What constitutes professional judgment?

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CIFPS
Ottawa, May 31st, 2017

Shawn Brayman, President & CEO

- PlanPlus President & CEO
- 30 years experience in financial services
- BSc (Math, Computers), MES (Expert Systems)
- Chartered Financial Planner (Canadian Institute of Financial Planning)
- Winner of Journal of Financial Planning's 2007 "Financial Frontier Research Award"& several other awards
- 2016 winner of "Best Applied Research" at FPA Baltimore and CFP Board-Academy of Financial Services "Best Research Paper Award"
- International speaker on financial planning
- Past Board Member, Financial Planning Association (Denver)
- Member of Future of Digital Advice Working Group

FINANCIAL FRONTIERS AWARDS

What is professional judgment?

- Some examples from other professional
- A case study from our research
- Using this audience as a “laboratory”
- Looking at results from structured research
- Summary and next steps

GOTO https://www.surveymonkey.com/r/PlanPlus

What is professional judgment?

- Chartered Professional Accountants (see here)
  - a structured process by which preparers and auditors, with an appropriate level of knowledge, experience, and objectivity, can form an opinion
  - To specify principles that regulators might use in challenging preparers' judgments

College of Dieticians

- “Use your professional judgment”, “She exercised professional judgment“ or “In my professional judgment…” come up frequently
- careful thought based on evidence, experience, knowledge and skills — to form opinions and make good decisions about what should be done to provide safe, competent and ethical … services

Others

- Office of the Auditor General of Canada
- Ontario Teachers
- Engineering
- And, and and …

Question #1

If you went to 10 different doctors for the same aliment, to what degree should you expect the same basic diagnosis?

- Not at all
- 3 to 5 similar
- 6 or 7 similar
- 8 or 9 similar
- Same high level assessment

Question #2

If the same case is provided to 10 different financial planners, to what degree should we expect the same high level application of professional judgment?

- Not at all
- 3 to 5 similar
- 6 or 7 similar
- 8 or 9 similar
- Same high level assessment

Our case study today

- Based on OSC-Investor Advisory Panel sponsored research: *Current Practices for Risk Profiling in Canada and Review of Global Best Practices*

Why do we care?

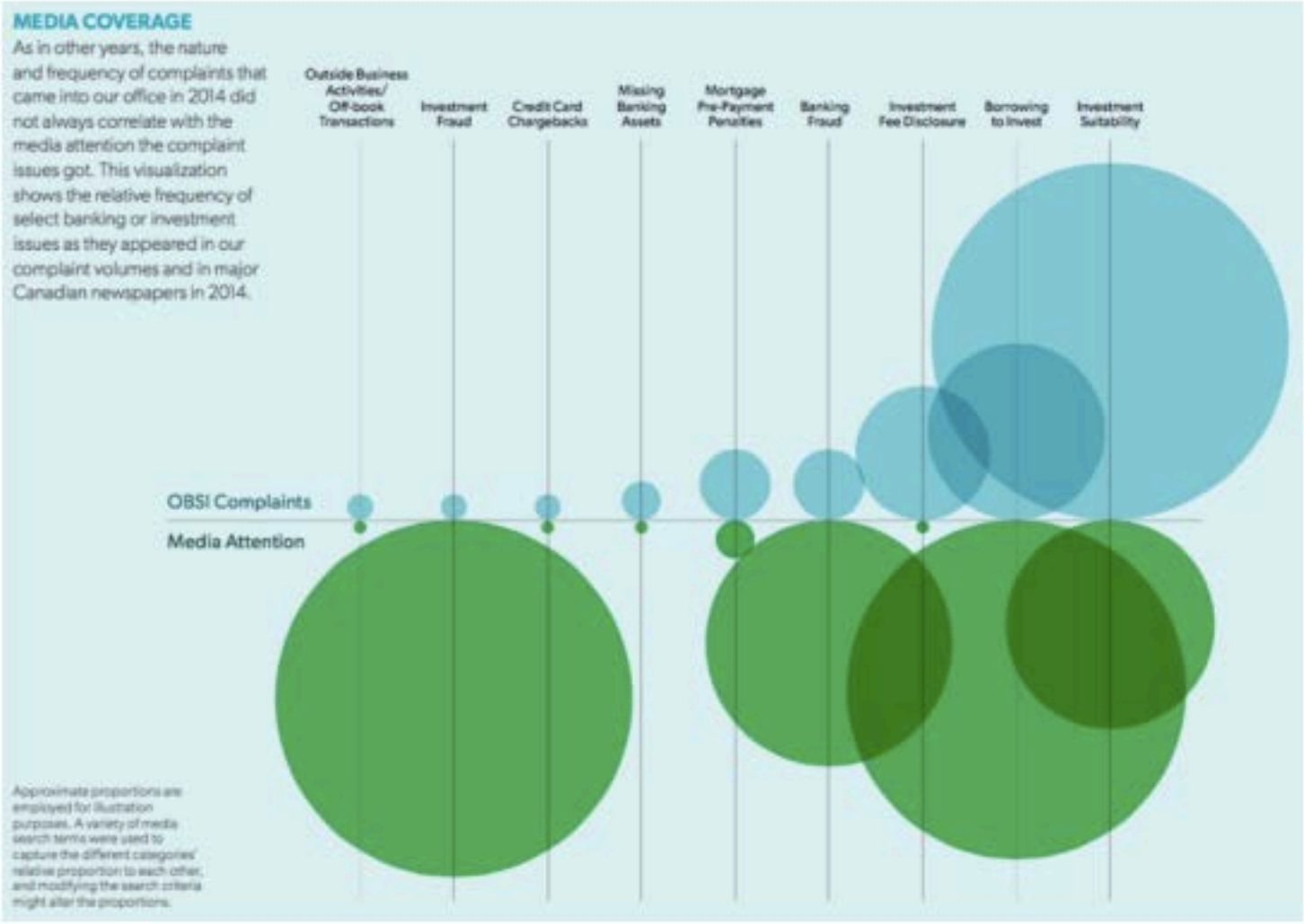
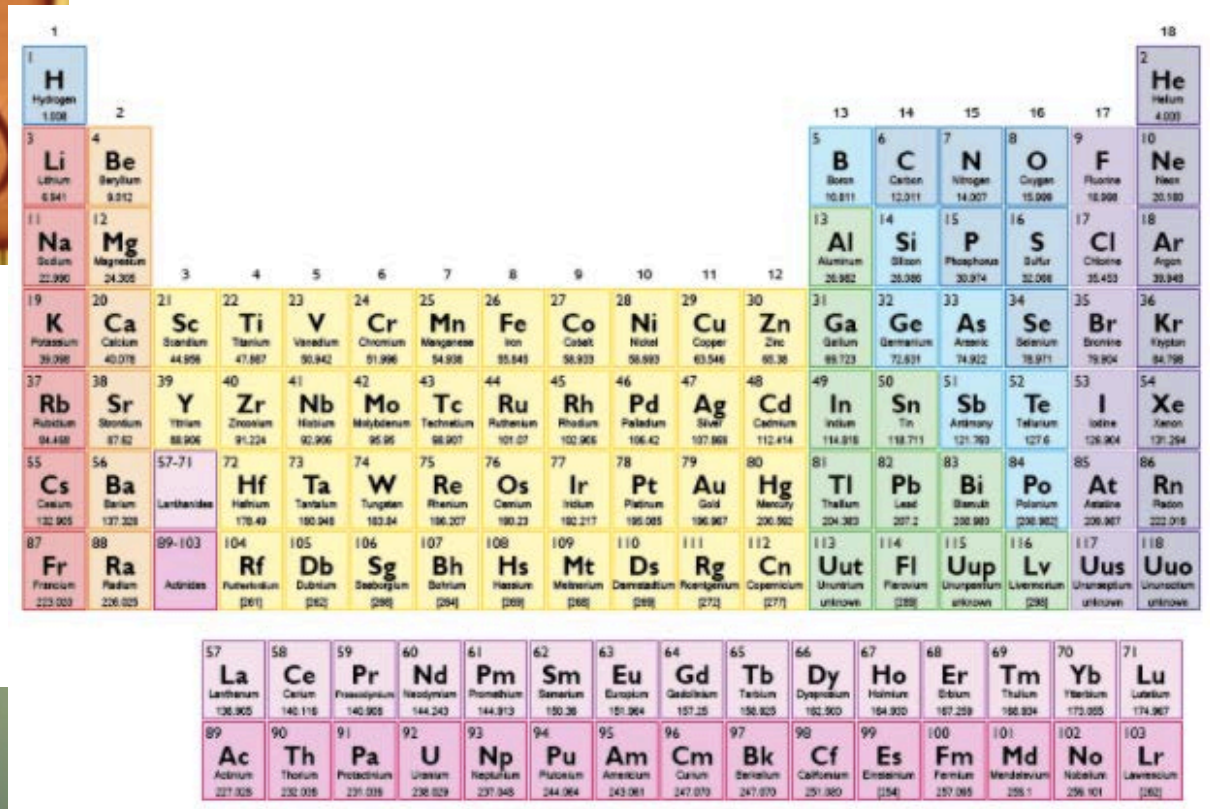


Figure 7: OBSI Disputes Source: OBSI's 2014 Annual Report.

