Guidance when using the Questionnaire

The following guide aims to provide you with a detailed understanding of how to best use the new Morningstar risk profiling questionnaire and the scoring methodology. It's important to read and familiarise yourself with the contents of this document, so when using the questionnaire you are clear on how the scoring works and can interpret and evaluate the results as applied to your individual clients.

A risk questionnaire is only part of the process and the aim of this tool is to provide structure and consistency within your investment process.

The risk questionnaire has been developed for Morningstar by Ibbotson Associates (part of the Morningstar Investment Consulting business), who are also responsible for creating the asset allocation guidance models. The questionnaire is tied to the Ibbotson capital markets data and subsequent asset allocation guidance models available within Morningstar Adviser Workstation. Below is a table that provides the risk bands and the broad asset breakdowns for each level of risk.

	Cautious	Moderately Cautious	Moderate	Moderately Adventurous	Adventurous
Equity	30%	50%	66%	85%%	96%
Fixed Income	56%	41%	28%	13%	2%
Cash	14%	9%	6%	2%	3%
Expected Return	5.3%	6.7%	7.8%	9%	9.9%
Expected Standard Deviation	6.9%	9.6%	12.4%	15.5%	18.1%

It's important to outline that this questionnaire should be used specifically with those clients that are looking to invest or review existing investments.

How does the questionnaire fit the FCA's good practice recommendation?

Capacity for Loss

The first question asked tests the client's capacity for loss and if the client answers "no" then the recommendation would be that it is most appropriate for the client to place their money in a cash deposit account.

Adviser Workstation will flag this response and recommend that these questions are revisited with clients to ensure their understanding.

Questions 4-11, are focused on Risk Aversion, which is comprised of many different concepts uncovered by behavioral economists in recent decades including capacity for loss.

Easy to Understand Questions

The questionnaire is constructed using plain but carefully considered language, road tested amongst individuals to ensure their understanding of what is being asked.

Questions also include graphics to help the investor visualize information.

Appropriately Interpreting Customer Information

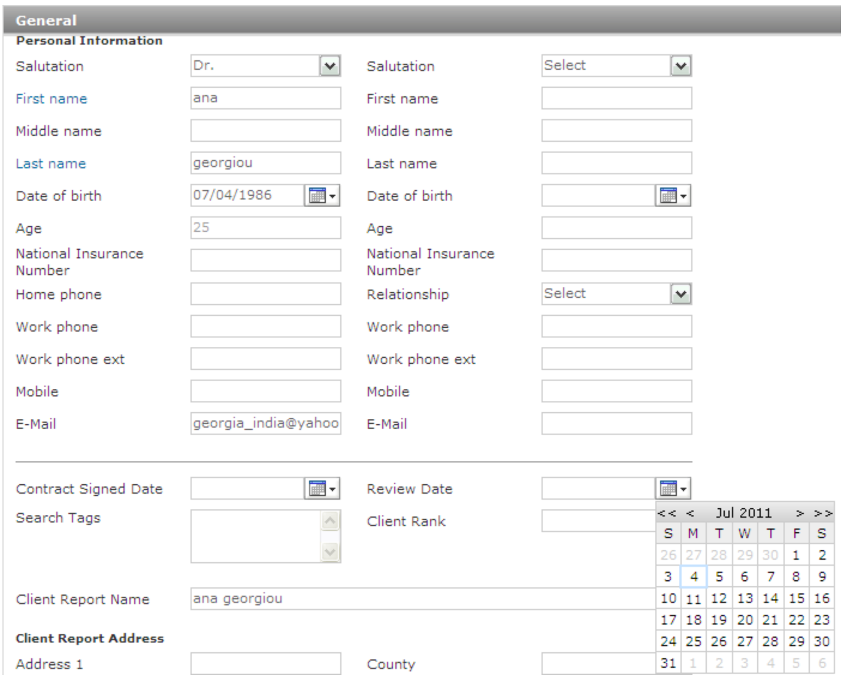
The questionnaire asks 11 questions, of these questions 4 and 5 are asking the same thing but in different ways and it's important to check your clients' response. If they provide conflicting answers to these two questions they may not have understood the questions correctly.

