IE INVESTMENT EXECUTIVE

Strategies

Helping clients manage risk

Understanding risk is key to staying invested

By Dwarka Lakhan | September 05, 2012 15:00

Educating your clients about managing risk can make them more comfortable about staying invested in various market conditions.

"Clients typically want to know that you have a risk-management process in place that would minimize any potential losses," says Prem Malik, chartered accountant and financial advisor with Queensbury Securities Inc. in Toronto.

It is important that your clients have a good understanding of how much risk they can take, Malik advises. And you must explain how you will manage their investments in order to meet their expectations. This way, they will not only trust your advice but stay invested over the long-haul.

"Clients often overestimate their level of risk tolerance," says George Hartman, CEO of Toronto-based Market Logics Inc. "You find out their true risk tolerance only when their investments fail."

Here are some ways to help make your clients understand risk:

> Get them to open up
Urge your clients to tell you as much as possible about themselves.

Explain to your clients that you need to know their goals and expectations, Malik says, so you can recommend the investments that are best suited to their current circumstances and helping them reach those goals.

"This makes them part of the process," he says, and shows them that you have their best interests at heart – earning their trust."

> Explain your risk profile methodology
Let your clients know that clients often overestimate their risk tolerance and that you want to be certain about how much risk they can take.

Use a risk profile tool or questionnaire in combination with practical and real-life examples to gauge your clients' appetite for risk, Hartman says. For example, present various portfolio scenarios and ask questions such as: "How would you react if you lost 30% of your money in a particular portfolio?" Vary the question in order to get the client's true reaction.

> Demonstrate scenarios for managing risk
Show your clients how risk can be counter-balanced in different scenarios.

"Provide various illustrations that show how the portfolios you recommend can meet their needs," Malik says. Show best- and worst-case scenarios by varying the allocations in your illustrations.

As well, encourage your clients to ask as many questions as necessary.

> Get consent
Ask your clients to confirm that they are in agreement with your approach and your recommendations. Hartman recommends having them sign an investment policy statement.

> Follow up

Advise your clients that you will be "taking their temperature" during each review period, Malik says, to ensure that they are comfortable with the performance of their investments in the context of market conditions. Make adjustments, if necessary, to ensure they will remain invested.