What is…


1 H Hydrogen 1.008
2 He Helium 4.003
3 Li Lithium 6.941
4 Be Beryllium 9.012
5 B Boron 10.811
6 C Carbon 12.011
7 N Nitrogen 14.007
8 O Oxygen 15.999
9 F Fluorine 18.998
10 Ne Neon 20.180
11 Na Sodium 22.990
12 Mg Magnesium 24.305
13 Al Aluminum 26.982
14 Si Silicon 28.086
15 P Phosphorus 30.974
16 S Sulfur 32.066
17 Cl Chlorine 35.453
18 Ar Argon 39.948
19 K Potassium 39.098
20 Ca Calcium 40.078
21 Sc Scandium 44.956
22 Ti Titanium 47.867
23 V Vanadium 50.942
24 Cr Chromium 51.996
25 Mn Manganese 54.938
26 Fe Iron 55.845
27 Co Cobalt 58.933
28 Ni Nickel 58.693
29 Cu Copper 63.546
30 Zn Zinc 65.38
31 Ga Gallium 69.723
32 Ge Germanium 72.631
33 As Arsenic 74.922
34 Se Selenium 78.971
35 Br Bromine 79.904
36 Kr Krypton 84.798
37 Rb Rubidium 84.468
38 Sr Strontium 87.62
39 Y Yttrium 88.906
40 Zr Zirconium 91.224
41 Nb Niobium 92.906
42 Mo Molybdenum 95.95
43 Tc Technetium 98.907
44 Ru Ruthenium 101.07
45 Rh Rhodium 102.906
46 Pd Palladium 106.42
47 Ag Silver 107.868
48 Cd Cadmium 112.414
49 In Indium 114.818
50 Sn Tin 118.711
51 Sb Antimony 121.760
52 Te Tellurium 127.6
53 I Iodine 126.904
54 Xe Xenon 131.294
55 Cs Cesium 132.905
56 Ba Barium 137.328
57-71 Lanthanides
72 Hf Hafnium 178.49
73 Ta Tantalum 180.948
74 W Tungsten 183.84
75 Re Rhenium 186.207
76 Os Osmium 190.23
77 Ir Iridium 192.217
78 Pt Platinum 195.085
79 Au Gold 196.967
80 Hg Mercury 200.592
81 Tl Thallium 204.383
82 Pb Lead 207.2
83 Bi Bismuth 208.980
84 Po Polonium [209]
85 At Astatine 209.987
86 Rn Radon 222.018
87 Fr Francium 223.020
88 Ra Radium 226.025
89-103 Actinides
104 Rf Rutherfordium [261]
105 Db Dubnium [262]
106 Sg Seaborgium [266]
107 Bh Bohrium [264]
108 Hs Hassium [269]
109 Mt Meitnerium [268]
110 Ds Darmstadtium [269]
111 Rg Roentgenium [272]
112 Cn Copernicium [277]
113 Uut Ununtrium unknown
114 Fl Flerovium [289]
115 Uup Ununpentium unknown
116 Lv Livermorium [298]
117 Uus Ununseptium unknown
118 Uuo Ununoctium unknown
57 La Lanthanum 138.905
58 Ce Cerium 140.116
59 Pr Praseodymium 140.908
60 Nd Neodymium 144.243
61 Pm Promethium 144.913
62 Sm Samarium 150.36
63 Eu Europium 151.964
64 Gd Gadolinium 157.25
65 Tb Terbium 158.925
66 Dy Dysprosium 162.500
67 Ho Holmium 164.930
68 Er Erbium 167.259
69 Tm Thulium 168.934
70 Yb Ytterbium 173.055
71 Lu Lutetium 174.967
89 Ac Actinium 227.028
90 Th Thorium 232.038
91 Pa Protactinium 231.036
92 U Uranium 238.029
93 Np Neptunium 237.048
94 Pu Plutonium 244.064
95 Am Americium 243.061
96 Cm Curium 247.070
97 Bk Berkelium 247.070
98 Cf Californium 251.080
99 Es Einsteinium [254]
100 Fm Fermium 257.095
101 Md Mendelevium 258.1
102 No Nobelium 259.101
103 Lr Lawrencium [262]

What is Risk Profiling?

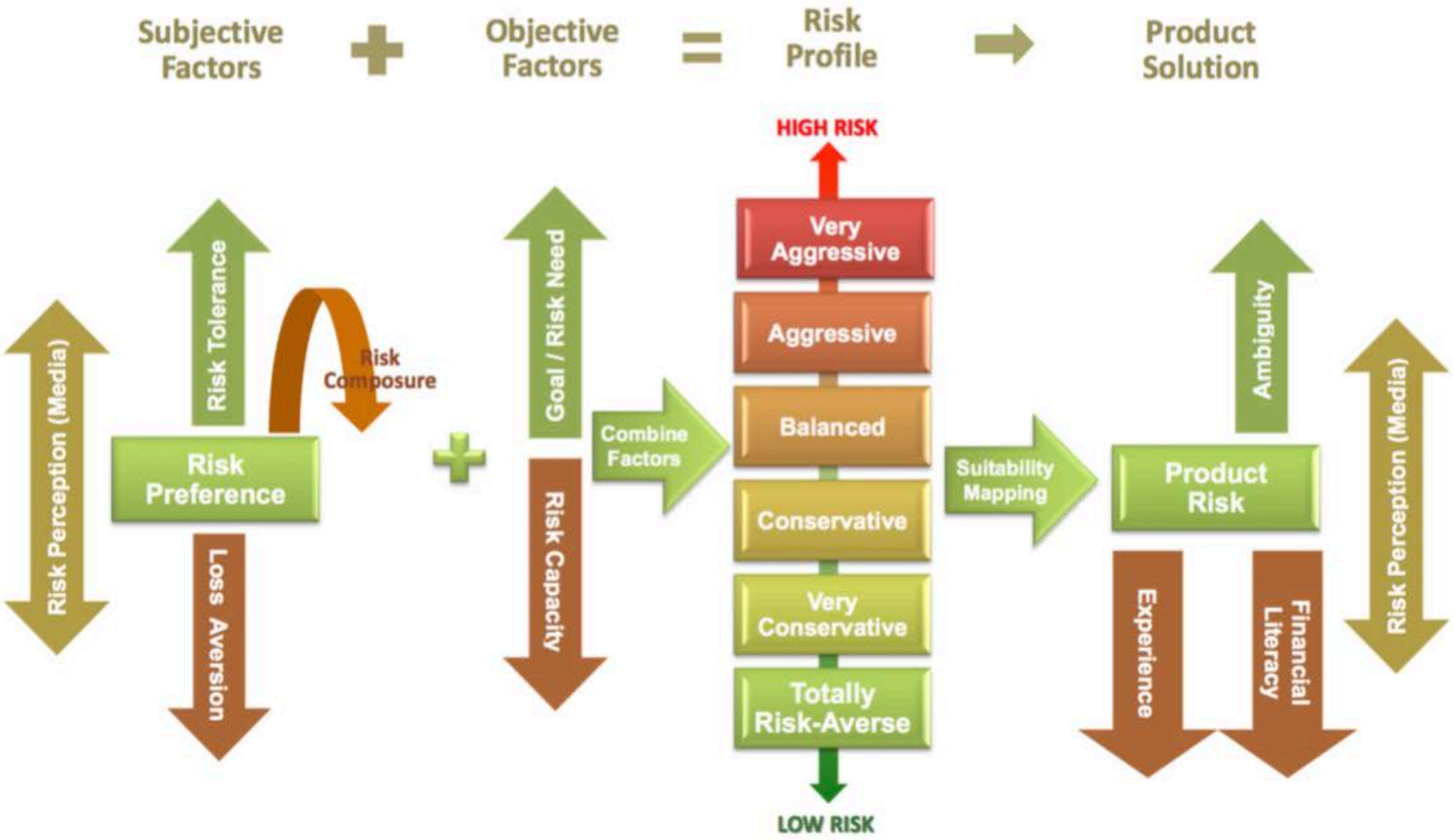


Figure 1: Visual Summary of Risk Concepts

What is important and how do we combine the factors?