If this is the case, Adviser Workstation will flag the conflicting responses from your client

The questionnaire incorporates a section for the investor to write their "investment objective" and we suggest you encourage your clients to add any comments they may have relating to their investment goals.

Updating the Assessment

The risk profile is attached to the client record, when running an updated annual review, Morningstar recommend that the adviser captures the date of the RTQ within the client record under the Review Date Calendar. In addition, the PDF version of the questionnaire has a date entry box for the investor to enter the date.



General
Personal Information
Salutation: Dr. | Salutation: Select
First name: ana | First name:
Middle name: | Middle name:
Last name: georgiou | Last name:
Date of birth: 07/04/1986 | Date of birth:
Age: 25 | Age:
National Insurance Number: | National Insurance Number:
Home phone: | Relationship: Select
Work phone: | Work phone:
Work phone ext: | Work phone ext:
Mobile: | Mobile:
E-Mail: georgia_india@yahoo | E-Mail:

Contract Signed Date: | Review Date:
Search Tags: | Client Rank:
Client Report Name: ana georgiou
Client Report Address
Address 1: | County:

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S	M	T	W	T	F	S
26	27	28	29	30	1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30
31	1	2	3	4	5	6

Clear Risk Descriptions

Morningstar descriptions incorporate both clearly worded bullet points and graphics that illustrate the type of investment experience an individual investor might have.

Customer Engagement and Understanding

Morningstar provide educational content that supports the investor's understanding of investment risk, specifically around the areas of Market Downturns and Recoveries, Market Timing and Asset Class Winners and Losers. We recommend that advisers utilize this content, specifically the "Principles of Investment" presentation that is available within Morningstar Adviser Workstation within the Home Section under the Presentations section. *Using this content can help your clients better understand the advice they are receiving from you and the risks associated with investment*.

Ensuring the Investment Selection is Consistent with the Customer's Risk Category Description

Morningstar designed the questionnaire to provide guidance on an appropriate asset allocation mix based on the individual's responses from the risk tolerance questionnaire.

The questionnaire and the asset allocation guidance models have both been created by Ibbotson Associates. Looking at an investor's risk aversion, capacity for loss and investment time horizon, providing 6 potential outcomes:

- No suitable investment – client best suited to a cash deposit account
- Cautious
- Moderately Cautious
- Moderate
- Moderately Adventurous
- Adventurous

Understanding the Underlying Risks in an Investment Selection

It's important that volatility is not used as the sole measure of risk and that you understand the underlying assets within a fund, an example of a fund labeled as "balanced" may not be suitable for a investor having a "balanced" attitude. Morningstar insist on the collection of full holdings and the asset allocation of a fund or portfolio is based on true representation of the investment(s). Morningstar's proprietary research tools such as the "Style Box", "Star Ratings" and "Qualitative Ratings" also help to provide further analysis to support an adviser's investment selection.

Questionnaire Scoring System

Morningstar designed the questionnaire scoring system to assign individuals to a portfolio based on their responses from the risk tolerance questionnaire.

Like the questionnaire itself, the scoring system is divided into two distinct sections:

- Time horizon score
- Risk tolerance score

Each section is scored separately, and then combined to form a total score. Morningstar uses the total score to make the portfolio recommendation. The sections below discuss this process.

Time Horizon Score

The time horizon portion of the scoring is taken from questions 2 and 3. The score on these questions determines the time horizon level. The time horizon level is used to assign various time horizon factors.

Each time horizon level gives the investor access to certain asset allocation models and restricts access to others. Investors that score into the shorter time horizon levels are not given access to the more adventurous portfolios. This is consistent with Morningstar's belief that individuals with shorter-term horizons should hold portfolios that are more cautious.

Within each time horizon level, Morningstar allows an investor's risk tolerance to determine the appropriate asset allocation. If an investor's risk tolerance suggests a portfolio that is restricted (due to the time horizon level), Morningstar recommends a more appropriate portfolio for that investor's specific time horizon level. This process allows cautious investors with short time horizons to score into a portfolio matched to their risk tolerance while at the same time protecting adventurous investors with short time horizons from excess risks.

