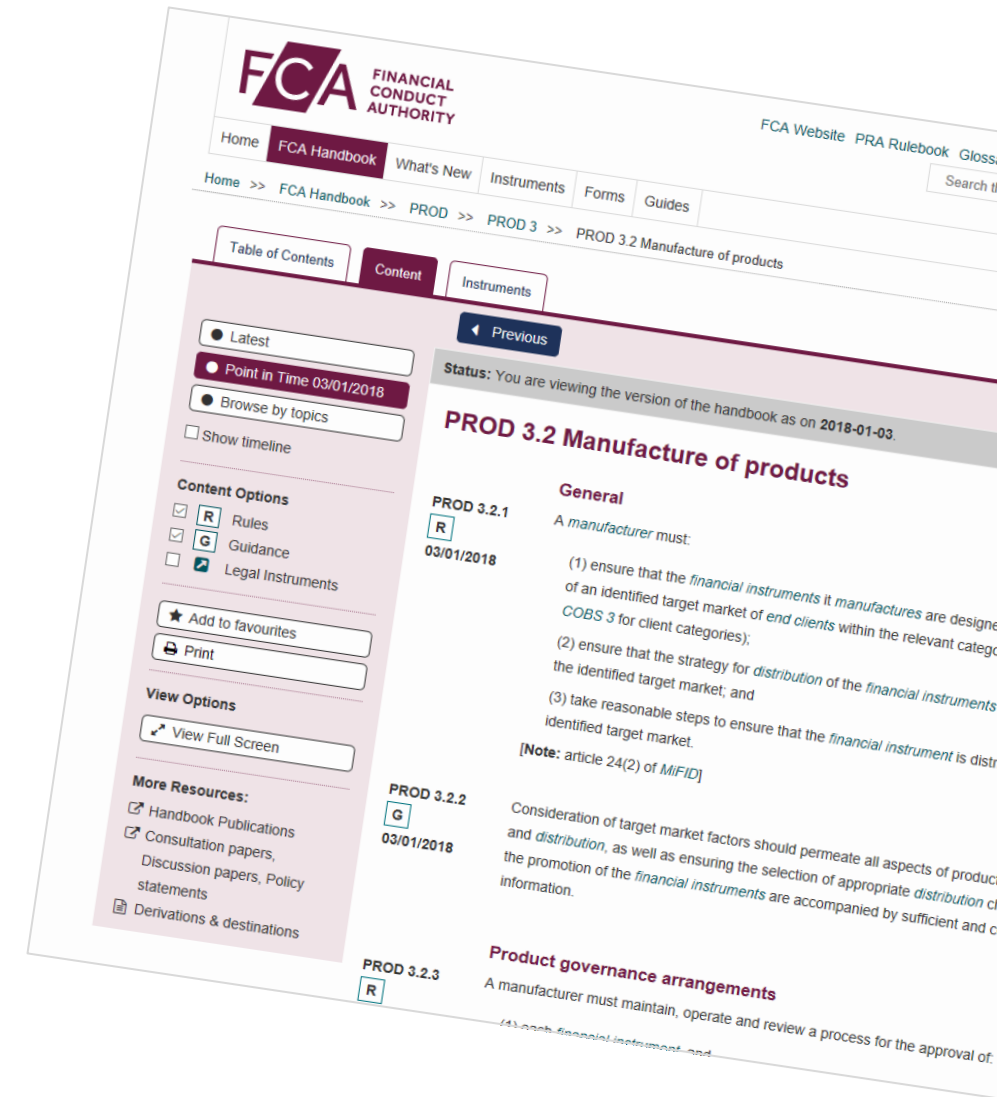
- **1654** – Pascal first introduced the concept of mathematical probability as a means of problem solving.
- **1952** – Harry Markowitz – Nobel prize winning article ‘Portfolio selection’. Importance of portfolios, risk, diversification (correlation).
- **1738** – Daniel Bernouilli – Paper, whose name translates to ‘*Exposition of a New Theory on the Measurement of Risk*’. Concept of ‘utility’ along with ‘risk aversion’ and ‘risk premium’.