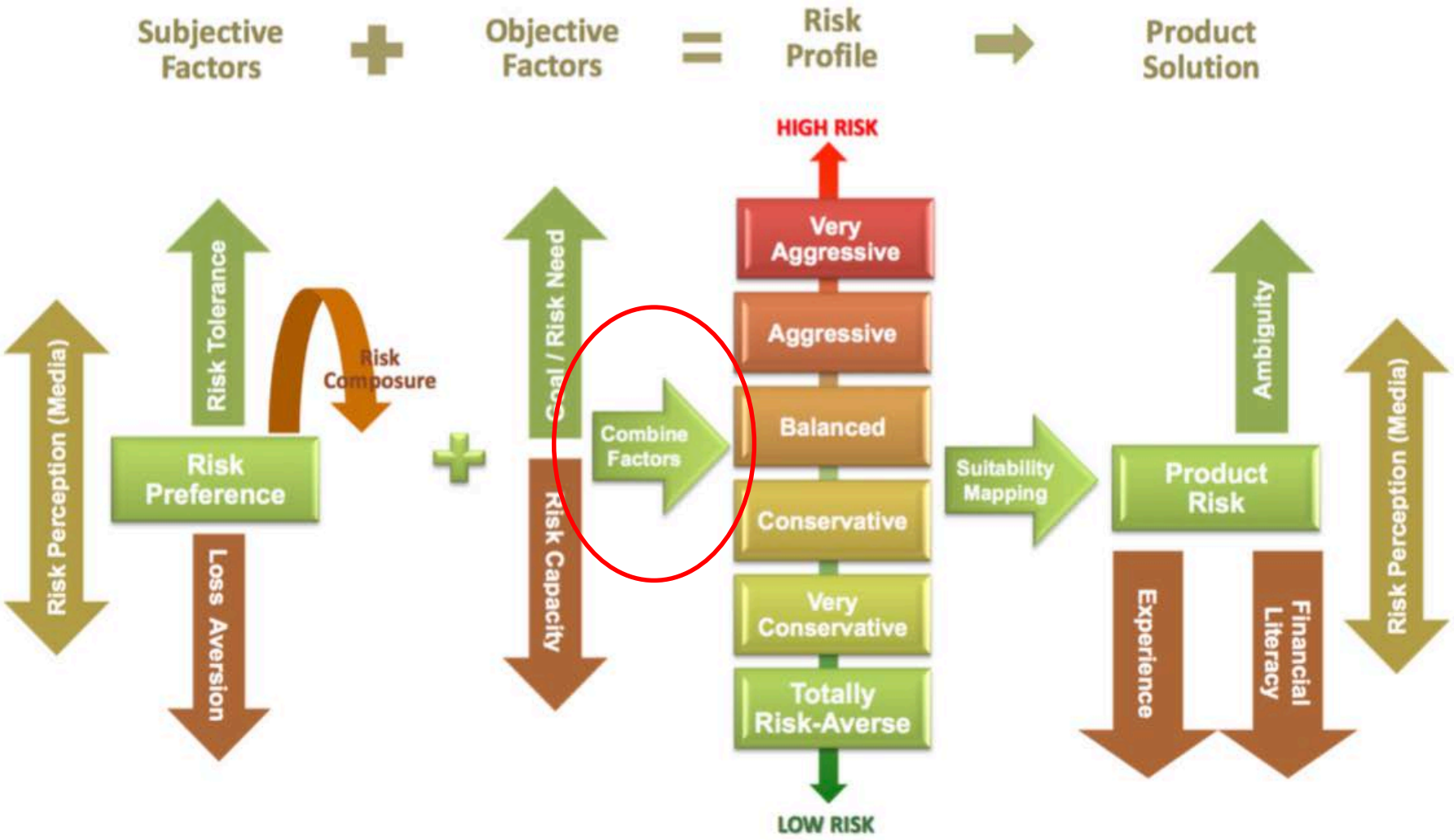


Figure 1: Visual Summary of Risk Concepts

Why is risk profiling important…

- Investing, as we all know
- Risk attitudes impact insurance
- Willingness to assume debt
- How we might think about our goals
- Other things???

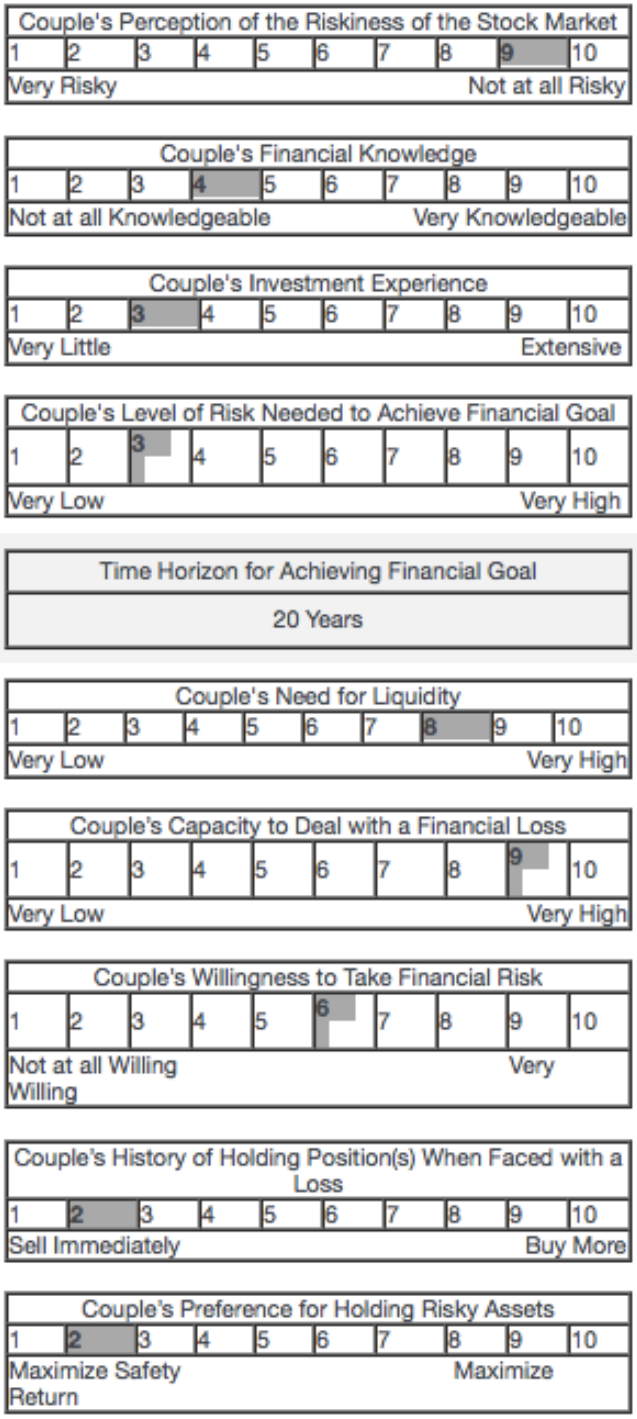
Research with University of Georgia

- A series of case studies sent to “thousands” of advisors (primarily planners) in several countries.
- Trying to access how professional judgment is applied by advisors.
- We will look at initial results later.

Question #3: What factors are most important to consider?

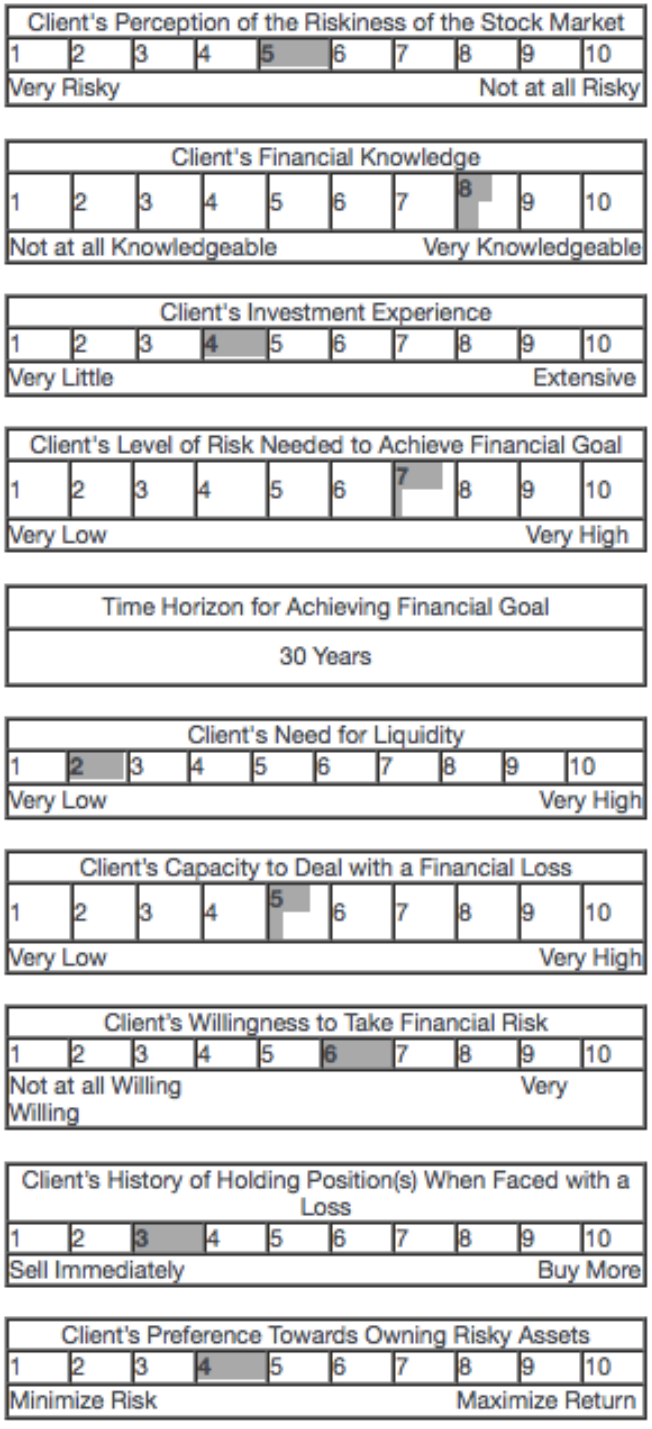
- Risk Tolerance – risk they feel they can take
- Loss Aversion – fear of loosing that they have
- Preference – what I prefer, not what I can live with
- Risk Capacity – what happens on the down side
- Risk Need – do they have enough money for their goals
  - Time Horizon – when do the need the money
  - Liquidity Needs – cash required from the portfolio
- Knowledge – do they understand what they are doing
- Experience – have they ever invested in equities before
- Risk Perception – what are the markets like today
- Risk Composure –subject to “knee jerk” reactions
- Something else?

