RISK PROFILING ROUNDTABLE

CONSULTATION SEPTEMBER 28, 2016

JOINTLY ORGANIZED BY THE INVESTOR ADVISORY PANEL AND THE ONTARIO SECURITIES COMMISSION INVESTOR OFFICE

FACILITATOR'S REPORT

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EXECUTIVE SUMMARY

INTRODUCTION

On September 28, 2016, the Investor Advisory Panel (IAP) and the Ontario Securities Commission's (OSC) Investor Office jointly organized a Risk Profiling Roundtable to facilitate dialogue among stakeholders regarding the findings of PlanPlus Inc.'s research report, *Current Practices for Risk Profiling in Canada and Review of Global Best Practices* ("Research Report"), which was commissioned by the IAP, and to provide insights and recommendations on possible next steps to improve the risk profiling used in the retail investment advice process.

The 24 participants included investor advocates, industry representatives, government and regulator representatives, and legal professionals and academics, among others.

HIGHLIGHTS OF THE RESEARCH REPORT

Some of the Research Report's key conclusions include that:

- There is a confusing and universal lack of existence or consistency of the definitions of risk concepts and a lack of understanding of the factors involved in risk profiling.
- Almost all regulators surveyed are principles-based and provide little guidance on how a firm or advisor should arrive at the determination of a risk profile. They all recognize and rely on the professional judgment of the advisor and the 'process' created by the advisor or firm to determine a consumer's risk profile. No regulator provides clear guidance on how to combine the multiple factors and form a client risk profile.
- Risk questionnaires are most widely used in retail channels using mutual funds and less so in wealth management and portfolio manager channels.
- Over 53% of respondents to the advisor survey indicated that between 76-100% of their clients had completed a risk questionnaire. Almost half of the firms reported that risk questionnaires were developed in-house and another 36% said that advisors could choose their own risk profiling methodology. Only 11% of firms could confirm that their questionnaires were 'validated' in some way.
- Most of the questionnaires (83.3%) in use by the industry are not fit for purpose - they have too few questions, poorly worded or confusing questions, arbitrary scoring models, merge multiple factors (75%) without clarity, or have outright poor scoring models. Fifty-five percent had no mechanism to recognize risk-averse clients who should remain only in cash.

HIGHLIGHTS OF THE ROUNDTABLE INPUT

Although this event was not designed for consensus-building, participants were surprised and pleased with the extent of common ground even among the different stakeholders in attendance.

There was general agreement that key challenges to consistently effective risk profiling include:

- the trade-off between thoroughness and simplicity: risk profiling tools and processes must be thorough enough to consider all relevant factors and yet not be so complex that they disengage the client or lead to cursory or incomplete answers to important questions, and
- the many factors that could prevent a client from providing complete and accurate input to the risk profiling process: examples include the client's financial literacy, bias, proficiency of record keeping, misunderstanding of the process and concerns about privacy.

There was general agreement that some of the most important ideas that emerged from this Roundtable are to:

- foster a culture across the financial sector that risk profiling is primarily conducted/ completed in the interests of the investor, not the advisor
- call upon regulators to:
    - standardize definitions
    - establish minimum standards for risk profiling
    - build a risk profiling framework and overall risk profiling template or approach that is both clear and flexible
    - provide guidance for the application of proportionality, and in doing so, develop a cost-effective risk profiling model that suits small portfolios, and
- emphasize laws and regulations that are principles-based and can be applied flexibly to suit the situation.

Some participants recommend the establishment of a best interest standard.

There was broad-based support for enhanced education of advisors by:

- developing higher levels of proficiency among advisors in risk modeling, risk tolerance and how to competently conduct the risk profiling conversation with active listening and competent consideration of behavioural factors, and
- providing education that extends beyond the transfer of knowledge to include the development and evaluation of appropriate competencies.

Technology, including productivity tools, has the potential to enhance the effectiveness and efficiency of the risk profiling process and help to better educate advisors and their clients. It can also be a game changer because it facilitates the investor's empowerment and direct involvement in their investments and changes the relationship between the client and the investment advisor, thus increasing the client's responsibility in the relationship.

All participants in the investment sector – law, regulators, firms, advisors, academics and researchers, advocacy organizations and clients – have a role to play in improving the path forward. The biggest challenge may well be to enable clients to fully play their very important role in their own risk profiling process.

There was general support among participants in this Roundtable that:

- stakeholders in our sector should work together to develop a holistic response to the challenges we face rather than our traditional approach of silo-based solutions developed according to segments of the sector or types of investments
- it is critically important to consider the need for and develop all constituent groups' understanding of, and buy-in to, the types of improvements that are needed; in this regard, a significant pipeline for successful change is education

- part of the challenge is to change mindsets regarding the risk profiling process, particularly within the firms, away from viewing it as a necessary evil; risk profiling should be viewed as a foundational element of the optimal relationship between the client and advisor

- as mentioned often, precise, client-centric, common definitions of all of the relevant risk concepts need to be developed and applied

- objective standards of "fit for purpose", such as in the case of a questionnaire, are required

- the current compensation model for advisors may be inconsistent with effective risk profiling in the best interests of the client; the compensation model should be reviewed

- in parallel to enhancing the quality and robustness of the risk profiling process, use technology, particularly productivity tools, to streamline the process and make best use of the client's and advisor's time to do it right, and

- more cross-sector conversations like this Roundtable would be very helpful.

In the end, participants were also surprised by:

- the complexity of the risk profiling issue
- that, to date, the industry has not developed a consensus on and solutions to the many issues related to risk profiling, including the basics such as to adopt and apply common definitions, and
- that only 16.7% of risk profiling questionnaires are “fit for purpose.”

RISK PROFILING ROUNDTABLE

INTRODUCTION

OBJECTIVE AND SCOPE

On September 28, 2016, the Investor Advisory Panel (IAP) and the Ontario Securities Commission's (OSC) Investor Office jointly organized a Risk Profiling Roundtable to explore the findings of PlanPlus Inc.'s research report, *Current Practices for Risk Profiling in Canada and Review of Global Best Practices,* commissioned by the IAP, and to provide insights and recommendations on possible next steps to improve the risk profiling used in the retail investment advice process. The OSC is the regulatory body responsible for overseeing Ontario's capital markets, and its mandate is to provide protection to investors from unfair, improper or fraudulent practices and foster fair and efficient capital markets and confidence in capital markets.