Regulatory milestones

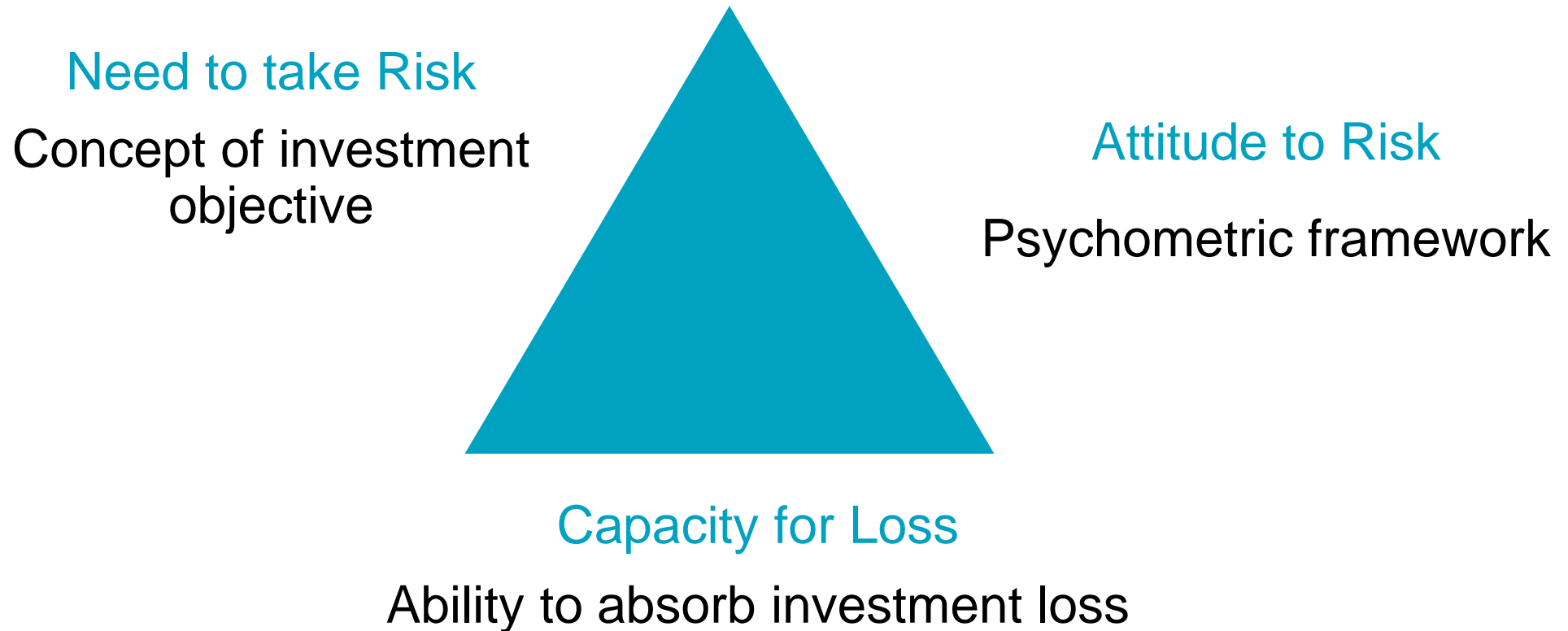
- **FG11/05** – Assessing suitability: Establishing the risk a customer is willing and able to take and making a suitable investment selection
- **TR16/1** - Assessing suitability: Research and due diligence of products and services.
- **MiFID II** – 3rd Jan 2018 – MiFID II applies within Member States
- **PROD** – Handbook to help enforce MiFID II directives. Stage 1 – framework to meet Suitability rules. Big on client segmentation and target markets.

Summary: advisers have unshakeable responsibilities in respect of suitability.



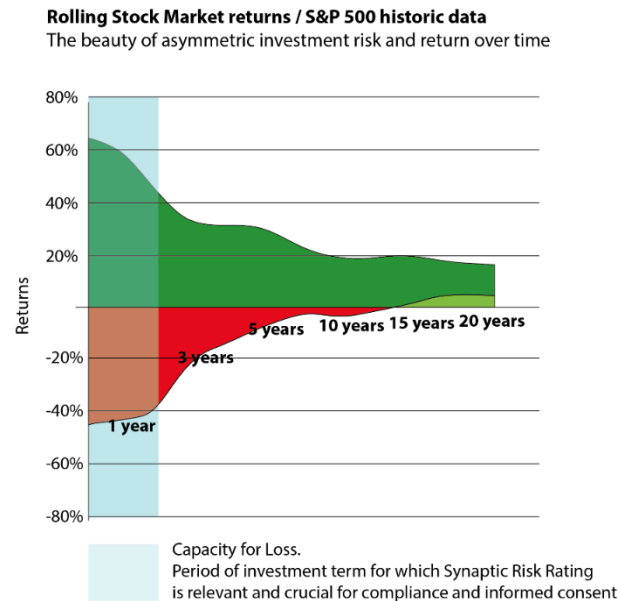
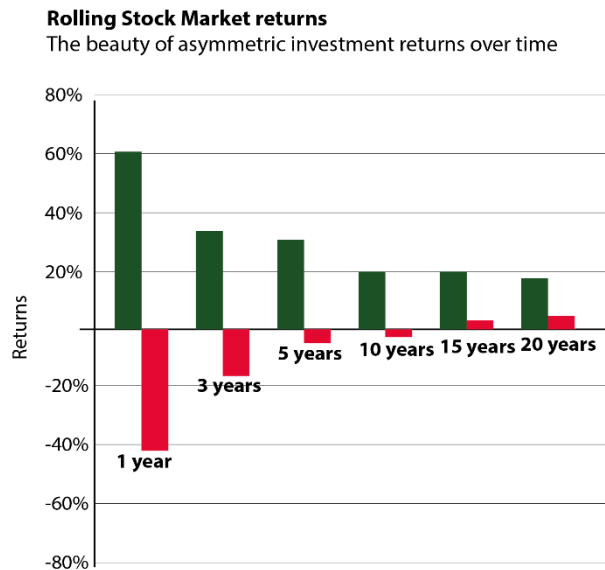
Risk Governance Model