Choices: Not important, Sometime, Crucial



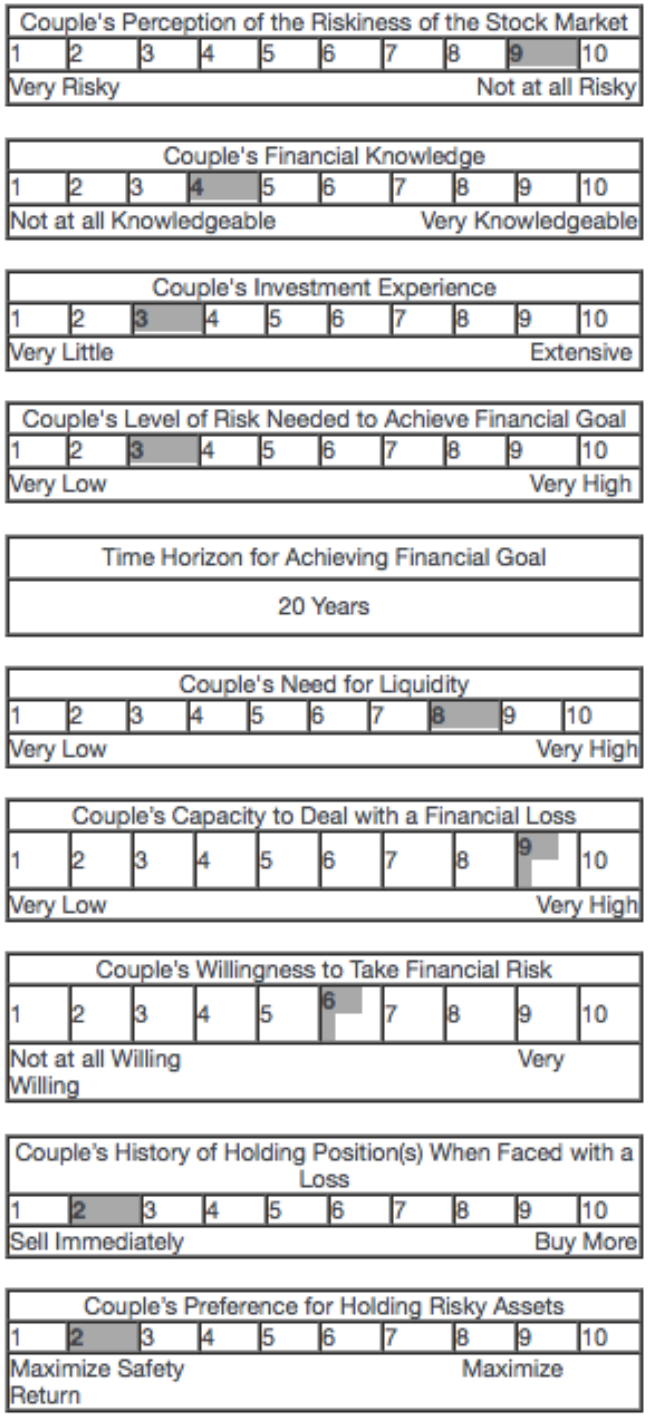
Scenario 1

- The client is a 35-year old single male employed as a high school teacher. The client owns a home and has a modest net worth. The client regularly saves between $5,000 and $7,000 per year in to a tax-deferred account for retirement.
- The client has a 30-year time horizon and average investing experience and knowledge.
- *Pick 3 most important factors*



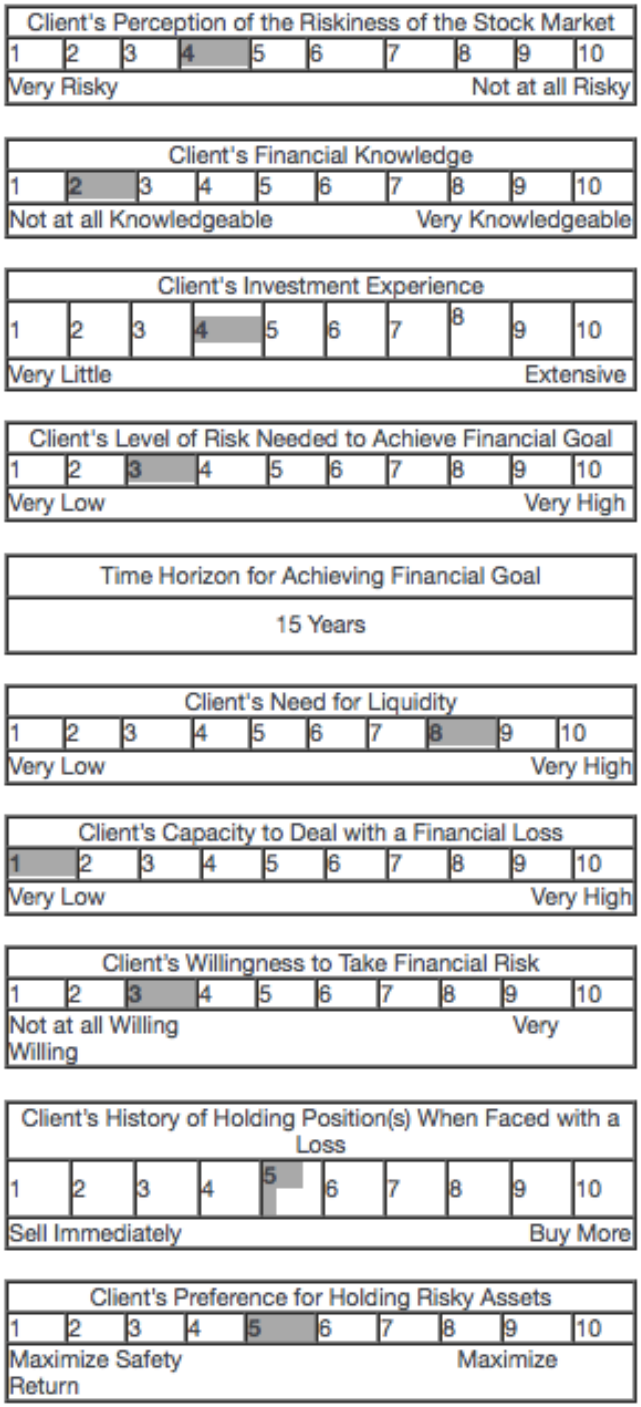
Scenario 2

- The client is a married couple. Partner 1 is 68 years old. Partner 2 is 66 years old. They are both retired. They own their home and have a net worth of about $1.5 million.
- Client has a 15-year time horizon and less investing experience and knowledge.
- *Pick 3 most important factors*