Risk Aversion Score

The risk aversion portion of the scoring is taken from questions 4 through 11. The score on these questions determines the risk aversion level. Where the primary purpose of the time horizon score is to find the investors ability to take on risk, the main goal of the risk aversion portion of the questionnaire is to capture how much risk the investor is willing to take.

The risk aversion level is comprised of many different concepts uncovered by behavioral economists in recent decades, including loss aversion, risk-reward tradeoff, and the ability to stay the course. An investor who feels uncomfortable with extreme volatility or the possibility of large losses to their portfolio is placed in a more cautious option, while an investor who is willing to accept greater risk is placed in a more adventurous option.

Risk Tolerance Score

Find two scores.

1. Time horizon score
2. Risk aversion score

We discuss this process below.

Time Horizon Score

The table below shows the point value of each answer choice in the time horizon section:

The score on these questions determines the time horizon level.

Question 2	Question 3
A. 0	A. 0
B. 3	B. 1
C. 7	C. 3
D. 10	D. 4

Time Horizon Score = sum of values of Question 2 and Question 3

Risk Aversion Score

Take the risk aversion score from questions 4 through 11. Morningstar assigns a point value to each response according to the investor's risk aversion. The highest points are awarded to the most adventurous answer choice. The risk aversion score ranges from zero (most cautious) to 100 (most adventurous).

The points assigned to each question are as follows:

PLEASE NOTE: You need this table and the formula that appears under it.

Question 4		Question 5		Question 6		Question 7	
A.	0	A.	0	A.	14	A.	0
B.	3	B.	3	B.	9	B.	5
C.	6	C.	6	C.	5	C.	9
D.	9	D.	9	D.	0	D.	14
E.	12	E.	12				

Question 8		Question 9		Question 10		Question 11	
A.	0	A.	0	A.	0	A.	0
B.	3	B.	3	B.	3	B.	3
C.	6	C.	6	C.	6	C.	6
D.	9	D.	9	D.	9	D.	9
E.	12	E.	12	E.	12	E.	12

Risk Aversion Score = sum of values of Question 4 through Question 11

Recommending an Asset Allocation Model

Please use Summary Scoring Grid below to find the appropriate client asset allocation model.

The summary scoring grid below facilitates the final portfolio recommendation process by combining the time horizon and risk aversion scores. To use the scoring grid, find the time horizon score on the horizontal axis and the risk aversion score on the vertical axis. The intersection of these two points is the recommended portfolio.

Risk Aversion	**Time Horizon Score**		
Score	0-1*	2-9	10+
0-15	No Suitable Investment	Cautious	Cautious
16-35	No Suitable Investment	Moderately Cautious	Moderately Cautious
36-60	No Suitable Investment	Moderate	Moderate
61-83	No Suitable Investment	Moderate	Moderately Adventurous
84-100	No Suitable Investment	Moderate	Adventurous

*A investor with a time horizon score of less than 2 may not be able to bear the risk associated with any of the investment options. The investment adviser may recommend a zero risk investment to the investor.

Question 1 – This question is not scored. If the investor cannot afford to lose money over a two-year period, the investment adviser may recommend a zero risk investment to the investor.

Question 2 - If an investor has a time horizon score of less than two-years, even the most cautious asset allocation model may not be an appropriate investment option. The investor should speak to an investment adviser before selecting a portfolio.

Ibbotson Associates – Risk Tolerance Questionnaires (RTQ) Background & Methodology

About Ibbotson

Ibbotson Associates is a leading authority on asset allocation, manager selection and portfolio construction services. Rooted in academic research, our core investment process approaches portfolio construction from the top-down, starting at the asset class level. Our mission is to deliver innovative asset allocation solutions, help investors reach their financial goals, and provide asset allocation thought leadership. Ibbotson was founded in 1977 and is a Morningstar company.

Experience in Developing RTQs

Ibbotson first started developing risk-profiling tools for its clients in the mid 1990s. True to its academic roots, Ibbotson consulted with leading scholars in the behavioral finance field such as Nobel Laureate Daniel Kahneman and Richard Thaler when developing its risk-tolerance questionnaire methodology, incorporating many best-practices of the field.

Ibbotson's risk profiling tools have been approved by the American Financial Industry Regulatory Authority (FINRA) and are used by many of the largest asset managers, insurance companies, banks, broker dealers, and retirement plan providers in the U.S., Europe, and Asia.