How do we ensure 'informed consent' for an appropriate level of risk.
Single most important regulatory and best advice proof point.



Term changes everything, including Capacity for Loss

The higher the Capacity for Loss, the higher the investment risk they can afford to take. Investment risk diminishes as the term extends, as 'Sequence of Return Risk' is mitigated.



CAPACITY FOR LOSS STATEMENTS **A2RISK**

a) I will need to start spending my investment at the following point in the future:
My investment horizon is: Less than 3 years 3-9 years 10-14 years 15+ years

b) I don't have any significant outstanding debts and don't expect to incur any during the period of my investment (e.g., mortgage or credit cards).
Strongly agree Agree Neither agree nor disagree Disagree Strongly disagree

c) My spouse or partner (or another family member) is likely to be able and willing to support me financially if circumstances require.
Strongly agree Agree Neither agree nor disagree Disagree Strongly disagree

d) It would be relatively easy for me to cut my spending in retirement if circumstances require.
Strongly agree Agree Neither agree nor disagree Disagree Strongly disagree

e) I am flexible about my investment horizon – I could wait before using my investment.
Strongly agree Agree Neither agree nor disagree Disagree Strongly disagree

A strategy around term

Risk rofile	Name	5 Year	10 years	15 years	20 years
1	Very Cautious		1	2	3
2	Cautious		2	3	4
3	Moderately Cautious (low end)	1	3	4	5
4	Moderately Cautious (high end)	2	4	5	6
5	Balanced (Low End)	3	5	6	7
6	Balanced (high end)	4	6	7	8
7	Moderately Adventurous (low end)	5	7	8	9
8	Moderately Adventurous (high end)	6	8	9	10
9	Adventurous	7	9	10	10
10	Very Adventurous	8	10	10	10

IDD Pension +1

IDD Pension +1

IDD Pension +1



Introducing **Moody's Asset Allocation**

- Who are Moody's
- What is a stochastic model?
- Adviser's plan can only be deemed Suitable if the following are true:
 - The growth projections are reliable and aligned to the objectives
 - Informed Consent exists, based on a full understanding of investment risk.
- Risk, or possibility of financial loss can be quantified.
Eg Portfolio is likely to lose up to 5% in a bad year and therefore is Cautious.
- This gives us a consistent measure for 'risk' as 'loss', allowing any investment to be mapped
- Why is Value at Risk (VAR) a better approach for advisers than Volatility banding?

Moody's model is the most reliable and proven model for forecasting loss and potential gains, on a probability basis.



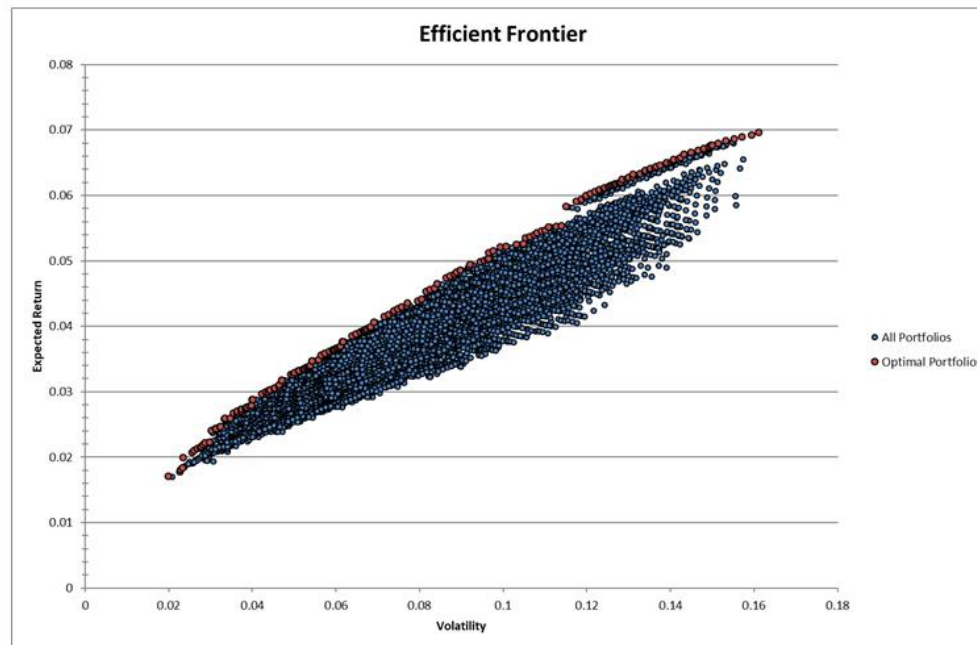
You can use it to:

