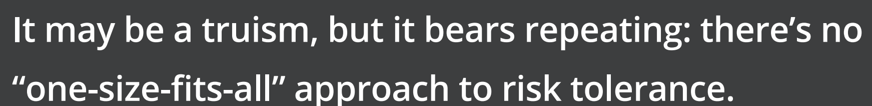
Risk Tolerance:

ALIGNING ONLINE RESPONSES WITH FACE-TO-FACE ASSESSMENTS



It may be a truism, but it bears repeating: there's no "one-size-fits-all" approach to risk tolerance. A client's comfort level will vary depending on personal circumstances, and no approach is inherently better than another.

Advisors have a professional responsibility to help clients understand their specific risk tolerance to make the best decisions for their situation and financial future. The most effective advisors are adept at taking the insights captured from online and in-person assessments to generate a customized and relevant financial plan.

Let's look at the basics of risk tolerance, how advisors can have an accurate view of their clients' risk levels, and an innovative tool from PreciseFP to streamline risk tolerance calculations.

What's Risk Tolerance, Anyway?

Risk tolerance is baked into any financial plan. This concept refers to the extent of investment return variation a client is willing and able to accept. How much exposure is a client willing to take on for an investment? This comfort level then informs investment strategies. Much goes into arriving at this spectrum, but age, financial goals, time horizon, and expenses certainly matter. These factors aren't fixed and can be fluid, so advisors must take care to check in and modify as needed.

Generally speaking, an advisor's success (or failure) hinges on their ability to connect beyond the face value. Clients are looking for more than just financial advice. They want someone in their corner with their best interest at heart. Depending on the situation, this can mean gently challenging assumptions that don't serve them or affirming their instincts. Understanding each client's motivations, values, insecurities, and general approach to money is vital to establishing a trusting relationship.

But it's not just about the numbers and dollars. Digging deeper, knowing your client's comfort zone as it relates to risk touches on the following areas:

EMOTIONAL WELL-BEING

Financial decisions are colored by emotions, such as fear, anxiety, or excitement. Pushing a client too far can evoke negative feelings, potentially causing them to make rash decisions or abandon their financial plan altogether. By knowing and honoring their limits, you can help clients feel more secure and confident when tackling money management. In turn, this helps them feel more settled.

LONG-TERM COMMITMENT

Investing often means playing the long game, and clients are more likely to follow advice during market fluctuations if it jives with their comfort level. If they feel uneasy about their investments, they may be inclined to act out of emotion and make choices that could negatively impact their long-term financial goals. Building a portfolio that aligns with their style helps promote consistency and adherence over time.

TRUST AND RELATIONSHIP BUILDING

Understanding your client's comfort zone shows that you value their perspectives, fostering trust and strengthening your relationship. When clients know you've put in the work, they're more likely to be upfront about financial goals, concerns, and changing dynamics. This helps you as an advisor offer personalized advice and support, helping to deepen the relationship.

CUSTOMIZED FINANCIAL PLANNING

Every person's financial situation is unique, and their relationship with risk helps shape their financial plan. By considering their comfort level in the context of financial objectives, timelines, and liquidity needs, you can create a bespoke financial plan that works for where they are mentally.

Understanding your client's comfort zone in money matters is a win-win. Respecting this boundary can help you help them more effectively, which can translate to greater client satisfaction and longevity and elevate your reputation at the same time.

Inside Your Client's Head

Ask 10 people about their feelings on money matters, and you might get 10 different responses. Money can stir up a lot of emotions, which can be good or bad, depending on the person and the given day. Other factors that can impact a client's attitude include:

PERSONAL EXPERIENCES

A person's childhood, financial successes, failures, or traumas can color their outlook around money, making them cautious to assume perceived risk.

CULTURAL BACKGROUND

Certain ethnic or cultural groups hold norms, values, and attitudes toward money that influence saving, spending, or investing.

FAMILY DYNAMICS

Clients often mirror their parents' approaches to money, which can help or hinder their financial health. Intergenerational wealth transfer can be a boon to a client's financial outlook.

