
Morningstar Risk Tolerance Questionnaire

Guidance for Financial Advisers

We recommend that you read this Guidance Document prior to using our Risk Tolerance Questionnaire (RTQ) in order that you understand how it works and how it is intended to form part of the overall suitability assessment process that you are undertaking with the investor.

How the tool works

Purpose:

The RTQ is designed as a tool to be used by an adviser to better understand the risks an investor may or may not feel comfortable taking. It will form the starting point for a discussion with the investor about their investment decisions and is intended to support the wider information gathering required under Know Your Client rules.

Scoring:

The RTQ is structured as a series of questions for the investor to answer which will provide a single result and indication of investment selection that, in Morningstar's opinion, matches that result.

The questions are scored on an individual basis and do not take into account responses to other questions. The score weightings have been tested to check that a single anomalous response does not result in the final outcome veering towards a result inconsistent with the rest of the investor's answers.

That said, you should be aware that the first two questions are not scored. These are intended to allow the adviser to record this information within a single document and place the result into context.

Furthermore, if the response to Question 2 indicates that the investor cannot tolerate a fall in the value of their money and therefore has no capacity for loss, the RTQ result will be that there is no suitable investment solution. This result will also arise if the investor's time period is such that an invested solution may not be appropriate on the basis that there is not adequate time for any losses to be recouped.

Risk Profile Results:

The RTQ result is shown as a list of bullet points to explain in broad terms how the risk profile is defined. This is supported by graphical images to show how a portfolio for such a risk profile may be allocated into the main asset classes, and how such a portfolio may perform over time. This should be used with the investor to confirm that the resulting description and imagery correspond with what the investor believes their profile to be and that the example performance shows a pattern that the investor would be comfortable being exposed to.

Once the RTQ has been completed and a result obtained, the adviser can of course discuss this with the investor in relation to their particular financial circumstances and objectives for the investment under consideration. It may be agreed with the investor that a different risk selection is appropriate. When using the RTQ through Morningstar Software, the adviser is able to select an alternative profile. The RTQ result will show both the tool output and the adviser selected profile.

Supporting Documents:

We suggest that you also read our Methodology document which provides more detail on the methodology behind the scoring, market testing undertaken and norm tables.

We also suggest you provide the investor with our Investor Guide which explains the broader concept of investment risk and explains the risk versus reward trade off.

How it helps you meet your regulatory requirements

The Financial Conduct Authority requires advisers to consider 4 elements when determining an investor's risk tolerance. These are listed below along with a summary of how our RTQ addresses these:

► **Risk tolerance**

Questions 4 to 12 aim to assess the investor attitude to risk in terms of their future intentions regarding the investment, emotional response to losses and willingness to accept losses.

► **Capacity for loss**

Question 2 and 3 address this to the extent of clarifying the reliance that the investor has on the monies subject to this RTQ assessment, and also the time horizon. You are reminded that Question 2 is not scored and is intended for the adviser to consider the appropriateness of the RTQ outcome in light of the investor's overall financial situation.

► **Knowledge and Experience**

The RTQ does not specifically ask questions about the investor's existing knowledge and experience.

► **Risk need**

Question 1 asks for information about the investor goals. This includes a free type space. The response to this question is not scored but allows an adviser to record what the investor is aiming for and therefore the level of investment risk that they may need to consider taking in order to achieve their goals. Obviously if the investor is ultimately not willing to take the required risk level, the adviser would need to explain this to the investor so that they can adjust their objectives accordingly.

Limitations of the RTQ and how to mitigate these

Anomalous responses:

Questions 6 and 7 do ask the investor the same question but in different ways and the software will flag to the adviser if these answers do not match through an onscreen message. The adviser will need to go back to the investor to ensure their understanding and which answer they want to go with before proceeding. If you are completing and scoring the RTQ on a paper version the adviser is responsible for reviewing and identifying contradictory responses to these questions.

Aside from that the RTQ deliberately asks similar questions in different ways but it will not flag instances where an investor has provided opposing answers.

To address this, the scoring has been structured so that a single anomalous response does not change the final result. In addition, the adviser needs to review the responses to determine whether the investor has provided contradictory answers. If so, they should have a further discussion with the investor in relation to those questions.

Knowledge and Experience:

The tool does not make an assessment of the investor's knowledge and experience.

To address this we would expect the adviser to consider the appropriateness of the outcome in the light of the investor knowledge and experience determined from their broader fact-finding. Consideration should also be given to whether the investor has reasonable investment experience but has responded in a way that indicates a cautious approach. The adviser should determine whether this is a sign that the investor's knowledge does not match their experience, or whether they have experienced significant market fluctuation in the past and would prefer not to expose their monies to the same level of investment risk in the future.

Existing Assets:

The tool does not take into account the value or liquidity of other assets that the investor has. While Question 2 does aim to assess the extent to which the investor is dependent on the monies being considered for investment, this question is not scored and the adviser should consider whether the investor has access to adequate liquid resources to meet their short term needs.

The tool does not consider the investment exposure that the investor may already have in other investments and the adviser should consider whether the RTQ result and any indicative asset allocation overly exposes the investor to particular sectors or asset classes and to consider the appropriateness of the resulting investment solution in light of the investor's wider needs and circumstances.

Risk associated with the investment selection provided in the result

Morningstar defines risk as the permanent loss of capital and the asset allocation results from the RTQ are based on this definition.

The adviser is of course responsible for selecting the underlying investments in accordance with this asset allocation and should be mindful of the inherent risks within those investments to ensure that they provide an overall suitable solution.

Advisers Subscribing to Morningstar Managed Portfolio Service

In addition to providing a risk profile result, the tool will also suggest a matching discretionary Morningstar Managed Portfolio. The funds selected by Morningstar within the various portfolio solutions available are considered in terms of how they will perform within a diversified portfolio and support the overall objectives and risk profile of the strategy. Therefore the short term performance of the funds is monitored but the funds are reviewed in the context of their role in the overall portfolio. In addition, the underlying funds will have individual risk profiles that range across the spectrum, but the overall blended result of the holdings and weighting applied will be in accordance with the risk profile of the selected portfolio.

The risk tolerance questionnaire should be repeated on an ongoing basis with the investor to ensure any changes to their risk tolerance, and consequent amendments to the resulting asset allocation result, are captured.