- Access an accurately aligned ATRQ and asset allocation model
- Explain risk and reward to gain 'informed consent'
- Create financial plans that pass MiFID II scrutiny on suitability at ex-ante and ex-post stages
- Easily identify Suitable investments for clients, risk assess CIP / CRPs
- Avoid ambiguity in your advice and compliance processes
- Save time
- Reap the benefits of the most sophisticated portfolio risk analysis available.



How is **strategic asset allocation** created?

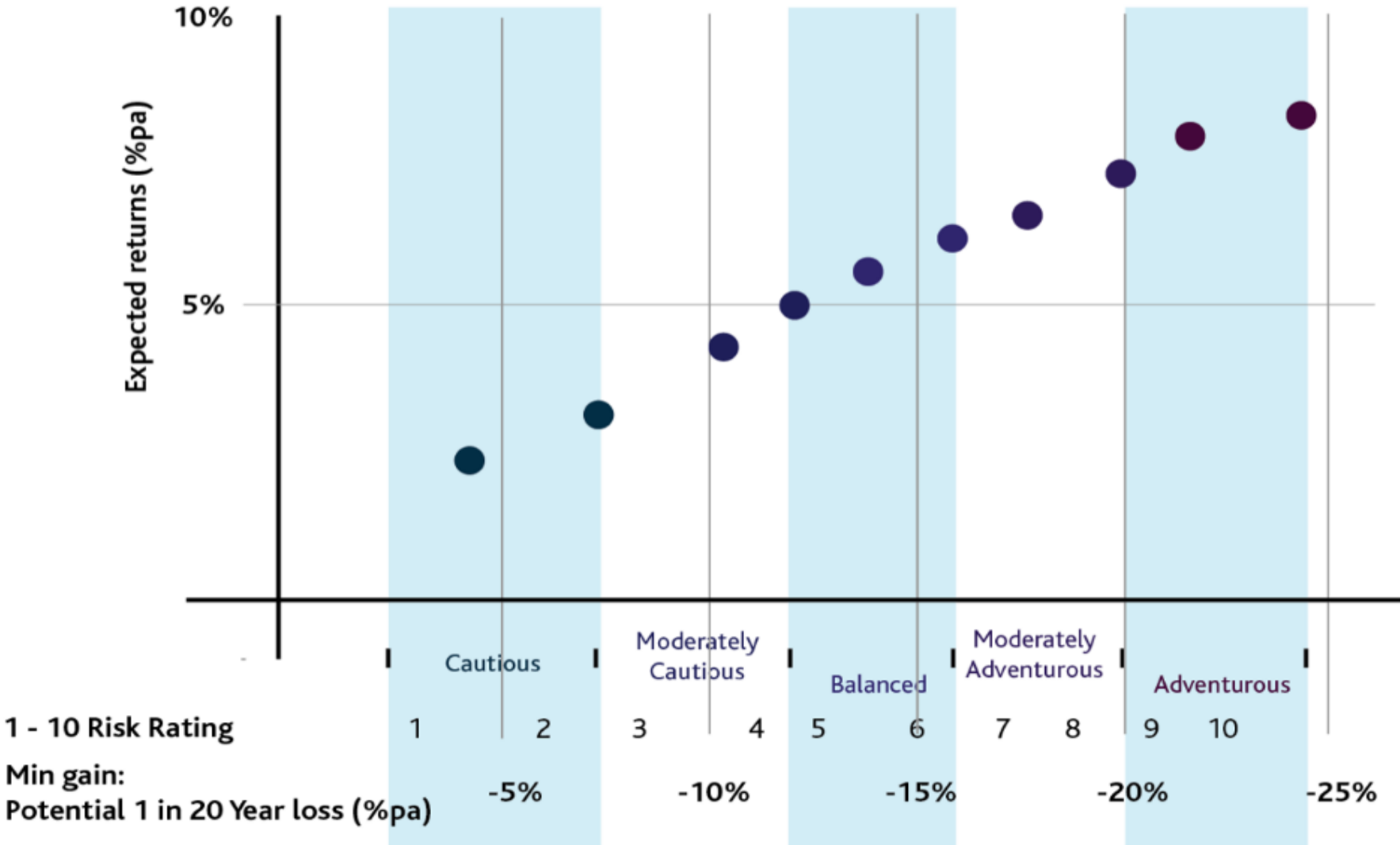
Moody's: 'For Portfolio 1 we had four candidates. Portfolio 'test 10' was selected as it had the best risk/return characteristics (i.e. target was 4.4% 1-year VAR (Value at Risk @95%), this was lower and had the better projected return).'