Key Features of the Ibbotson RTQ

Assessing risk tolerance and risk capacity

The primary objective of Ibbotson's risk-tolerance questionnaire and scoring system is to identify the investor's *willingness* to accept various level of risk via responses to risk-tolerance questions and to determine the investor's *capacity* to accept risk via responses to time horizon questions, and ultimately direct investors to the appropriate portfolios.

An investor's time horizon is an important determinant of his or her capacity to bear investment risk. Time horizon is a necessary constraining variable, especially for investors with a short time horizon. An investor who has a short time to accumulate portfolio wealth may not be able to recoup losses that a risky portfolio may experience. Therefore, it is necessary to restrict an investor with a short time horizon from investing in a portfolio that has a high probability of experiencing short-term declines. If a client has a longer time horizon, he or she can afford a higher level of investment risk. The longer the money is invested, the higher the chance to recover from market downturns.

Investor risk tolerance is another essential factor in determining what portfolio is appropriate for the investor. Risk tolerance is a measure of the investor's attitudes and perceptions towards the uncertainties associated with investing. A risk-averse investor requires greater certainty in portfolio returns, while a risk-tolerant investor is willing to accept higher volatility of returns in exchange for potentially higher average returns. A risk-averse investor becomes anxious when his or her portfolio declines in value by even a small percentage. A risk-tolerant investor is able to endure market fluctuations and to focus on the expected end result.

Ibbotson focuses on the following concepts when identifying an investor's willingness to accept risk:

1. Risk-Return Tradeoff (Evaluating Range of Returns):
   High return is desired by any investor, but it comes at a price-uncertainty of future returns. The higher the return one desires, the higher risk he or she must take. This concept summarizes the willingness of an investor to endure increasing fluctuations of portfolio values in exchange for the possibility to gain additional units of return.

2. Loss Aversion:
   Investors tend to feel a greater psychological pain from losing than they do joy from gaining. This concept is called loss aversion. Loss aversion measures the unwillingness of an investor to experience potential losses.

3. Ability to Stay the Course:
   Short-term downfalls in the market are likely to occur during anyone's investment time frame. These downturns make it difficult for many investors to cope and could be discouraging to stay invested. Over the short term, people can "see" downward trends in the performance of their portfolios, and feel compelled to switch policies. Some investors are particularly prone to regret losses that have resulted from their choice of investment policy and may not be able to stay the course when those losses occur. A financial advisor should be aware of this tendency of investors to overreact to single events and should recommend a policy that investors are likely to adhere.

Levering Ibbotson's expertise in capital market assumptions

The Ibbotson risk tolerance questionnaire is unique in that it leverages Ibbotson's expertise in building capital market assumptions. Rooted in Roger G. Ibbotson and Rex Sinquefield's seminal research on Stocks, Bond, Bills and Inflation® in the mid-1970s - which led Roger Ibbotson to the founding of Ibbotson Associates in 1977- Ibbotson has a long history of analyzing the risk and return characteristics of different asset classes. The risk and return estimates referenced in the questionnaire are based on Ibbotson capital market assumptions, and are tied directly to the asset allocation of our clients' portfolios. The direct link between the questionnaire and the recommended portfolios ensures consistency between the investment recommendation and the investor's risk profile.

A multi-dimensional scoring system

Like the questionnaire itself, the scoring system is divided into two distinct sections: Time horizon and the Risk tolerance score. The time horizon restricts the investor's access to certain portfolios based on the investor's need for liquidity. Investors that need to withdraw large sums from their portfolios within a certain period of time are not given access to the more risky portfolios. This protects investors from the risk of locking needed funds in a volatile portfolio and withdrawing when that portfolio is experiencing losses. Where the primary purpose of the time horizon score is to find the investors ability to take risk, the main goal of the risk aversion portion of the questionnaire is to capture the investor's willingness to take risk. Ibbotson also does multiple scenario testing with the potential responses to avoid any potential outcomes that would score an investor too far from their intended risk profile. Risk tolerance questions consider a number of behavioral concerns, including investor loss aversion, choice of risk-reward combination, and the ability to stay the course.