FinaMetrica

Risk Tolerance Profiling

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FinaMetrica
401K Solution

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Contents

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FinaMetrica 401K Solution

1. Introduction

The FinaMetrica 401k Solution can be used to recommend a specific portfolio from one or more sets of portfolios to a plan participant who is investing into a retirement savings plan.

The FinaMetrica 401k Solution is suitable for an advisor or institution with multiple 401k sponsors that wishes to provide limited advice to participants in an efficient and cost effective manner.

2. How the FinaMetrica 401k Solution Works

- Participants complete a FinaMetrica 12-question risk tolerance profile online via a link on the advisor's website.
- Advisor and plan sponsor will have access to participants' risk tolerance profiles managed under a single administrative account. Advisor with multiple plans will have access to risk tolerance profiles of all participants and all plans managed under a centralized administrative account.
- Results of the risk tolerance profile can then be linked to a suitable investment portfolio by the advisor utilizing FinaMetrica's portfolio mapping methodology. Mapped portfolios can then be distributed to participants for educational purposes.

IMPORTANT CONSIDERATIONS:

- In addition to risk tolerance, advisors should encourage participants to also consider their time horizon and risk capacity in regards to the recommended portfolio.
- In some cases participants may exhibit inconsistencies with regard to the way they have responded to certain FinaMetrica risk tolerance questions. If there are too many inconsistencies then participants will receive an "Inconsistency Alert" whereby the participant will be referred to the advisor for consultation.
- In thinking about their investment time horizon participants need to take into account the time between investing and when the portfolio is likely to be cashed out or withdrawn. Typically the shorter the period the more likely a participant should select a portfolio with a lower exposure to growth assets, such as shares and property.
- In assessing their risk capacity or capacity for loss participants should think about how much variation in value they might be able to accept and still meet their financial goals when the portfolio is likely to be cashed out or withdrawn. The lower the flexibility the more likely a participant should select a portfolio with a lower exposure to growth assets, such as shares and property. Typically those with specific financial obligations to meet should pay attention to their capacity for loss.

3. FinaMetrica 12-Question Risk Tolerance Profile

The 12-question risk tolerance profile scores risk tolerance on a 0 to 100 scale. It consists of:

- 12 risk tolerance questions,
- a Personal Risk Tolerance Report (Your Risk Tolerance Score, Your Risk Group, a Differences Summary, and possibly a Consistency Warning and often an Adjusted Risk Score which occasionally will result in an Adjusted Risk Group) and
- a Completed Risk Questionnaire report.

Where there are inconsistencies in the client's answers, the 12-question test uses an adjustment algorithm to adjust the Risk Group where necessary.

As noted above, some sets of answers are so inconsistent as to make algorithmic adjustment too difficult/ dangerous. To deal with this there is a consistency algorithm which is applied before the adjustment algorithm. If the answers are too inconsistent a Consistency Alert is included in the report. If they are not too inconsistent the adjustment algorithm is used to determine whether there should be an Adjusted Risk Score (and possibly Risk Group) in the report.

The 12-question risk tolerance profile uses five statistically determined risk groups.

Risk Group	Very Low	Low	Average	High	Very High
Score Range	<35	35 – 44	45 – 54	55 – 64	>64
No in Group	7%	24%	38%	24%	7%

The Risk Group descriptions have been developed by analyzing how those whose scores fall into a particular group typically answer the questionnaire. Five of the twelve questions have been considered in the analysis. These were selected on the basis of their utility in providing a general understanding of the Risk Groups.

4. Linking Risk Tolerance Scores to Portfolios

FinaMetrica's portfolio mapping calculates comfort zone score ranges for each of your portfolios. For example, the Prudent portfolios Comfort Zone is a risk tolerance score of 38 to 50. The table also provides Best Fit ranges for each of the portfolios. Essentially, these answer the question, "Given that I have these six portfolios from which to choose, how do I divide up the 0 -100 scale so that I can see, for any particular score, which portfolio best fits that score?"