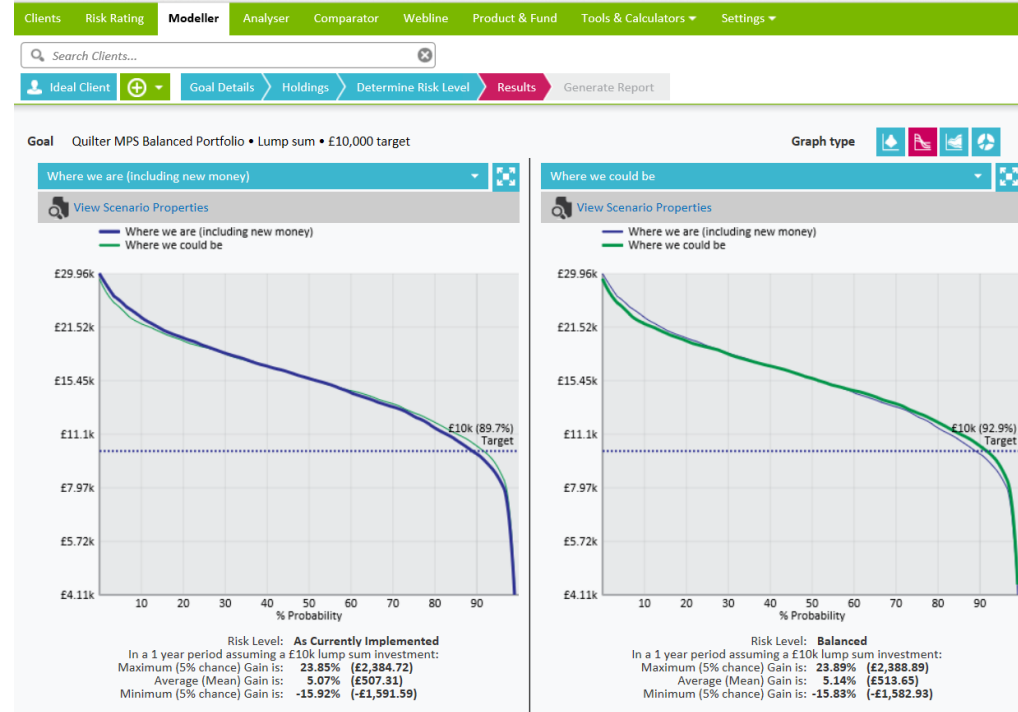
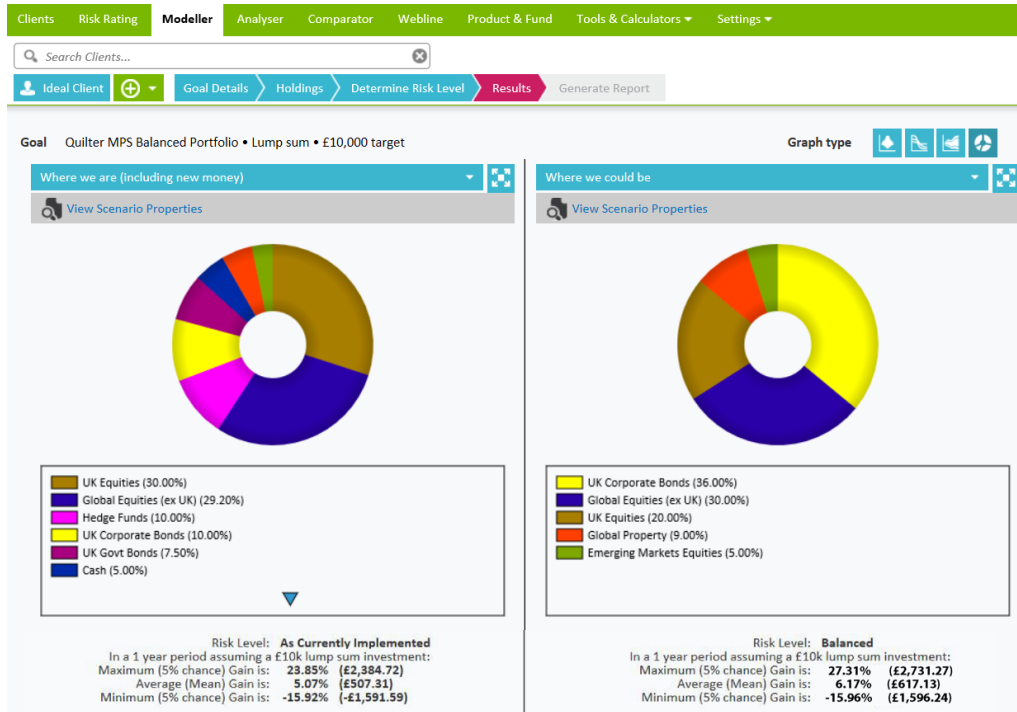
Cash	60%
UK Corporate Bonds	30%
Property	0%
UK Equity	5%
Global Equity ex UK	5%
US Equity	0%
Emerging Markets Equity	0%