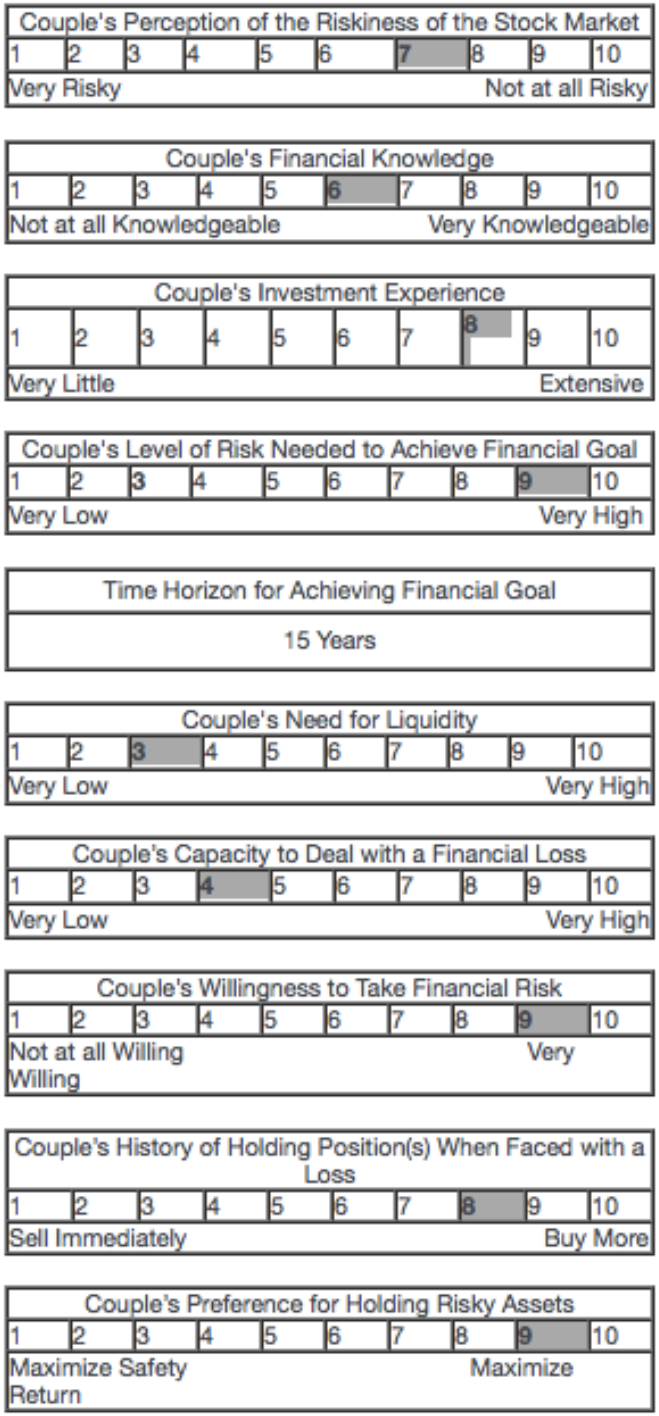
Scenario 3

- The client is a married couple. Partner 1 is 45 years old. Partner 2 is 57 years old. They are both employed professionally and have a high combined family income. They own their home and have a net worth in excess of $1 million. They would like to build a retirement portfolio consisting of taxable and tax-advantaged investments.
- Client has a 20-year time horizon and a low level of risk tolerance and knowledge.
- *Pick 3 most important factors*



Scenario 4

- The client is a married couple. Partner 1 is 68 years old. Partner 2 is 66 years old. They are both retired and own their home. They have a net worth of about $1.5 million.
- Client has a 20-year time horizon and a low level of risk tolerance and knowledge.
- *Pick 3 most important factors*



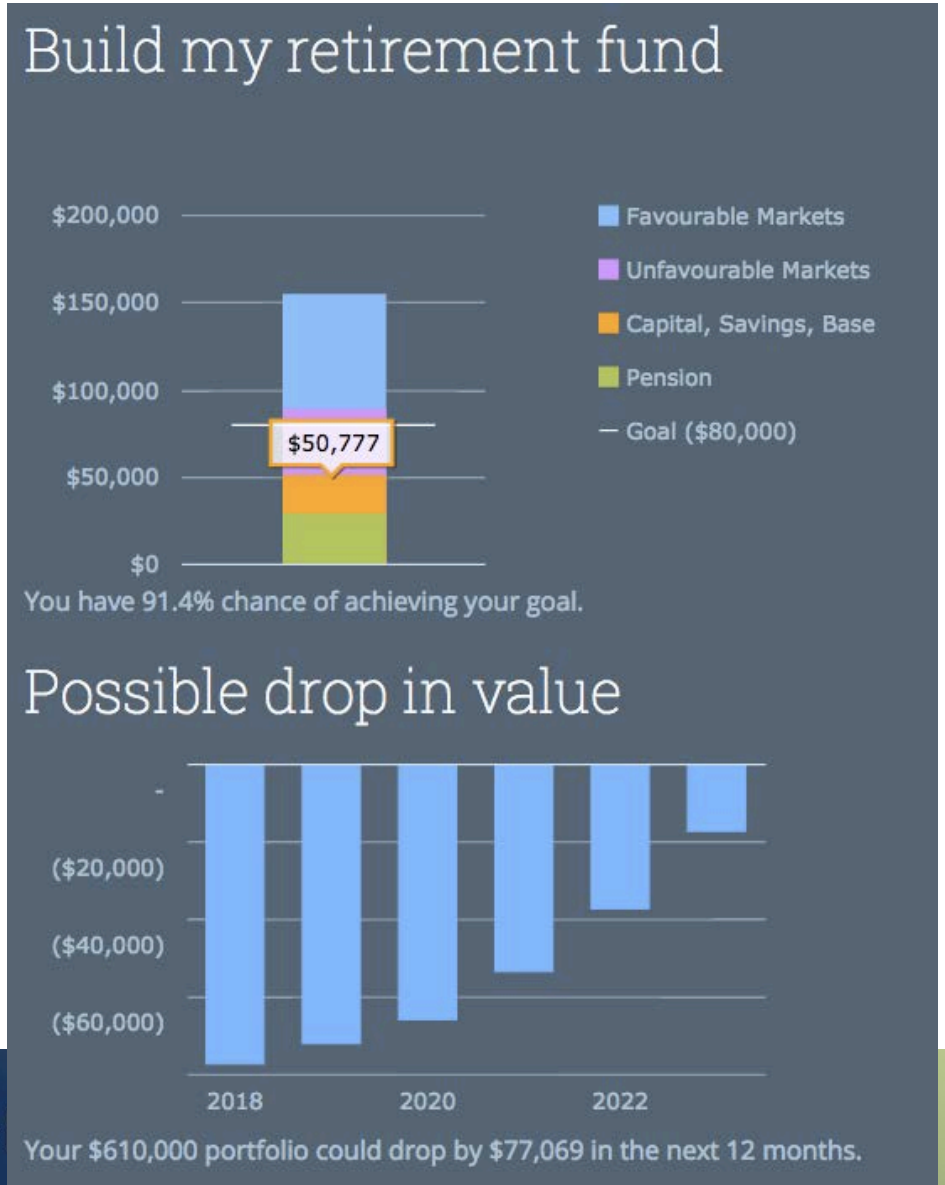
Scenario 5

- The client is a 75-year-old single female. She is a retired widow with a net worth of approximately $800,00. Her retirement portfolio is her only asset. She has been taking retirement distributions for 13 years and would like to leave a bequest to her only daughter.
- Client has a 20-year time horizon and a low level of risk tolerance and knowledge.
- *Pick 3 most important factors*

How do we know each factor, or at least the critical and important ones?