The Investor Office sets the strategic direction and leads the OSC's efforts in investor engagement, education, outreach and research. The Office also brings the investor perspective to policy-making and operations.

The IAP is an independent advisory committee created by the OSC in 2010. Its mandate is to:

- solicit and represent the views of investors through written submissions on the Commission's policy and rule-making initiatives, and
- engage in investor outreach and research in discharging its mandate.

Effective and open communication among experts and stakeholders develops a common understanding of issues and different perspectives, and helps create a stronger environment for protecting investors.

The extensive experience and insights of the Roundtable participants were helpful in providing insights to the OSC and the IAP.

INDEPENDENTLY FACILITATED

The consultation was designed, led and reported on by an independent facilitator, Scott Ferguson of *Progress Consulting™.*

Mr. Ferguson has more than 25 years of experience in facilitating stakeholder consultations and working with Canadian regulators and the financial sector in Canada.

This document is the facilitator's report of the key themes that arose in the discussion.

This report is intended to be a resource for the OSC, the IAP, the consultation participants and all stakeholders.

RESEARCH REPORT

As part of its efforts to enhance its understanding of current risk profiling practices, the IAP commissioned PlanPlus Inc., an Ontario-based firm that provides products and services for and about personal financial and investment planning, to prepare a Research Report, *Current Practices for Risk Profiling in Canada and Review of Global Best Practices.*

The Research Report was issued on October 28, 2015 and was prepared by:

Shawn Brayman	PlanPlus Inc.
Michael Finke	Texas Tech University
Ellen Bessner	Babin Bessner Spry LLP
John Grable	University of Georgia
Paul Griffin	Humber Institute of Technology and Advanced Learning
Rebecca Clement	Humber Institute of Technology and Advanced Learning

Excerpts of the Research Report that were used to stimulate discussion at the Roundtable:

- appear in this report, and
- explain many of the reasons for improving the risk profiling process in Canada.

Three of the authors, Ms. Bessner, Mr. Brayman and Dr. Grable, observed some or all of the roundtable discussions, and were the speakers at a noon hour panel discussion moderated by the facilitator.

CONSULTATION THEMES

This consultation sought input regarding four major themes:

1. The appropriate scope of risk profiling
2. Tools and technologies to support risk profiling and the appropriate use of them
3. The appropriate process for high quality risk profiling, and
4. How to achieve successful changes in risk profiling scope, tools, technology and process.

WIDE RANGE OF PARTICIPANTS

The event involved a wide range of participants. A list of participants and observers appears as Appendix A.

TERMINOLOGY AND SCOPE

Throughout the course of the day, participants used the term “investment advisor” as a generic term to include investment advisors, salespeople, planners and those who carry out their work under a professional standard of care. Not all investment professionals are regulated by the OSC.

INPUT, NOT NECESSARILY A CONSENSUS

This event was designed to obtain stakeholder input, not necessarily to build a consensus among participants. Accordingly, the views expressed in the report are not necessarily shared by all participants.

Where participants expressed significant agreement or differences of opinion, those are noted.

REPETITION

Different discussion groups were assigned primary responsibility to respond to different questions. As a result, different groups discussing different topics occasionally arrived at the same conclusions. Accordingly, this report includes some repetition, which has been retained to demonstrate the extent to which a variety of participants in the financial services industry share a common view of the strengths and need for improvement of the risk profiling process.

CATEGORIZATION OF INPUT

Participants were asked for their input according to several categories and topics. Where input in response to a question better suited a different category, it is reported under the category it best suits.

A SUCCESSFUL EVENT

Participants actively engaged in five hours of discussion.

Of those who provided written feedback:

- 100% rated the event as “Excellent” or “Very good” in achieving its objectives
- 54% said “Excellent”
- 100% said that the event “Met” or “Exceeded” their expectations
- 67% said “Exceeded”.

SCOPE OF A RISK PROFILE

THE CURRENT STATE

Regarding the current state, the Research Report states that:[1]

a. Risk profiling often considers factors such as:

   Risk Assessment
   - Risk tolerance
   - Risk capacity (pensions, debt, flexibility)
   - Loss aversion
   - Risk preference
   - Risk need

   Demographic and Factual
   - Age
   - Annual income
   - Net worth
   - Stability of employment

   Knowledge and experience
   - Investment knowledge
   - Investment experience
   - Level of education
   - Current and prior vocation

   Goals or use of funds
   - Investment objectives
   - Time horizon
   - Specified goal
   - Other uses of funds

b. There is widespread conflicting understanding and use of such terms by every stakeholder – regulators, advisors, solution providers and academics.[2]

c. The application of these factors is inconsistent and there is no academic consensus on consistent methodologies.

d. Almost all regulators are principles-based and provide little guidance on how a firm or advisor should arrive at the determination of risk, although all agree that an advisor's professional judgment is critical.

[1] Excerpts from the Research Report, in some cases paraphrased slightly, were chosen for discussion purposes.

[2] The Research Report established definitions for key terms that it discusses.

CONTENT OF A RISK PROFILE

To develop a reliable risk profile, what factors or information ought to be collected and considered (e.g. compared to those listed in section "a" on the previous page)? [3]

Participants were generally supportive and not critical of the scope of a risk profile as outlined in excerpt "a" of the Research Report (see previous page).

They were asked to identify additional factors to consider. Under demographic and factual factors, they suggested the following for consideration.

- mental capacity and health status
- liquid assets or net financial assets as a measure of the client's liquidity
- level and type of debt (which should be considered separately and not only as an element of net worth)
- special circumstances such as:
    - dependent adults such as sons, daughters or parents
    - 'special needs' children
    - uncertainty, such as in the case of current divorce proceedings
    - spousal or child support, which may or may not have a fixed term.

Some clients may require a separate risk profile at the account level, such as where they have different accounts for different purposes.

Some participants disagree that mental capacity should be a factor because it is beyond the competence of an advisor to evaluate. Conversely, there could be a requirement for the advisor to take specific action when the client's behaviour creates blatant doubt in the mind of the advisor that the client is capable of fulfilling the investor's role in the risk profiling process.