Synaptic Risk Ratings - graph showing efficient frontier using Moody's VAR (1 in 20 Year Loss %pa) / Min Gain as boundaries



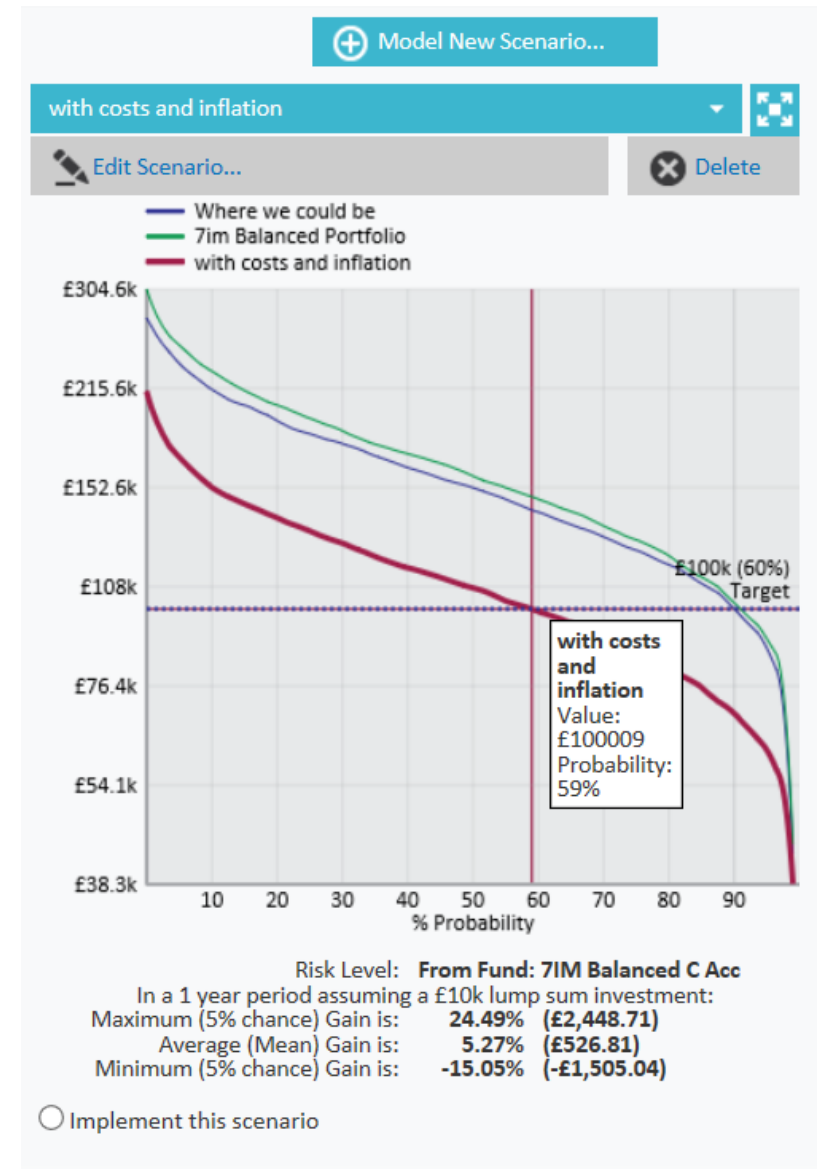
The Moody's stochastic model in action



Asset allocations drive investment returns. Risk analysis is quant driven - NO QUALITATIVE OVERLAY

What about inflation and stress testing?