MEDIA AND SOCIAL INFLUENCES

Though we don't always realize it, popular culture can affect how certain people perceive their financial status and goals.

FINANCIAL EDUCATION

Familiarity and comfort around important money-related decisions is nothing to take for granted.

LIFE EVENTS

Milestones and stressors like marriage, divorce, childbirth, job loss, or illness can weigh heavily on people and change mindsets about money.

Beyond events, it's human nature to make decisions rooted in emotions, not logic. Common emotions that can impact decision-making around money include:

FEAR AND ANXIETY

Fear of loss or the unknown can mean people lean toward conservative moves, such as avoiding investments, even if that's not the best path forward.

GREED AND OVERCONFIDENCE

Hubris can lead to excessive risk-taking and speculative behavior that can have dire consequences.

GUILT AND SHAME

Negative feelings about past decisions and one's ability to make sound decisions can make them less likely to get professional help and further set them back.

HAPPINESS AND EUPHORIA

Positive emotions resulting from major wins in the financial arena can lead to erratic money moves that may not support long-term goals.

STRESS AND OVERWHELM

Facing ongoing financial stress in a household can cloud judgment and cause people to lose sight of the big picture.

REGRET AND LOSS AVERSION

Overthinking can make investors leery of selling underperforming investments, even when it might make sense to do so, leading to less-than-optimal results.

Understanding how emotions influence money decisions can help advisors offer more relevant guidance, support emotional health, and set clients up for long-term success.

PreciseFP: A Modern Solution for Modern Advisors

The PreciseFP risk tolerance questionnaire is a game-changer because it takes the guesswork out of assessing a client's comfort level concerning risk. And because of its automation, the questionnaire also saves time, money, and resources associated with client onboarding — a notoriously slow and cumbersome process.

The questionnaire, developed by academics and experts in the field, presents 13 scenarios to the client to gauge their attitudes and values around money. The results instantly show the client or prospect will learn where they fall in the spectrum from "low to very high" risk.

The intuitive nature of the tool means advisors can seamlessly integrate it into their operations. However, it's not a substitute for having important conversations in person. Designed to complement face-to-face interaction, this tool — and related score — can help you deepen the client relationship. It will either solidify your instincts based on the in-person meeting or prompt you to adjust their risk. Either way, it can lead to meaningful discussion and next steps for helping them achieve their financial goals.

A tool is only as good as its real-world application, so let's look at what this looks like in a modern advisory setting. You might be working with a gentleman named Daniel. After meeting with him in person, you send the questionnaire to his inbox. After Daniel receives the email and clicks the link, he's invited to complete the questionnaire. Doing this during a calm market period is best to prevent emotional decision-making.

Once Daniel completes the questionnaire, his risk tolerance score is generated, showing Daniel has a moderate risk tolerance level. These insights can help you determine how to allocate assets and will be available in his profile for future reference. It's also a good idea to send the questionnaire annually to track changes in risk tolerance.

Another important point is that Daniel might have a partner who's also an investor. In this case, it's best to send the questionnaire to both of them, as attitudes about investing and risk can vary among couples. In reviewing the responses from each party, you can compare and contrast their styles and hopefully find common ground.

Calculating Risk Vs. Reward

Risk tolerance and financial goals are two essential elements that inform each other in investment and financial planning. The dance between risk tolerance and goals involves the happy medium that ensures optimal wealth generation while limiting unnecessary exposure to potential losses.

As mentioned above, risk tolerance reflects an individual's willingness and ability to withstand market fluctuations. Some investors are comfortable with higher risk levels because they associate it with potentially higher returns over the long term. On the other hand, some investors are more comfortable with lower-risk investments out of an abundance of caution.

Financial goals, conversely, reflect a person's objectives, dreams, and milestones they hope to see materialize because of their investments. These goals can be short-term, such as saving to build a pool, or long-term ambitions, such as funding a retirement. Each comes with its own timeline, liquidity needs, and return requirements.