COLLECTION CHALLENGES

Describe the challenges that will be faced in gathering and analyzing such information.

Participants mentioned the following factors, each of which is described in greater detail, below.

1. the trade-off between thoroughness and simplicity
2. the quality of the client's diligence
3. the completeness and quality of the client's record keeping and document retention
4. the level of the client's self-awareness
5. the impact of the client's mood
6. the client's hesitation or refusal to provide information
7. the different needs of the holders of a joint account
8. the client's inadequate understanding of the KYC [4] process.

The challenge mentioned most often is how to achieve a balance between thoroughness and simplicity. The risk profiling process has to be thorough enough to consider all relevant factors and yet not be so complex or lengthy and time consuming that it disengages the client or leads to cursory or incomplete answers to important questions.

[3] Questions that appear for each topic are those that participants responded to in the discussion.

[4] "Know your client"

A second identified challenge is the client's diligence. Some clients may not be diligent enough to gather all the necessary information even when prompted by a checklist or questionnaire.

Third, the level of the client's self-awareness - such as what biases they may be applying - could affect the completeness and accuracy of their information and responses to questions.

Fourth, a client's mood - whether they are having a good day, a bad day or a great day - as they respond to questions that depend partly on their optimism, could unduly influence their responses.

Fifth, the more thorough the scope of the risk profile becomes, the more likely that some of the requests for information will feel invasive to the client who may respond by giving an incomplete response or no response at all.

Sixth, spouses or others who share a joint account may each have a different risk profile, which is a complicating factor in trying to develop a conclusive risk profile for the account that they share.

Seventh, the client may not adequately understand the KYC process and its intentions and therefore may not provide all of the information and according to why it is being requested. Similarly, the client may not appreciate the need to keep the risk profile up-to-date, particularly following a material change in their circumstances.

Eighth, the process of developing a risk profile, including the advisor's ability to skilfully dialogue with the client as part of the process (both of which are addressed later in this report), can have a significant effect on the quality of the outcome.

ROLES AND RESPONSIBILITIES TO ACHIEVE CHANGE

To achieve change and overcome the challenges, what should be the roles and responsibilities, if any, of the following?

Participants described the following roles and responsibilities of each of the parties:

Law [5]

Generally, the law and regulations are appropriate. It is very important that they be principles-based to provide sufficient flexibility for optimal risk profiling. Investors' assets and circumstances vary widely and restrictive laws and regulations could create an unworkable or invalid "one size fits all" approach. The KYC process must be scalable.

Regulators

Provide clear principles-based guidance.

Create and enforce a "best interests" standard.

Build a risk-profiling framework that is clear and also flexible.

[5] Participants interpreted "law" in this context in at least two different ways. Some interpreted this to mean the role of courts in interpreting securities laws. Others interpreted this term as referring to regulators who make the rules.

Fulfill a role in educating the public on the nature and significance of the KYC process and the fundamentals of risk.

Require continuous education for advisors on the interviewing and active listening competencies that are necessary to conduct a skilful and effective risk profiling interaction. There is a risk that an advisor may limit the risk profiling conversation to the scope of a questionnaire. The longer and more detailed the questionnaire, the greater there is risk that the advisor will merely use it as a script.

Some participants emphasize the role of continuing education for advisors while others place more emphasis on the initial education of advisors as they join the industry.

Firms

Develop, nurture and monitor a corporate culture of compliance.

Assess, and improve as necessary, systems of internal control.

Create effective tools for risk profiling. However, all the relevant competencies for creating tools such as questionnaires, including psychometrics and behavioural economics, may not reside within the firm. In such cases, the firm should identify and engage those resources externally.

Advisors

Advisors need to be aware of and ensure that they develop the competencies required to lead an effective risk profiling interaction. These competencies include the ability to develop and maintain the client's receptivity and confidence in the process throughout the risk profiling exercise.

Advisors also have a responsibility to educate clients on the different types of risk, especially the:

- risk of loss, and
- relationship between risk and return.

On the latter point, it is quite dangerous when a client misunderstands that intentionally taking on more risk necessarily results in a greater return.

Advisors should also educate clients on the nature and intended benefits of the KYC process and of the client's responsibility to proactively keep the risk profile up-to-date, such as by alerting their advisor of a material change in their circumstances.

Advisors also have somewhat of a responsibility to assess the client's ability to make sound risk profiling decisions, or at least to respond to anything they observe that suggests inability or insufficient ability to perform the client’s role in risk profiling.

Academics and researchers

Academics and researchers have a role to conduct and disseminate unbiased research and to assess and validate risk-profiling practices.

They also have a role to help develop questionnaires and other risk profiling tools, and in particular contribute expertise in areas such as behavioural economics that may not reside within firms or be common across the financial services sector.

Advocacy organizations

Clients' interests are the interests of investor advocacy organizations, which have a role to:

- provide information or tools that will help the client contribute to accurate risk profiling, and
- identify and communicate best practices.

Clients

Clients are responsible for:

- being actively involved in the risk profiling process
- investing sufficient effort and due diligence to contribute to a successful result
- being candid
- providing full disclosure
- applying due diligence and gathering complete and accurate information
- proactively ensuring that their risk profile is up-to-date and reflects current life circumstances, and
- continuously considering and improving their level of financial literacy.

Others

Certification providers have a responsibility to develop and assess candidates' competencies regarding risk profiling based on up-to-date and appropriate standards.

School systems have a responsibility to develop financial literacy programs beginning at an early age.

TOOLS AND TECHNOLOGIES

Topic 1 addressed the scope of a risk profile. This section addresses various tools that can be used to assist in its development. A subsequent topic will address the process by which a risk profile is developed.