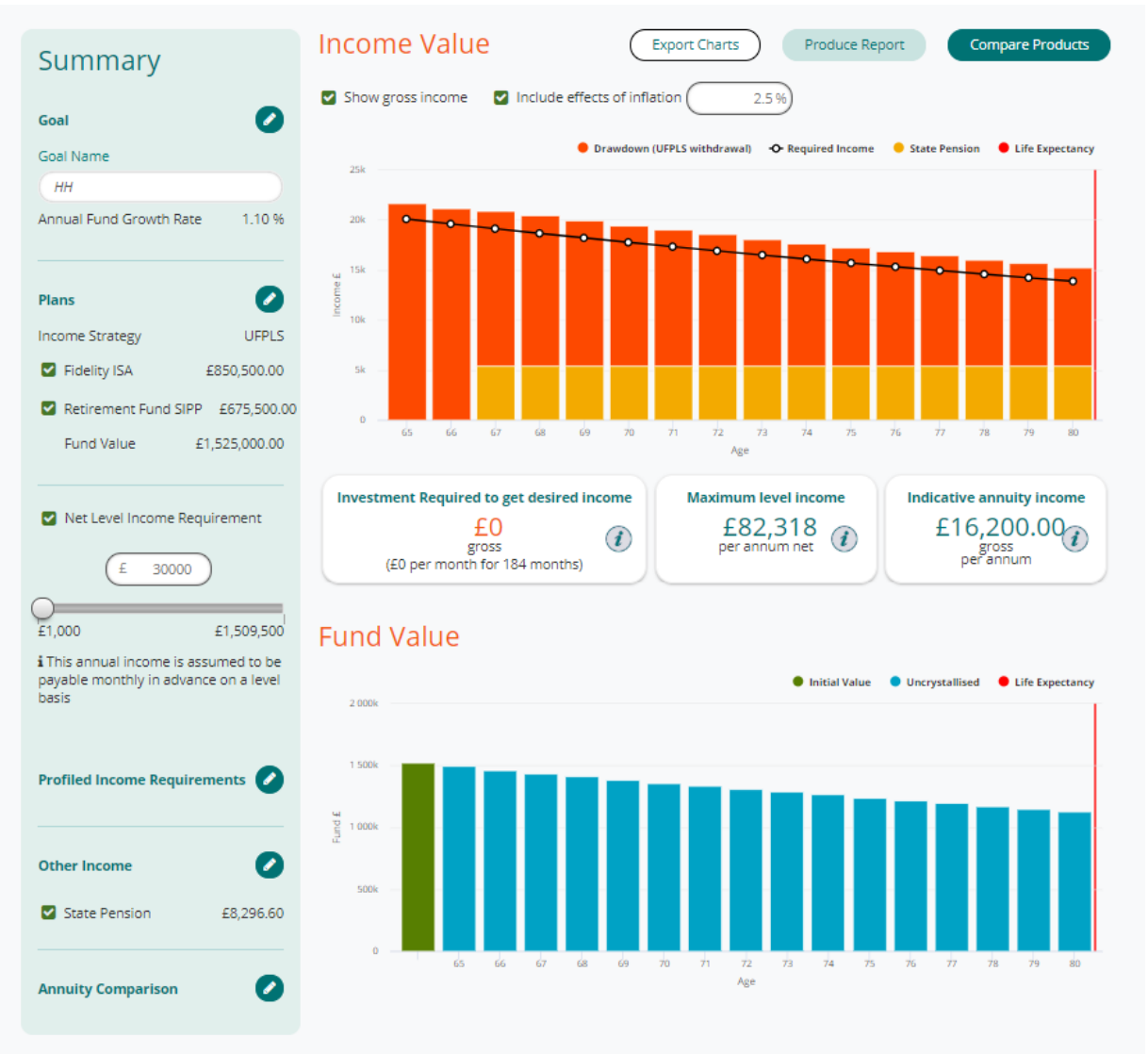
- Moody's calculate the impact of inflation historically to average 4.5% loss per year, in any 10-year period.
- The stochastic approach covers all viable scenarios (good and bad).