Risk tolerance and goals align when the investment strategy meets the specific objectives and constraints of the investor. This hinges on the advisor having a firm command of the investor's risk tolerance so they can introduce investment portfolios that strike an artful balance between risk and return. Effective advisors know how to optimize a financial plan based on when the client needs the funds, how much they need to realize their goal, and what level of risk fulfills that.

As personal situations and goals change over time, there's a need for periodic check-ins. Open communication and giving adequate attention to the investor's risk tolerance and goals can help advisors succeed. Ultimately, the relationship between risk tolerance and goals can bear fruit when done right. The result can be an investment strategy that empowers investors to feel more confident about their ability to achieve their goals.

Behind (and Beyond) the Data

What does the balance of risk tolerance and financial goals look like in action? The first step is to understand each client's unique perspective.

The PreciseFP Risk Tolerance Questionnaire presents 13 questions to the investor, including those that gauge levels of financial risk tolerance:

1. **WILLINGNESS TO MAKE INVESTMENTS.**
2. **COMFORT WITH AND EXPERIENCE IN TAKING RISKS.**
3. **WILLINGNESS TO TAKE A SPECULATIVE RISK.**

This tool will help you engage with the investor on a deeper level because you know where they're coming from.

Higher scores are descriptive of increased risk tolerance. Traditionally, scores have been interpreted as follows:

Score	Tolerance for risk
0–42	**VERY LOW**
43–50	**LOW**
51–62	**MODERATE**
63–70	**HIGH**
71–100	**VERY HIGH**

Posing these questions can generate valuable insights into clients' risk preferences. However, advisors shouldn't rely on them as the only source of truth. Instead, they should make a point to engage in discussions about risk for several reasons:

CLARIFICATION AND CONTEXT

In-person meetings give advisors a more black-and-white picture of the client's situation. This is the venue to drill down into the clients' answers, seeking context and greater meaning behind their risk preferences.

EMOTIONAL FACTORS

Conversations about risk allow advisors to explore nuances. Understanding clients' fears, biases, and past experiences with risk can help advisors employ a more empathetic approach.

COMPLEX SITUATIONS

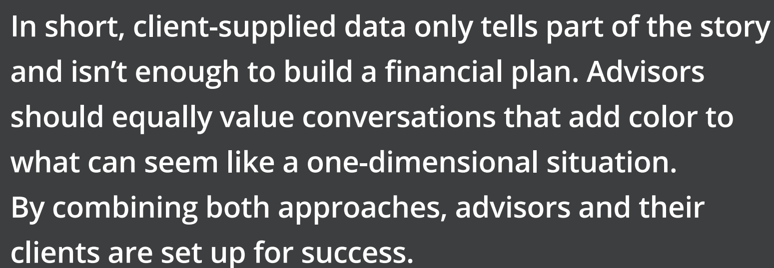
Some clients may have complex financial situations or unique risk considerations that can't be easily captured on paper. In-person discussions can help them uncover additional factors, such as family dynamics, business pursuits, or estate planning considerations that can color their outlook.

EDUCATIONAL OPPORTUNITIES

Discussing risk with clients presents an opportunity for advisors to educate them about important concepts and how they can affect their posture in the market. This information sharing can make them savvy investors and increase their chances of success.

BUILDING TRUST AND RAPPORT

Engaging in these important conversations about risk builds trust and rapport between advisors and clients. Advisors can demonstrate their ability to connect beyond numbers through empathy, active listening, and eye contact.



In short, client-supplied data only tells part of the story and isn't enough to build a financial plan. Advisors should equally value conversations that add color to what can seem like a one-dimensional situation. By combining both approaches, advisors and their clients are set up for success.

Unlock the power of PreciseFP and the Risk Tolerance Tool to elevate your advisory services to new heights. Designed to empower both prospects and existing clients, these tools seamlessly integrate into your service offerings, providing unparalleled insights and personalized care. By incorporating these cutting-edge solutions, you not only demonstrate your commitment to going above and beyond for your clients but also instill confidence in their financial journey. It's time to exceed expectations and create lasting, meaningful relationships built on trust and expertise.

A more robust client experience starts here. Sign up for a free 14-day trial **here**.