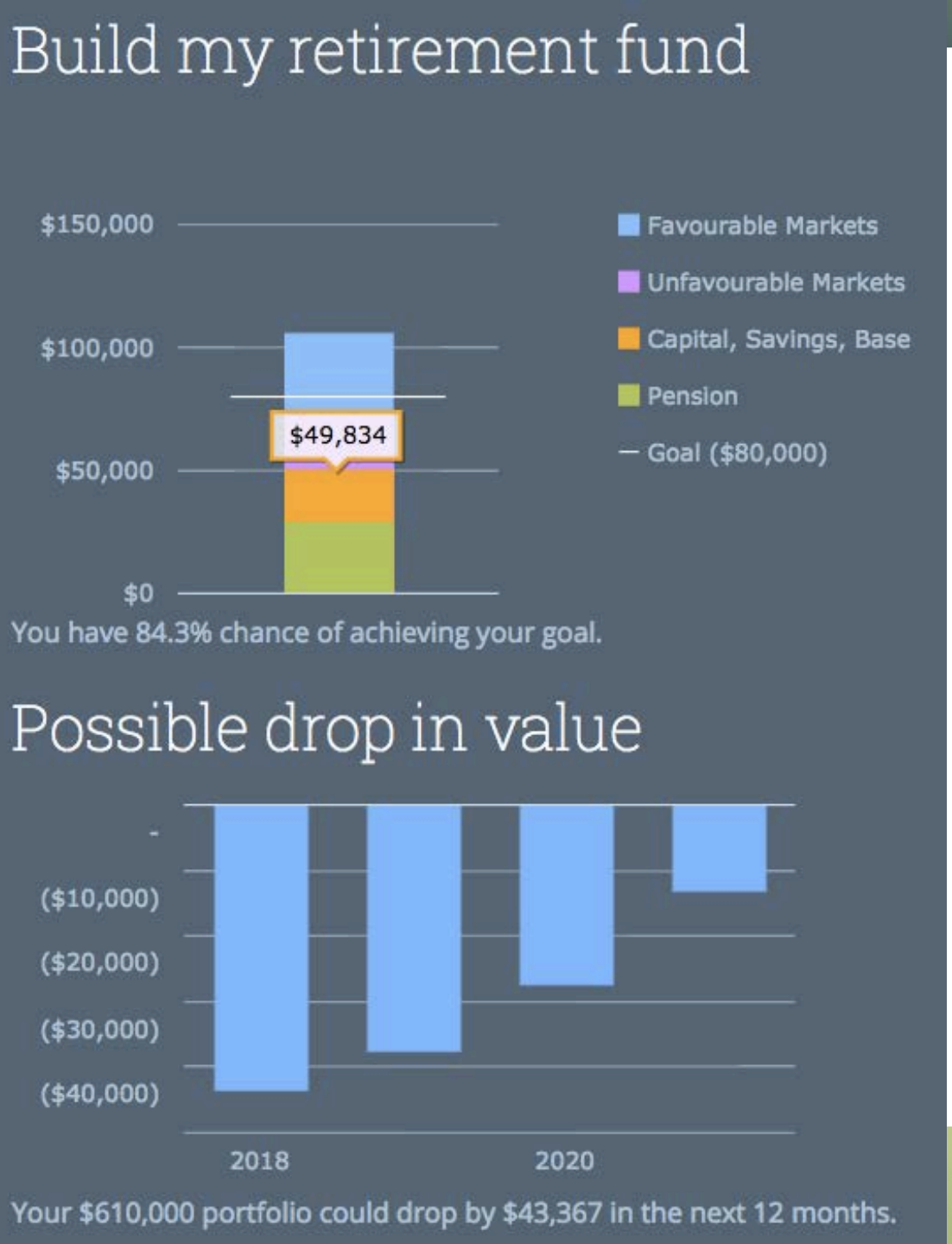
- Less discuss
  - Capacity
  - Preference
  - Composure
  - Perception

Risk Capacity



- 46 years old
- Retire at 58
- Growth & Income portfolio
- $77,069 possible decline
- $50,777 worst case
- $88,448 expected
- 91.4% chance of success (mortality weighted)

- Balanced portfolio
- $56,856 possible decline
- $50,487 worst case
- $79,310 expected
- 89.3% chance of success (mortality weighted)



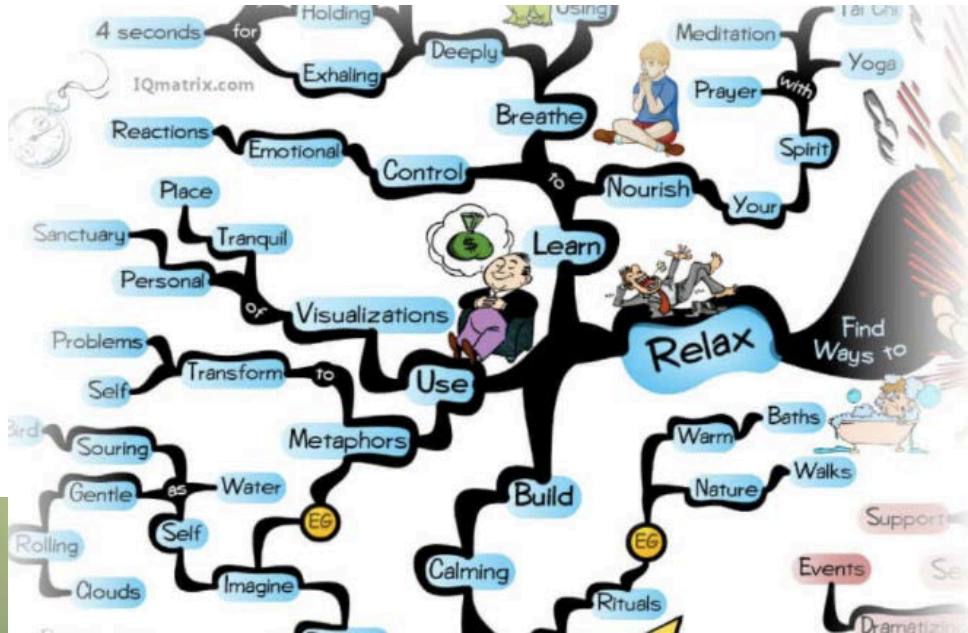
- Balanced portfolio
- $43,367 possible decline
- $49,834 worst case
- $72,614 expected
- 84.3% chance of success (mortality weighted)

Preference

- Presenting to OSC and Dr. Grable explained he does not like equities, prefers fixed income
- He is a finance professor and knows the power of equity of time, impact of time horizon and will tolerate more risk to achieve his goals.
- Do you have a process that if a client has “more funds” than required, you can reduce the risk from what is tolerated?

Composure

- Between 2006 and 2008, 57% of US households reduced stock holdings
- Although “we believe”, there is no research to prove people in portfolios matched to risk profile were any more or less likely to react (composure)



Perception

Do you like water slides into a pool?

What if you think the pool is filled with sharks?

How do we combine the factors?

- Do we weight factors? i.e. 40% tolerance and 20% capacity and 5% knowledge and 35% need
- Do we use heuristics to determine which factors win?
- Do we focus on only the extreme factors?
- Do we have a couple factors we believe are most important and that drives everything?
- Do we use a questionnaire and let it determine?

Our Research at UGA

- Special thanks to Dr. John Grable, Michelle and Amy for their ongoing work on the project
- Results are based on about 180 responses. Results are not complete at this time.

Most Important Factors

Table 4. Ranking of Risk Profiling Factors When Determining a Client's Investment Portfolio

Risk Profiling Factor	Ranking (1 = Highest, 12 = Lowest)
Time horizon for achieving financial goal.	1
Client's capacity to deal with a financial loss.	2
Client's willingness to take financial risk.	3
Client's level of risk needed to achieve financial goal.	4
Client's financial knowledge.	5
Client's need for liquidity.	6
Client's investment experience.	7
Client's perception of the riskiness of the stock market.	8
Client's history of holding position(s) when faced with a loss.	9
External factors (i.e., average equity returns, average fixed-income returns, etc.).	10
Client's preferences towards holding risky assets.	11
Other[1]	12

Table 6. Maximum Weights (%) Assigned Per Factor Across Scenarios

	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Client's perception of the riskiness of the stock market.	40	30	30	30	30
Client's financial knowledge.	50	40	40	40	50
Client's investment experience.	15	20	25	20	20
Client's level of risk needed to achieve financial goal.	30	30	30	30	40
Time horizon for achieving financial goal.	90	60	80	65	60
Client's need for liquidity.	30	30	30	40	50
Client's capacity to deal with a financial loss.	30	25	40	30	50
Client's willingness to take financial risk.	25	20	20	20	30
Client's history of holding position(s) when faced with a loss.	20	30	25	20	15
Client's preferences towards holding risky assets.	15	40	25	100	100
External factors	100	40	50	30	20
Other	30	100	30	100	100

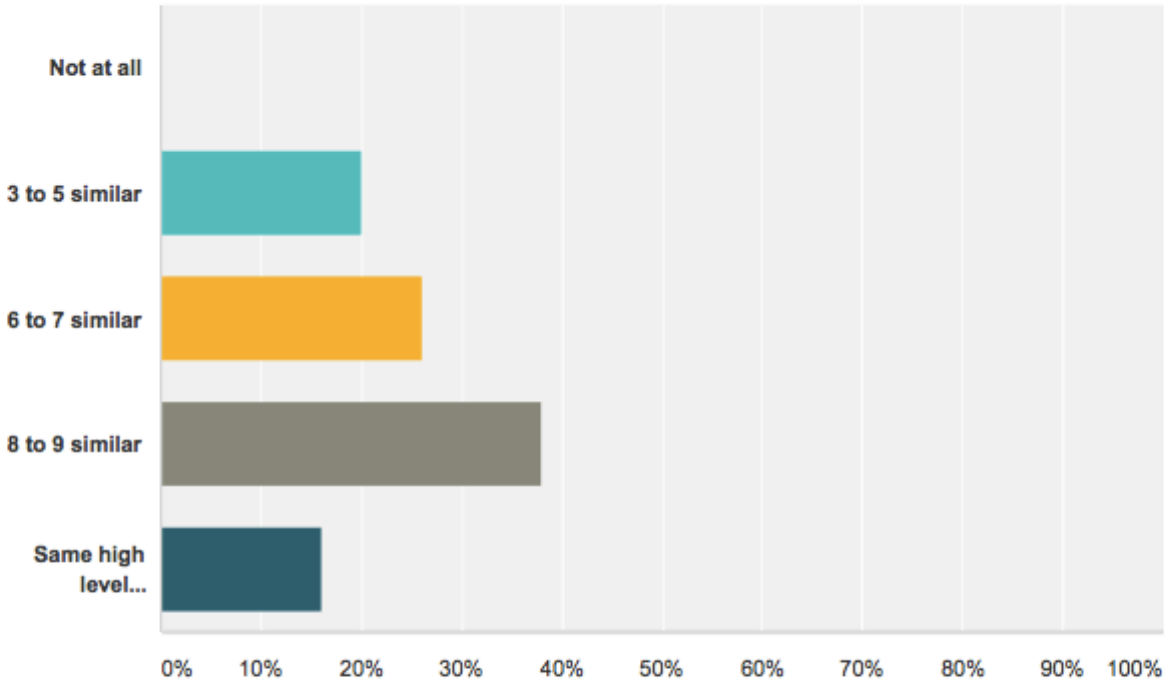
Wrap Up

- Look at results from today
- Would you like to participate in the UGA research?
- Would you like to try a next generation “judgment matrix”?