THE CURRENT STATE

Regarding the current state, the Research Report says:

a. A number of tools have been developed to assist in risk profiling, such as risk profile questionnaires (automated or non-automated)
b. A "fit for purpose" questionnaire or other tool, when required, encourages transparency, consistency and accountability for all concerned
c. There are situations where a skilled advisor can determine their client's risk profile without using a risk-profiling tool
d. A related issue is proportionality ("one size doesn't fit all"), such as:
   - Whether the size of a client's portfolio should influence the nature or amount of information gathered
   - Whether the frequency of transactions for a client should influence how frequently the advisor should update the client's risk profile
e. Regardless of whether a tool is used, the advisor must keep detailed records to show that they have received their client's consent about the level of risk required to achieve their objectives
f. Risk questionnaires are most widely used in retail channels using mutual funds and less so in wealth management and portfolio manager channels
g. Over 53% of respondents to an advisor survey indicated that between 76% and 100% of clients had completed a risk questionnaire, creating a strong dependency on the fitness of these tools
h. 48% of firms indicated that risk questionnaires are developed in-house; 36% said advisors could choose their own risk profiling methodology; only 11% who have questionnaires said they were "validated" in some way
i. While a good advisor uses "professional judgement", only one questionnaire reviewed for the Research Report provides the advisor with the opportunity to modify the questionnaire or add additional information that, in the opinion of the advisor, is material to the assessment of risk
j. 16.7% of questionnaires reviewed are "fit for purpose"
k. A poor tool is worse than no tool at all.

IMPROVEMENT REQUIRED

What improvements are required in the use of questionnaires and tools in the process of risk profiling? To what extent can or should they be mandated, standardized, etc.?

The following is input provided from the various discussion groups at the Roundtable.

Risk is not a standardized concept. Different people, even within our sector, have different definitions related to risk. Standard definitions would be an improvement.

Develop better and more consistent language and vocabulary that is client-centric and not “regulatory” or “investment jargon” oriented.

Risk profiling requires a broad-based holistic analysis combined with proficiency. The risk-profiling tool is just one element of arriving at an accurate risk profile.

At present, risk-profiling tools are inconsistent and are "a blunt instrument" both in terms of inputs and outputs.

Participants reached a strong consensus in support of standardization combined with flexibility regarding the inputs to get to standardized outcomes.

Apply available tools that exist today and that can generate better qualitative and quantitative information regarding the investment behaviour of clients.

Risk profiling should be flexible to include if appropriate influential or affected members of the investor's household.

Consider multiple questionnaires such as to adapt to:

- the sophistication and experience of the investor
- various individuals who may be involved in a client’s risk profiling process (relatives, etc.), and
- various time horizons (eg: younger vs. older investors).

As tools are improved, they should be tested for validity. This is where the academic community can make a considerable contribution.

PROPORTIONALITY

To what extent should proportionality be considered? What guidance should be provided on proportionality?

The following five criteria were suggested by some of the participants as guides in determining whether risk profiling should be greater or lesser:

1. the amount of assets available for investment relative to the client's total assets, including liquid financial assets as a proportion of total net worth
2. the absolute size of the investment
3. the probability of a negative outcome; the greater the probability, the more risk profiling should be done
4. the risk of unknown information or variability of inputs; for example, there is more variability in the risk profile of a 30-year-old who has dependents, potential rising debt and a long time to build up assets versus an 88-year-old, and
5. the simplicity or complexity of the investor's circumstances.

Another aspect of proportionality is whether and when to expand the inquiry based on the input it generates. For example, the advisor should expand risk-profiling efforts when the information is inconsistent or initially unreliable. It would be helpful to have a standard decision tree for the sector to guide advisors through such considerations.

It would be helpful if the industry could provide a cost-effective risk-profiling model that suits smaller accounts in the range of $50,000 to $200,000 of assets available for investment.

OTHER TOOLS AND TECHNOLOGIES

What other tools or uses of technology should be considered?

While participants were asked to describe and discuss specific tools and technologies, they adopted a much broader perspective and provided the following input.

Technology is a game changer because it facilitates the investor's empowerment and direct involvement in their investments and changes the relationship between the client and the investment advisor, thus increasing the client's responsibility in the relationship.

There are, and should be more, educational videos that investors can access at their convenience and view multiple times.

Technology allows the creation and use of "smart" documents that adapt to the client's sophistication and circumstances on a "real-time" basis in a process of continuous tailoring and customization.

Advances in technology democratize investing by providing the small investor with some of the same sophisticated tools previously available only to large investors.

Technology provides richer and more dynamic information such as tracking and analyzing real-time investor behaviour, both of the individual and across cohorts, compared to relying on traditional point-in-time surveys. This results in higher quality and more objective baseline information, which requires a higher level of proficiency of the advisor in using that information to inform subjective decision-making.

Technology enables the investor and advisor to exchange information about the investor in advance of a meeting and, for example, makes it possible for the advisor to make a decision much earlier in the process that this particular investor is not part of the advisor's target market or, for other reasons, is someone that the advisor cannot or should not assist.

The availability and application of artificial intelligence may be not very far in the future.

Technology, including productivity tools, can play a vital role to appropriately enhance the extent and quality of risk profiling without a corresponding increase in the amount of client and investor time and "paperwork" in the process.

CIRCUMSTANCES FOR USING QUESTIONNAIRES AND OTHER TOOLS

Excerpt “b” from the Research above describes the benefits of questionnaires and other tools, while excerpt “c” indicates that they are not required in all circumstances. When should they not be required?

Participants generally agreed that a discussion of the investor's goals is crucial. Some form of questionnaire or frame for the discussion is always needed, while the extent and complexity of the tool should be appropriate for the client's circumstances.

ROLES AND RESPONSIBILITIES TO ACHIEVE CHANGE

To achieve change, what should be the roles and responsibilities if any, of the following?

Participants described the following roles and responsibilities of each of the parties:

Law [6]

Establish minimum standards of risk profiling and use of tools and technologies through appropriate combination of laws, regulations and principles.

Regulators

In addition to enforcing minimum expectations and standards, regulators can contribute to the development of common definitions of concepts that relate to risk.

Firms

Educate advisors on the minimum expectations and standards and the proper and skilful use of risk profiling tools and technologies.

Advisors

In addition to buying into, supporting and complying with minimum expectations and standards, advisors have a responsibility to apply a proper and consistent overall process for risk profiling, although adaptable to different clients' circumstances.

Academics and researchers

Academics and researchers can help identify best practices, provide cost-benefit analyses of various tools and technologies, and contribute to ensuring tools' validity.

Advocacy organizations

Investor advocacy organizations have a responsibility to promote investors' interests and provide thoughtful leadership on their stakeholders' behalf.