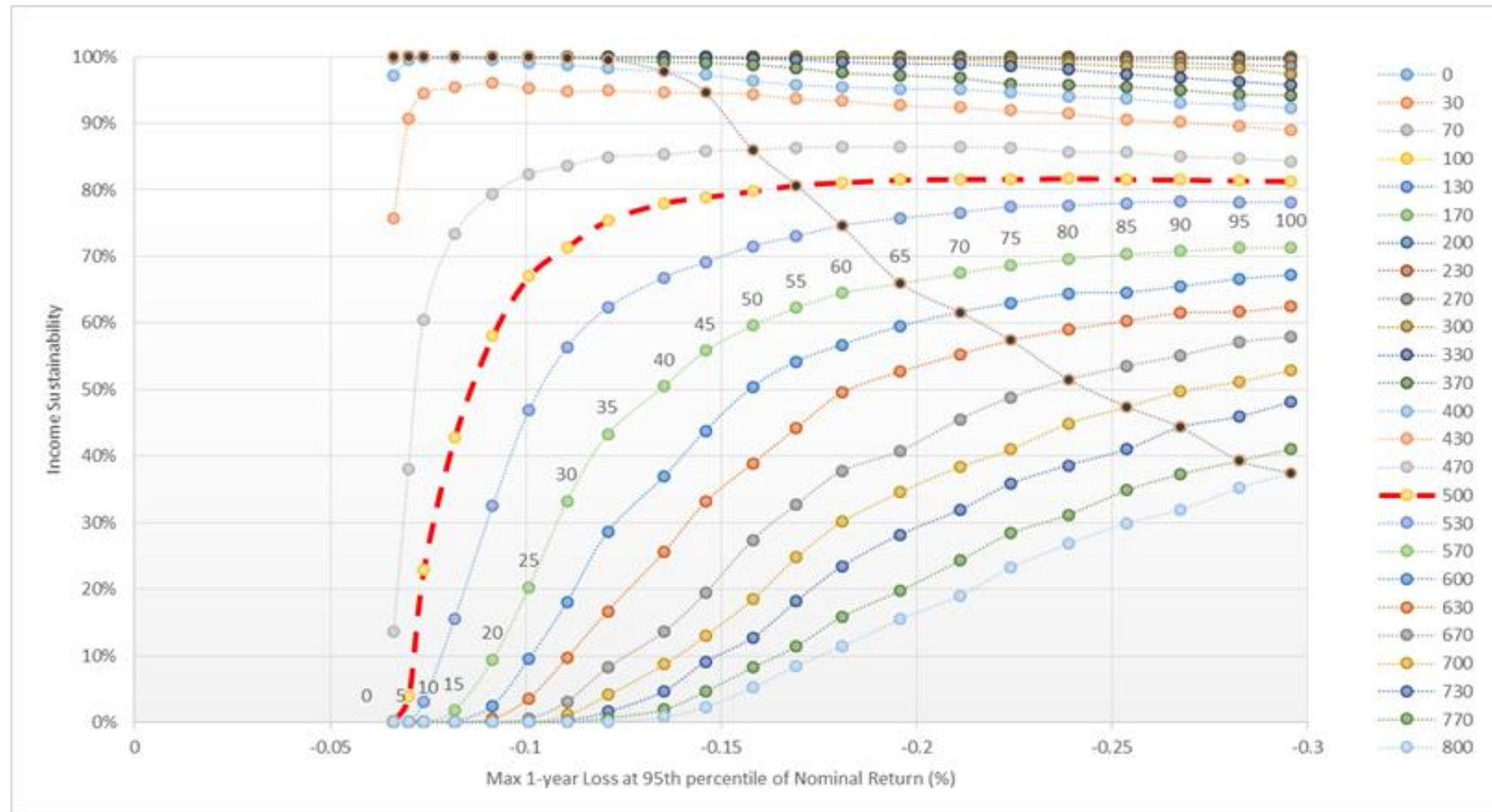
Use of cash-flows







- ‘Cash-flow planning can be about any form of income and outgoings and does not have to be related to the client’s overall position.’
- The second point is that the cash-flow plan can, and should, establish the Capacity for Loss for most clients.
- Cash-flow users can use the Synaptic Risk profile for growth assumptions.

Illustration from Synaptic Analyser



What about investment risk in retirement?



 <p>SYNAPTIC RISK</p>	 <p>SYNAPTIC MODELLER</p>	 <p>SYNAPTIC ANALYSER</p>	 <p>SYNAPTIC COMPARATOR</p>	 <p>SYNAPTIC WEBLINE</p>	 <p>SYNAPTIC PRODUCT & FUND</p>
<p>An objective risk measure utilising Moody's stochastic engine</p>	<p>Sophisticated risk analysis tool providing meaningful and consistent measurement</p>	<p>Quickly and easily model all aspects of your clients retirement income and instantly compare the best products available</p>	<p>Full charges analysis at platform, product, fund and adviser charging levels</p>	<p>Quote and e-apply portal for protection and annuities</p>	<p>Whole of market product and fund research</p>

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