		Risk Tolerance Score Ranges					
		Risk Comfort/Discomfort Zones for Each Asset Allocation					
Asset Allocation	**Growth Assets**	**Best Fit**	**Too Much Risk**	**Marginal**	**OK Risk**	**Marginal**	**Too Little Risk**
Conservative	0%	0 - 22	n.a.	n.a.	0 - 23	24 - 31	> 31
Cautious	20%	23 - 38	< 12	12 - 23	24 - 37	38 - 44	> 44
Prudent	40%	39 - 51	< 32	32 - 37	38 - 50	51 - 56	> 56
Balanced	60%	52 - 63	< 45	45 - 50	51 - 62	63 - 69	> 69
Growth	80%	64 - 81	< 57	57 - 62	63 - 78	79 - 92	> 92
High Growth	100%	82 - 100	< 71	71 - 78	79 - 100	n.a.	n.a.

You can use this information to help decide on which portfolio is suitable for each participant based on their risk tolerance. A sample guide on how to present this is shown on the next page. For more information, including the methodology upon which the table is based, advisors should refer to the Asset Allocation Mappings calculator and its Guide, which can be found under System Resources at www.riskprofiling.com.

5. Pricing

- An annual licensing fee of $990
- Plan fee of $10 per risk tolerance profile completed billed to advisor in arrears every six months
- Please refer to our terms and conditions that apply to this subscription:
  https://www.riskprofiling.com/Downloads/TERMS_AND_CONDITIONS_OF_USE_GENERAL_ADVISER_SUBSCRIPTION.pdf

5. Sample Educational Guide for Participants

FinaMetrica Risk Tolerance Score Mappings

The FinaMetrica comfort zones for #### portfolios are shown in the table below, where

- the Best Fit ranges divide the FinaMetrica 0 to 100 risk tolerance scoring scale across the portfolios, showing, for this set of portfolios, which is most appropriate for a particular risk tolerance score, and
- the Too Much/Marginal/OK/Marginal/Too Little score ranges provide score ranges for each of the portfolios considered in isolation and are the primary guide to whether a particular portfolio is suitable from a risk tolerance perspective.

Risk Tolerance Score Ranges

Risk Comfort/Discomfort Zones for Each Asset Allocation

Asset Allocation	Growth Assets	Best Fit	Too Much Risk	Marginal	OK Risk	Marginal	Too Little Risk
Conservative	0%	0 - 22	n.a.	n.a.	0 - 23	24 - 31	> 31
Cautious	20%	23 - 38	< 12	12 - 23	24 - 37	38 - 44	> 44
Prudent	40%	39 - 51	< 32	32 - 37	38 - 50	51 - 56	> 56
Balanced	60%	52 - 63	< 45	45 - 50	51 - 62	63 - 69	> 69
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High Growth	100%	82 - 100	< 71	71 - 78	79 - 100	n.a.	n.a.

Selecting a portfolio almost invariably involves having to make trade-off decisions to resolve conflicts between your situation, aspirations and resources. A key trade-off decision commonly confronted is between risk tolerance, time horizon and risk capacity.

Effective trade-off decisions can only be made when the elements of the trade-off have been separated, and can be clearly understood and compared. A useful start to this process is to assess whether the portfolio consistent with your risk tolerance will meet your needs as they fall due, taking into consideration your time horizon and the level of financial risk you can afford to take (your risk capacity).

In thinking about your investment time horizon you need to take into account the time between investing and when the portfolio is likely to be cashed out or withdrawn. Typically the shorter the period the more likely a you should select a portfolio with a lower exposure to growth assets, such as shares and property.

In assessing your risk capacity or capacity for loss you should think about how much variation in value they might be able to accept and still meet their financial goals when the portfolio is likely to be cashed out or withdrawn. The lower the flexibility the more likely you should select a portfolio with a lower exposure to growth assets, such as shares and property. Typically those with specific financial obligations to meet should pay attention to their capacity for loss.

There is often a gap between the level of risk which you would normally choose to take - your risk tolerance, and the risk associated with the return required to achieve your goals - your time horizon and the risk you can afford to take - your risk capacity. Please discuss this with your advisor to see whether there is a gap and how you can resolve it.

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