Clients

Clients have the initial and crucial responsibility to provide complete and accurate information about themselves, their goals, tendencies and circumstances. It is important that they understand this responsibility and the importance of keeping their information up-to-date as well as to not respond to any questionnaire or framework in a cursory manner.

[6] Participants interpreted "law" in this context in at least two different ways. Some interpreted this to mean the role of courts in interpreting securities laws. Others interpreted this term as referring to regulators who make the rules.

They have a responsibility to educate themselves which can be increasingly facilitated through various means, including videos available on the Internet.

All

All of these constituent groups have a responsibility to contribute to the development and dissemination of and to apply best practices.

RISK PROFILING PROCESS

THE CURRENT STATE

Regarding the current state, the Research Report says:

a. Academic research has shown that clients are not bad, but not great, at predicting their own behaviour with respect to risk

b. In Canada … advisors cannot delegate responsibility for determining risk to clients or to anyone else

c. A good advisor uses "professional judgement" to combine objective and subjective or emotional factors to determine a client's risk profile

d. It is often difficult for a client to truthfully and completely answer the questions in a questionnaire.

ELEMENTS OF THE PROCESS

To achieve effective risk profiling, what should be the elements of the risk profiling process between client and advisor, including the consideration of the results of a questionnaire or other assessment tool? What is the role of the firm in this process, if any?

Participants in this Roundtable offered the following as input.

The Research Report says, "A poor tool is worse than no tool at all". Similarly, a tool that is not supported by a proper and robust process is of little value.

Suitability is the responsibility of the firm and the advisor. Accordingly, the design of the risk profiling process is the responsibility of each firm. However, there should be a defined and consistent standard for the risk profiling process that is applied and enforced across the industry that includes minimum standards for the nature and reliability[7] of the information provided by the client.

The process should recognize and make provision for the facts that:

- the investor cannot be forced to read and absorb information that the advisor and the firm provide; for example, the process should require that the advisor test the investor's understanding of crucial concepts
- investors can make decisions that are irrational and that are not necessarily in their own best interests, and
- there is a broad range of knowledge, skills and experience among investors; the process should recognize and adapt rather than be designed solely to suit the capabilities of a "typical" investor.

Regarding inconsistencies or irrationality among a client's answers and inputs, the process should provide advisors with guidance as to their role and responsibility to challenge the client as opposed to accept such responses at face value. For example, an older investor who does not have a lot of savings may unwisely seek high-risk investments in an effort to "catch up" their portfolio to a level that will properly fund their retirement.

Similarly, and as mentioned previously, a client may perceive that an increase in the risk of investments necessarily delivers a proportionate amount of increased returns.

[7] Reliability includes providing third party evidence such as a T4 or income tax assessment.

Also, the process should address the advisor's role and responsibility, if any, to override the investor's conclusions. While it may be appealing to allow the advisor to override the investor as a way to protect investors from themselves, evidence from the enforcement process indicates that overrides are often used by advisors to increase the level of risk over and above what the client requests. Any right of override should be supported with a robust process, guidance and enforcement to ensure that it is applied wisely and properly.

The risk profiling process should always require a person-to-person dialogue and discussion between the advisor and investor such as in person, via telephone or by Skype, etc.

The process should build in time for client reflection. For example, it should require that the client receive, consider and reflect on information sent by the advisor in advance of a meeting. Some clients may resist this where they want to minimize the amount of their time and involvement in the process.

As mentioned earlier, it is important that the sector develop common and easily understandable definitions of all of the relevant risk concepts.

The process should be based on a defined methodology that addresses the risk of bias, such as how to frame questions, asks the same questions differently and tests for consistency of responses, all based on the latest available behavioural science.

Behavioural factors include:

- the client's perception of how risky the markets are, and
- the accuracy of the client's self-assessment of risk appetite, such as the difference between the client's perception of risk in the abstract (when chatting generally about an investment) and in reality (when signing a contract to actually purchase it).

It is important that the client, not the advisor, complete the questionnaire to prevent an inadvertent changing of the messaging in the questionnaire completion process.

CHANGES IN TECHNOLOGY

How might changes in technology improve, or alternatively threaten, the effectiveness of the process?

Participants indicated that technology has the potential to improve:

- the education of clients
- data-at-a-glance for clients and firms
- the application of standardized concepts and definitions (once they become standardized)
- the best use of the client’s time in the risk-profiling process
- oversight through:
  - enhanced access to client information
  - the application of data analytics to assess risk and compliance and identify systemic issues across the sector.

IMPROVEMENT REQUIRED

What changes should be made to improve the process for risk profiling?

Participants' suggestions include:

- minimum standards and expectations, including the requirement that firms provide an objective[8] "sober second look" at risk profiles that are triggered by defined "red flags"
- client-centric definitions and vocabulary
- education of investors, including their general financial literacy, and
- the sophistication and skill of advisors to conduct risk profiling conversations and assess the reliability and implications of the information that clients provide.

CHALLENGES

Describe the challenges that will be faced in trying to make such changes.

According to participants, key challenges include:

- clarifying the primary purpose of risk profiling. Is it primarily to:
  - help the client to make proper investment decisions, or
  - avoid litigation?
- how the sector will best balance privacy with duty of care for clients, especially in the midst of increasingly robust privacy laws
- how to strike an appropriate balance between the professional's roles of:
  - salesperson and advisor
- increasing clients' understanding of their role and responsibilities in the risk profiling process.

ROLES AND RESPONSIBILITIES TO ACHIEVE CHANGE

To achieve change and overcome the challenges, what should be the roles and responsibilities, if any, of the following?

Participants described the following roles and responsibilities of each of the parties:

Law

The role of law can be a bit of a wildcard because much of it is driven by case law.

Nonetheless, standards for risk profiling need to be improved.

Regulators

As mentioned, regulators are responsible for the development and enforcement of minimum expectations and standards, including the standards of the education of advisors.

[8] By "objective", what is meant is someone other than an advisor who is not rewarded in any way based on the outcome of the profile.

Firms

Firms have a role and responsibility for active intervention (such as, but not limited to, the "sober second look" mentioned earlier) to create positive change and make sure that advisors support and help achieve necessary change.

Advisors

Advisors have a responsibility to keep up with current standards, including the development of competence in addressing behavioural aspects of investing and the ability to manage conflict.