Email: Shawn.brayman@planplus.com

Q1 If you went to 10 different doctors for the same aliment, to what degree should you expect the same basic diagnosis?

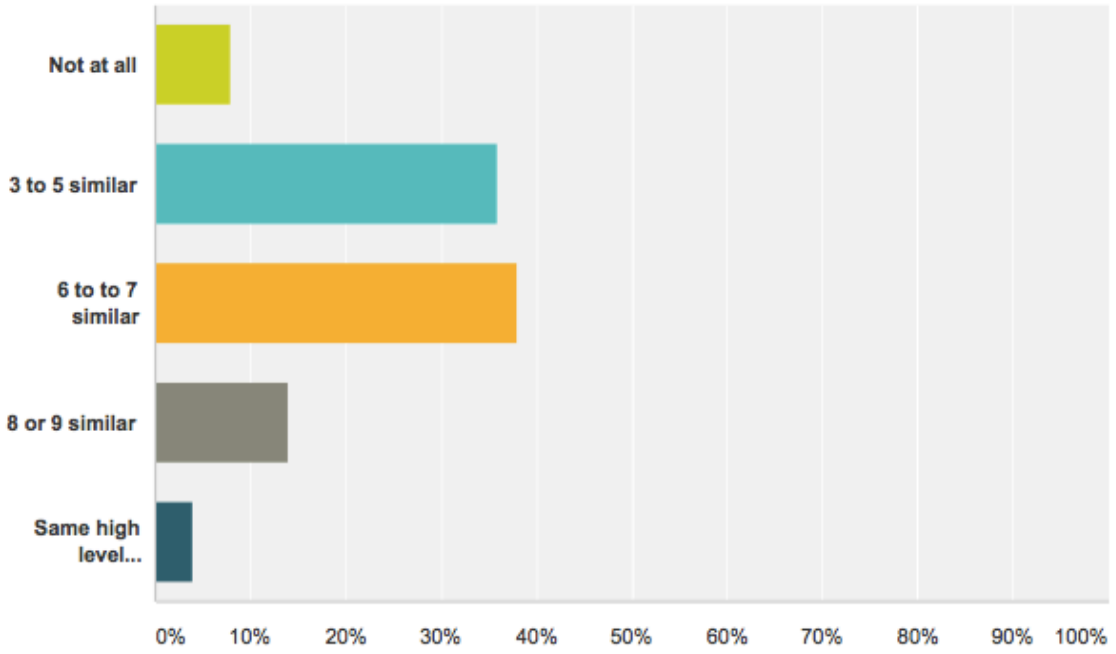
Answered: 50 Skipped: 0



Answer Choices	Responses	
Not at all	0.00%	0
3 to 5 similar	20.00%	10
6 to 7 similar	26.00%	13
8 to 9 similar	38.00%	19
Same high level assessment	16.00%	8
Total		50

Q2 If the same case is provided to 10 different financial planners, to what degree should we expect the same high level application of professional judgment?

Answered: 50 Skipped: 0

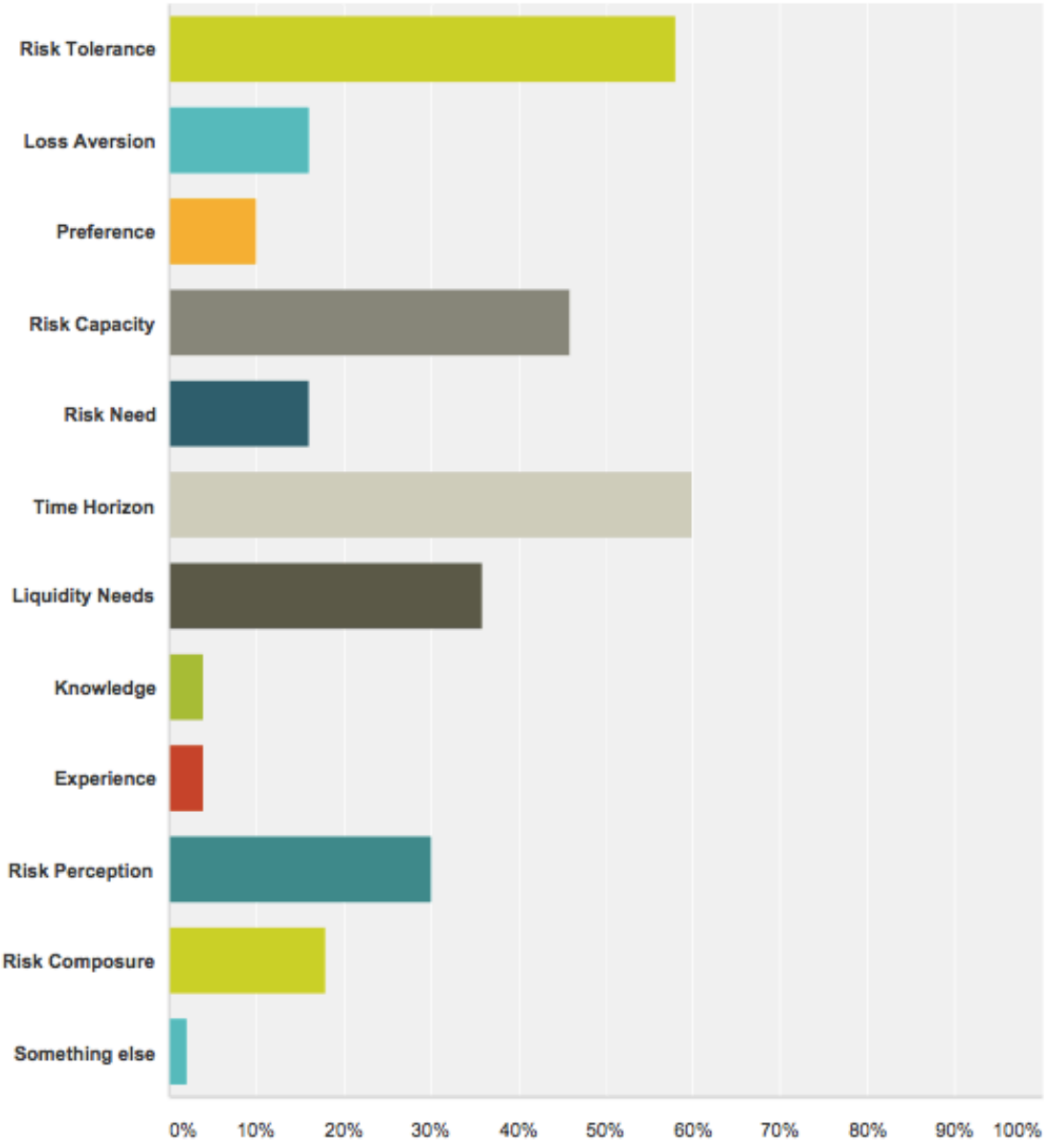


Answer Choices	Responses	
Not at all	8.00%	4
3 to 5 similar	36.00%	18
6 to to 7 similar	38.00%	19
8 or 9 similar	14.00%	7
Same high level assessment	4.00%	2
Total		50