Academics and researchers

Academics and researchers can contribute to:

- developing and verifying the validity of standards, tools and technology, and
- education, including the standards that are set and the quality of education that is provided to advisors.

Advocacy organizations

Advocacy organizations, particularly investor advocates, can contribute significantly to the improvement of financial literacy.

Clients

Clients have responsibility for:

- their own financial literacy, including:
    - understanding:
        - the purpose and intended benefits of the risk profiling process
        - their role and responsibility within that process
- keeping their risk profile up to date to reflect material changes in circumstances or goals, and
- their own due diligence as they carry out their role in the process.

THE PATH FORWARD

The fourth and last topic of this Roundtable was on how to improve risk profiling in Canada.

THE PATH FORWARD

Overall, describe a path forward, in the short and long term, to achieve successful change.

There was a strong consensus among participants that achieving improvement is both necessary and complicated. Specifically, they suggested the following steps, about which there was strong agreement.

From the outset, stakeholders in our sector should work together to develop an holistic response to the challenges we face rather than our traditional approach of silo-based solutions developed according to segments of the sector or types of investments.

It is critically important to consider the need for and develop all constituent groups' understanding of, and buy-in to, the types of improvements that are needed. In this regard, a significant pipeline for successful change is education.

Part of the challenge is to change mindsets regarding the risk profiling process, particularly within the firms, away from viewing it as a necessary evil. Risk profiling should be viewed as a foundational element of the optimal relationship between the client and advisor.

As mentioned often, precise, client-centric, common definitions of all of the relevant risk concepts need to be developed and applied.

Objective standards of "fit for purpose", such as in the case of a questionnaire, are required.

The compensation model for advisors may be inconsistent with effective risk profiling in the best interests of the client. The compensation model should be reviewed.

In parallel to enhancing the quality and robustness of the risk profiling process, use technology, particularly productivity tools, to streamline the process and make best use of the client's and advisor's time to do it right.

Having more cross-sector conversations like this Roundtable would be very helpful.

ROLES AND RESPONSIBILITIES

Consistent with that path, what should be the role and responsibilities of each of the following in the change process?

In addition to points raised in previous sections, participants mentioned the following roles in the path for change:

Firms

Firms have a responsibility to:

- develop, nurture and enforce a culture of compliance
- be more disciplined in their choice of the clients they accept

- emphasize the need for a quality conversation and an advisor's active listening rather than the mere necessity to get through a questionnaire and tick the boxes, and
- provide advisors with sufficient time and other resources to complete risk profiles properly.

Advocacy organizations

When investor and industry advocacy organizations see the need for change in the industry, they should continue to communicate with regulators proactively.

Industry groups may have an important role to come together to develop common categories of investments according to their level of risk. For example, it may be very beneficial for investors if common investments were classified in more detailed risk categories and where these classifications have earned the broad support of the industry.

Other

OBSI (Ombudsman for Banking Services and Investments) may be able to contribute insights about trends across the sector that can help regulators and industry identify best practices.

RESEARCHERS' COMMENTS

During the lunch hour, three of the Research Paper authors took part in a panel discussion moderated by the facilitator. Questions focused on what surprised them during their research, particular challenges in meeting investors' needs, and what they believe is the most important aspect of risk profiling to change.

The following are highlights of researchers' comments that arose during the panel discussion.

AS YOU CONDUCTED YOUR RESEARCH, WHAT SURPRISED YOU OR CAUGHT YOUR ATTENTION?

There are relatively few researchers examining investment risk profiling at the household level.

Perhaps the biggest surprise was, despite the industry's involvement in looking at this subject for years, there is so much more that we don't know than we had realized.

For example:

- *we cannot find academic evidence anywhere (in the world) that indicates whether an improved risk profile can lead to improvements in the client's behaviour[9] or investment outcomes, partly because the industry has not provided the data that academics and researchers would need to examine that question, and*
- *when our attention proceeds beyond risk tolerance, risk assessment and behavioral pieces to also include risk need, risk capacity, etc... we cannot find any academic research as to what proportion of each of these factors leads to an accurate overall risk profile.*

So here we are trying to establish risk-profiling standards without the evidence we would like to have to support us in these efforts.

Suitability is very complicated and challenging, even more so than some of us understood. We have a long road ahead of us to really get advisers to dig into, fully understand and help to address these issues.

The research confirms the complexity of developing effective questionnaires and heightens an understanding of the importance of behavioural factors in the gathering and proper analysis of risk related information.

The Research Report and the conversation today at this Roundtable refer to the lack of common definitions of the fundamental concepts of risk profiling. Indeed, early in today's discussion, we heard examples of terms used incorrectly or incorrectly used interchangeably. This is not unusual. It is common to witness the misunderstanding or misuse of fundamental risk profiling concepts even at the most significant and prestigious industry conferences and conventions.

As far as we know, the only paper that defines most of these terms is one Dr. Grable wrote to address this need.

DESCRIBE SOME OF THE SPECIFIC CHALLENGES IN SERVING OUR CLIENTS

There is general skepticism in the industry that you can use a questionnaire or series of questionnaires to accurately assess a client's attitude. By contrast, evidence in the academic community says the opposite.

[9] An example of potentially counter-productive investor behaviour is to instinctively crystalize losses in a market downturn.

Similarly, there is evidence that investment advisors tend to overrate their ability to achieve their clients' financial well-being based on the volume of their assets under management. For example, many believe that a large volume of assets under management is a sign that they manage assets well, which in turn, indicates that they deserve a larger volume of assets to manage. Accordingly, many do not see the need for a questionnaire or process to supplement their professional judgment in serving their clients.

Even for those who have confidence in the benefits of process and questionnaires, it is unclear:

- *how best or to what extent to integrate these with the advisor's professional judgement, and*
- *how best to apply professional judgement without bias.*

Even where the client has an excellent risk profile and investment recommendations that reflect it, there remains the "say/do gap", which is getting the client to do what they say they will, which includes periodically updating their profile and rebalancing their portfolio.

There may be situations where the client's current "risk need" cannot be met. For example, a client may desire a "riskless" investment (which many believe does not exist); nonetheless, the client's "risk need" remains. Accordingly, the client and advisor can then get into a conversation about "necessary risk". This serves the client where the conversation is designed to try to match the client with the most appropriate available investment. It does not serve the client where the advisor uses it to steer the conversation to simply achieve a sale.

Today, we face many investors at or near the end of their careers whose "risk need" may not be possible to fulfill because they have accumulated too few assets and have too little time to bring the amount of those assets up to a level that will match their need.

The focus of our research was on risk profiling, which is a mere subset of suitability. There is also the need to properly evaluate the risk associated with assets as part of the process of matching assets to risk profile. All of these are elements of properly serving clients and, as said; only risk profiling was the subject of our examination.

What is an advisor to do when the client looks at the overall risk profile and doesn't recognize themselves in it, concluding, "But that's not me"? The advisor faces the challenge as to the extent to which that reaction is:

- *the victory of fairly objective and rigorous analysis over the client's own misperceptions or low level of self-awareness, versus*
- *the benefit of the client's knowledge of self and overall use of intuition to put the overall risk profile conclusion to a reliable "common sense test".*

Again, the client's behaviour and what they do with the risk profile and investment advice is a significant factor. Behavioural issues include risk perception (how risky are the markets?) and risk composure (not panicking).

Clients have the ability to overrule their own risk perception and choose some investments that are outside of their own comfort zone to better meet their risk need. This can be a helpful or harmful element of the risk profiling process depending on how thoughtfully it is performed.

A broader need is to address the widespread inherent tension between the professional's role of advisor and salesperson. Clients are best served by the professional acting as an advisor.

All industry solutions and improvements must apply to all types of economic performance, such as varying levels of growth, interest rates and inflation.

PLEASE PUT THIS ROUNDTABLE INTO PERSPECTIVE

Having read the Research Report and invested a day in this Roundtable to discuss it, the participants in this room are likely among the most knowledgeable about risk profiling issues in North America.

We are not aware of any similar multi-stakeholder Roundtable on the subject of risk profiling that has been held anywhere in Canada or the United States.

WHAT IS THE MOST SIGNIFICANT ASPECT OF RISK PROFILING THAT NEEDS TO CHANGE?

Examples include to:

- *improve advisor understanding and proper consideration of various sub-components of risk profiling*
- *move from a sales paradigm to one of gathering evidence to make investments in the client's best interests*
- *maintain the momentum in commissioning this type of research and roundtable, increase discussion and advisors' focus on what should be the ultimate purpose of a risk profile and*
- *provide (regulatory) definitions for some of the terminology mentioned above.*

CLOSING REFLECTIONS AND NEXT STEPS

CLOSING REFLECTIONS

Participants were:

- very impressed with the quality of the Research Report, and
- very pleased with the organized process that this Roundtable used to pull together a large and varied amount of information and make the best use of participants' time.

They describe some of their biggest surprises as:

- the complexity of the risk profiling issue
- that, to date, the industry has not developed a consensus on and solutions to the many issues related to risk profiling, including the basics such as to adopt and apply common definitions
- how aligned participants in this discussion are despite the complexity of the issue and participants' own varied interests, and
- that only 16.7% of risk profiling questionnaires are “fit for purpose”.

They conclude that some of the most important ideas that emerged from this Roundtable are to:

- foster a culture across the financial sector that risk profiling is primarily in the interests of the investor, not the advisor
- call upon regulators to:
    - standardize definitions
    - establish minimum standards, and
    - provide an overall risk profiling template or guiding approach.
- enhance education to achieve higher levels of proficiency among advisors in risk modelling, risk tolerance and how to competently conduct the risk profiling conversation with active listening and competent consideration of behavioural factors, and
- extend education beyond the transfer of knowledge to include the development of appropriate competencies.

NEXT STEPS

The IAP and OSC’s Investor Office will:

- report the summary of the Roundtable discussions to participants and other stakeholders, and
- consider further efforts to improve risk profiling.

Participants and Observers

Participants
Marshall Beyer - Senior Director, Canadian Securities Institute
Caroline Cakebread - President, Cakebread Associates Inc.
Noémie Corneau-Girard - Policy Adviser, Supervision of Intermediaries, Autorité des marchés financiers
Manny DaSilva - Chair, Association of Canadian Compliance Professionals
Shaun Devlin - Senior Vice-President, Member Regulation, Enforcement, Mutual Fund Dealers Association of Canada
Andrée Dion - Director of Compliance of Registered Firms, Autorité des marchés financiers
Margaret Franklin - President, BNY Mellon Wealth Management Advisory Services
Marsha Gerhart - Vice-President, Member Regulation Policy, Investment Industry Regulatory Organization of Canada
Neil Gross - former Executive Director, Canadian Foundation for Advancement of Investor Rights[10]
Alan Goldhar - Chief Investment Officer, Office of the Public Guardian and Trustee, Ministry of the Attorney General
Dan Hallett - Vice President & Principal, Highview Financial Group
Malcolm Hamilton - Senior Fellow, C.D. Howe Institute
Ralf Hensel - General Counsel, Corporate Secretary and Vice President, Policy, Investment Funds Institute of Canada
Michelle Hilscher - Associate, BEworks Inc.
Kelley Hoffer - Vice-Chair, Compliance & Legal Section, Investment Industry Regulatory Organization of Canada,
Marie-Claude Lepage - Chief Compliance Officer, BNY Mellon Wealth Management Advisory Services
Peter Matter - Vice President, Corporate Compliance, Raymond James Ltd.
Parham Nasseri - Manager, Investment Analysis, Ombudsman for Banking Services and Investments
Kelly Peters - CEO and Co-Founder, BEworks Inc.
Cora Pettipas - President, National Exempt Market Association
Alykhan Surani - Policy Adviser, Ontario Ministry of Finance (observer)
Tom Trainor - Managing Director, Hanover Private Client Corporation
Adrian Weiss - Vice President, Portfolio Risk Management & Portfolio Manager of Record, Raymond James Ltd.
Joel Wiesenfeld, Mediator
Joan Yudelson - Vice President, Professional Practice, Financial Planning Standards Council

[10] Attended the Roundtable in his capacity as the Executive Director of the Canadian Foundation for Advancement of Investor Rights.

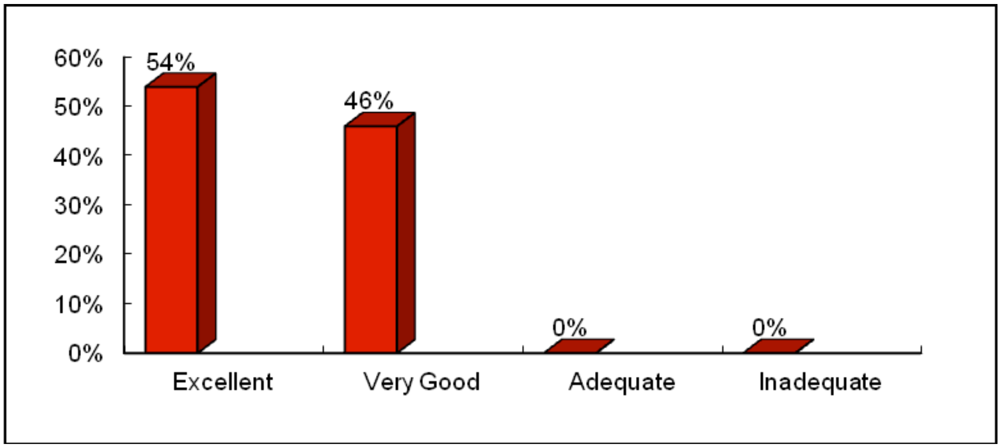
Researchers
Ellen Bessner - Partner, Babin Bressner Spry
Shawn Brayman - President and CEO, PlanPlus Inc.
Dr. John Grable - Professor, University of Georgia
Investor Advisory Panel (observers)
Ursula Menke, Chair
Letty Dewar, Member
Harold Geller, Member
Ken Kivenko, Member
Louise Tardif, Member
Ontario Securities Commission Staff
Maureen Jensen - Chair (observer)
Leslie Byberg - Executive Director (observer)
Tyler Fleming - Director, Investor Office (observer)
Denise Morris - Manager, Policy, Investor Office (observer)
Joseph Della Manna - Senior Accountant, Market Regulation
Shauna Flynn - Senior Investigation Counsel, Enforcement
Debra Foubert - Director, Compliance and Registrant Regulation
Katherine Kruk - Senior Policy Advisor, Office of Domestic and International Affairs
Maye Moufta - Senior Legal Counsel, Compliance and Registrant Regulation
Facilitator
Scott Ferguson, *Progress Consulting*™

RESULTS OF PARTICIPANTS' EVALUATIONS

24 Respondents

1. Overall Evaluation

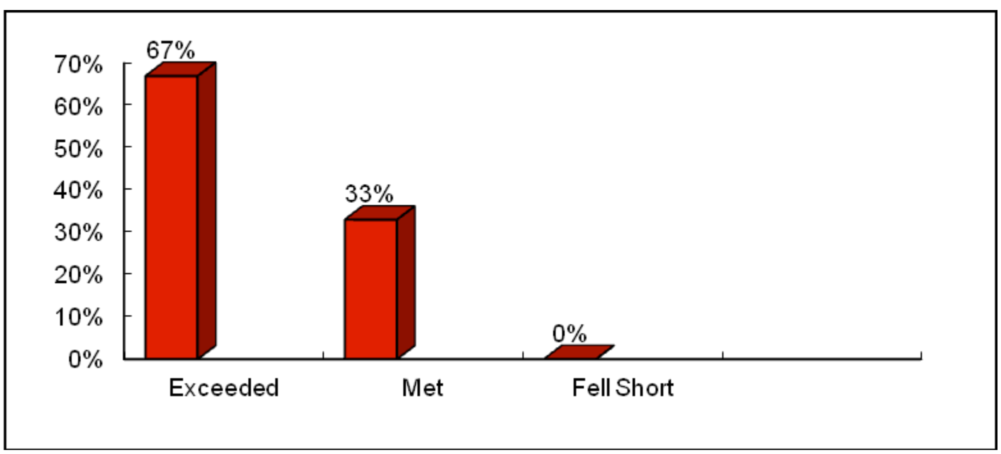
How was this Roundtable in meeting its stated objectives?



100% said "Excellent" or "Very Good". 54% said "Excellent".

2. Compared To Expectations

How did this Roundtable compare to your expectations?



100% said the Roundtable "met" or "exceeded" expectations. 67% said "exceeded"

Summary Of Participant Evaluations, *Continued …*

("√" indicates multiple submissions of the same feedback)

What contributed to the success of this workshop?

Quality of a very interesting Research Report

Presence and involvement of the Research Report authors

OSC's support of this initiative; without OSC's active role, individual constituent groups would not make as much progress towards common goals and better outcomes

Diverse group of participants and variety of perspectives; a highly professional and well-rounded group with significant experience and relevant backgrounds √ √ √ √ √ √ √

Participants were very disciplined to keep the discussion focused and on track

Active participation by all √ √

Participants are highly motivated to develop approaches, structures and models that best serve the public interest

Timely Roundtable for this particular topic

Well organized and structured √ √ √ √ √ √ √ √ √ √

An organized process based on clear roles and responsibilities, colour-coded papers and coaching on good process

Well-defined roles and responsibilities for a successful discussion

Timekeeping was excellent; we began and ended right on time √ √

Excellent use of our time

Great discussion questions to focus and engage people in the topics √

The discussion questions helped me prepare ahead and focused my attention on the key parts of the report

Right sized discussion groups where everyone had enough time to contribute √

Very focused √

A format that promoted an exchange of ideas

A helpful facilitator

Excellent facilitator √ √ √ √

Facilitator's ability to reduce a complex topic to make it easy to work with

What would have made this workshop more successful?

Somehow addressing definitions of risk so that we can work with a common set of terms [11]

I don't know. It is difficult to put together an accurate risk profile of clients who have no real appreciation of risk

Risk profiling in isolation is a difficult process and should be included in a broader review of the investment process

More panelists

Getting to the meat of the issues and debating it more

Occasionally, the interventions of the facilitator to keep us moving and on time and to get us through the agenda interrupted the conversation; not sure I have a solution for that

More detail ahead of the session regarding the mix of attendees

Note takers who are separate from participants

Consider distributing a list of participants with their contact information

Perhaps a bit shorter √

[11] FACILITATOR'S NOTE: The Research Report provides definitions for all key risk profiling terms that it uses