	Not important	Sometimes	Crucial	Total
Risk Tolerance – risk they feel they can take	**0.00%** 0	**20.41%** 10	**79.59%** 39	49
Loss Aversion – fear of loosing that they have	**0.00%** 0	**18.37%** 9	**81.63%** 40	49
Preference – what I prefer, not what I can live with	**12.00%** 6	**68.00%** 34	**20.00%** 10	50
Risk Capacity – what happens on the down side	**4.17%** 2	**14.58%** 7	**81.25%** 39	48
Risk Need – do they have enough money for their goals	**2.00%** 1	**20.00%** 10	**78.00%** 39	50
Time Horizon – when do the need the money	**0.00%** 0	**4.08%** 2	**95.92%** 47	49
Liquidity Needs – cash required from the portfolio	**2.04%** 1	**24.49%** 12	**73.47%** 36	49
Knowledge – do they understand what they are doing	**2.00%** 1	**40.00%** 20	**58.00%** 29	50
Experience – have they ever invested in equities before	**12.00%** 6	**56.00%** 28	**32.00%** 16	50
Risk Perception – what are the markets like today	**20.41%** 10	**55.10%** 27	**24.49%** 12	49
Risk Composure –subject to "knee jerk" reactions	**6.00%** 3	**34.00%** 17	**60.00%** 30	50

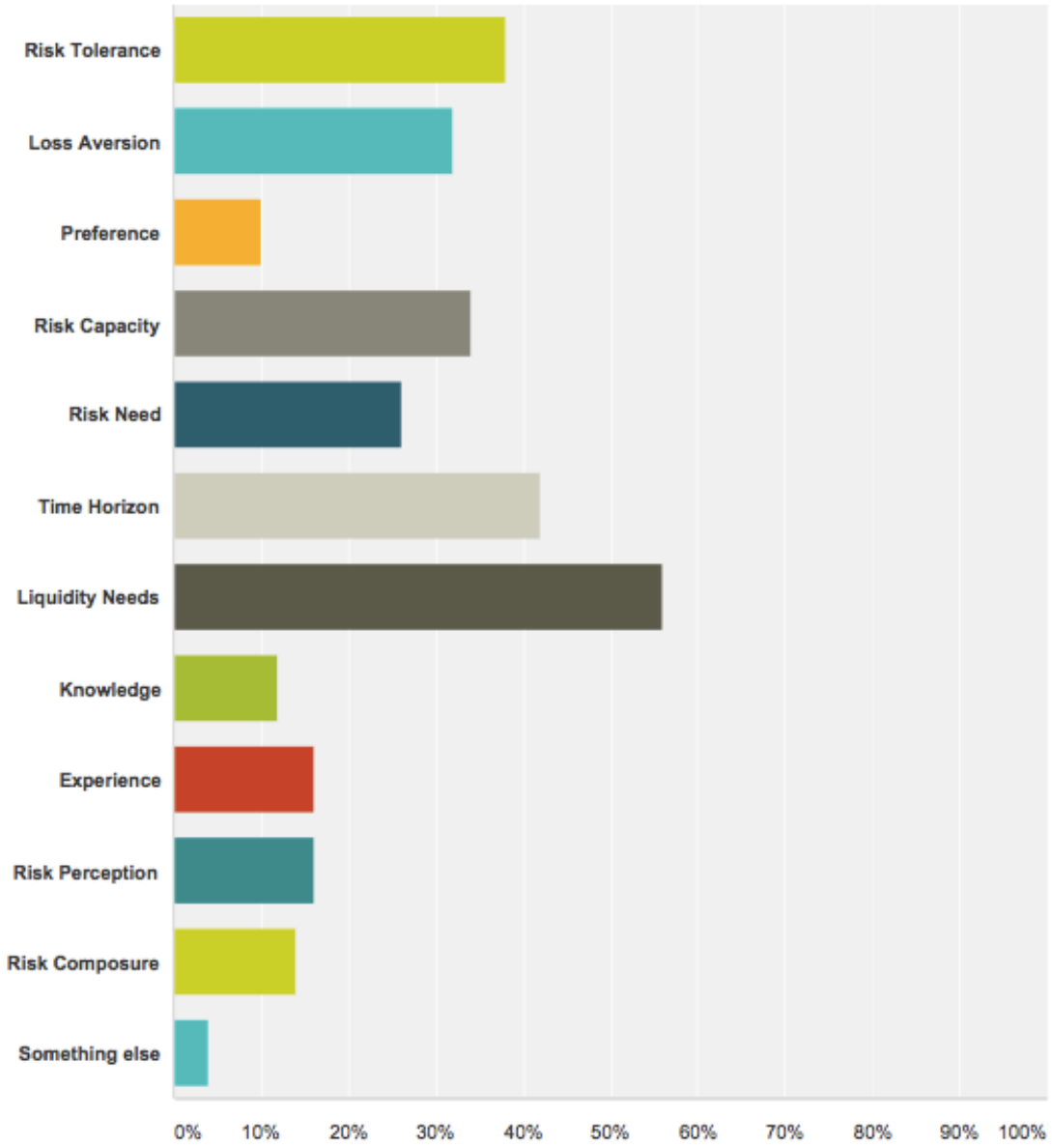
Q4 Scenario 1: Rank the top 3 factors that would influence your assessment in this scenario.

Answered: 50 Skipped: 0



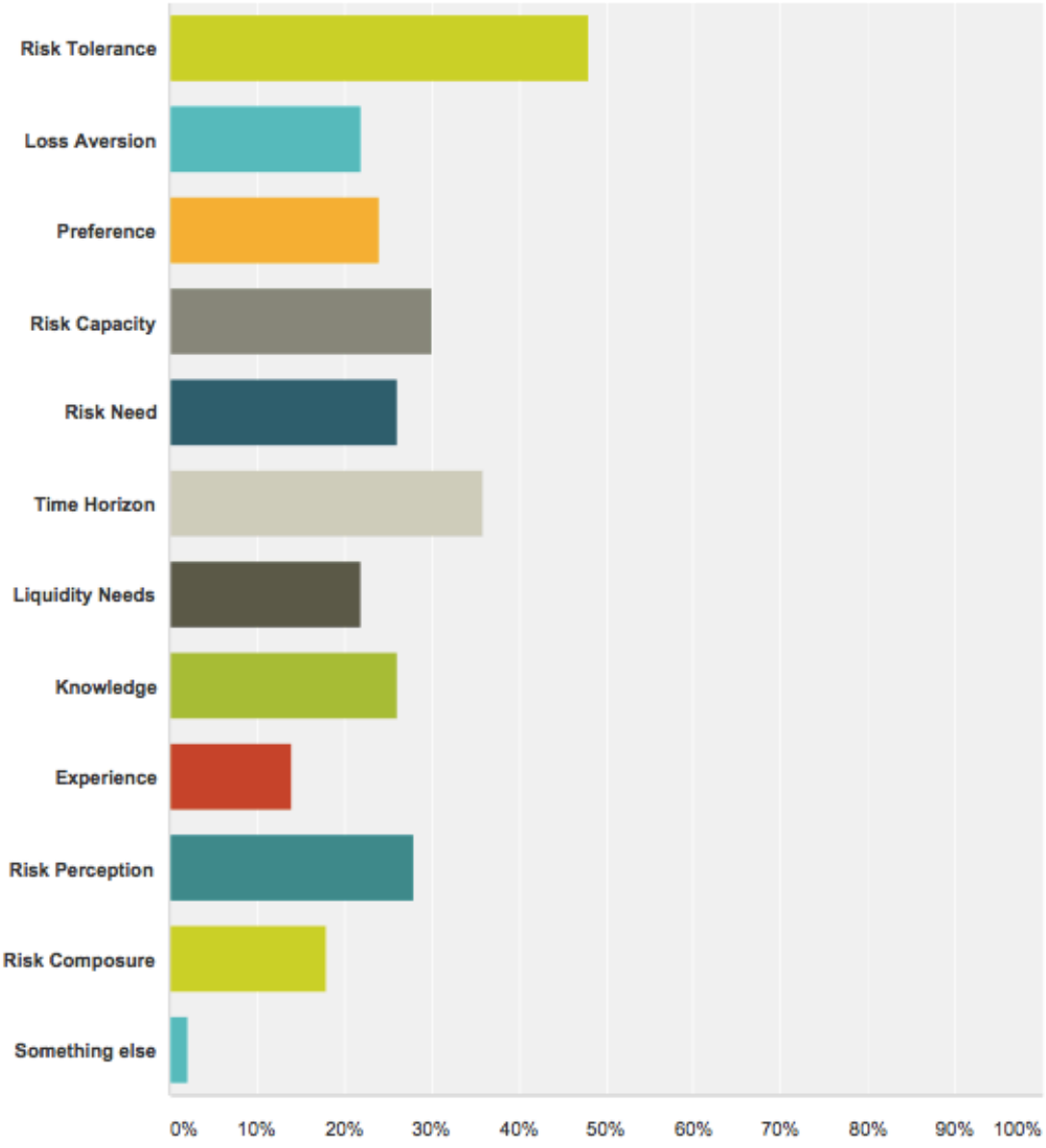
Q5 Scenario 2: Rank the top 3 factors that would influence your assessment in this scenario.

Answered: 50 Skipped: 0



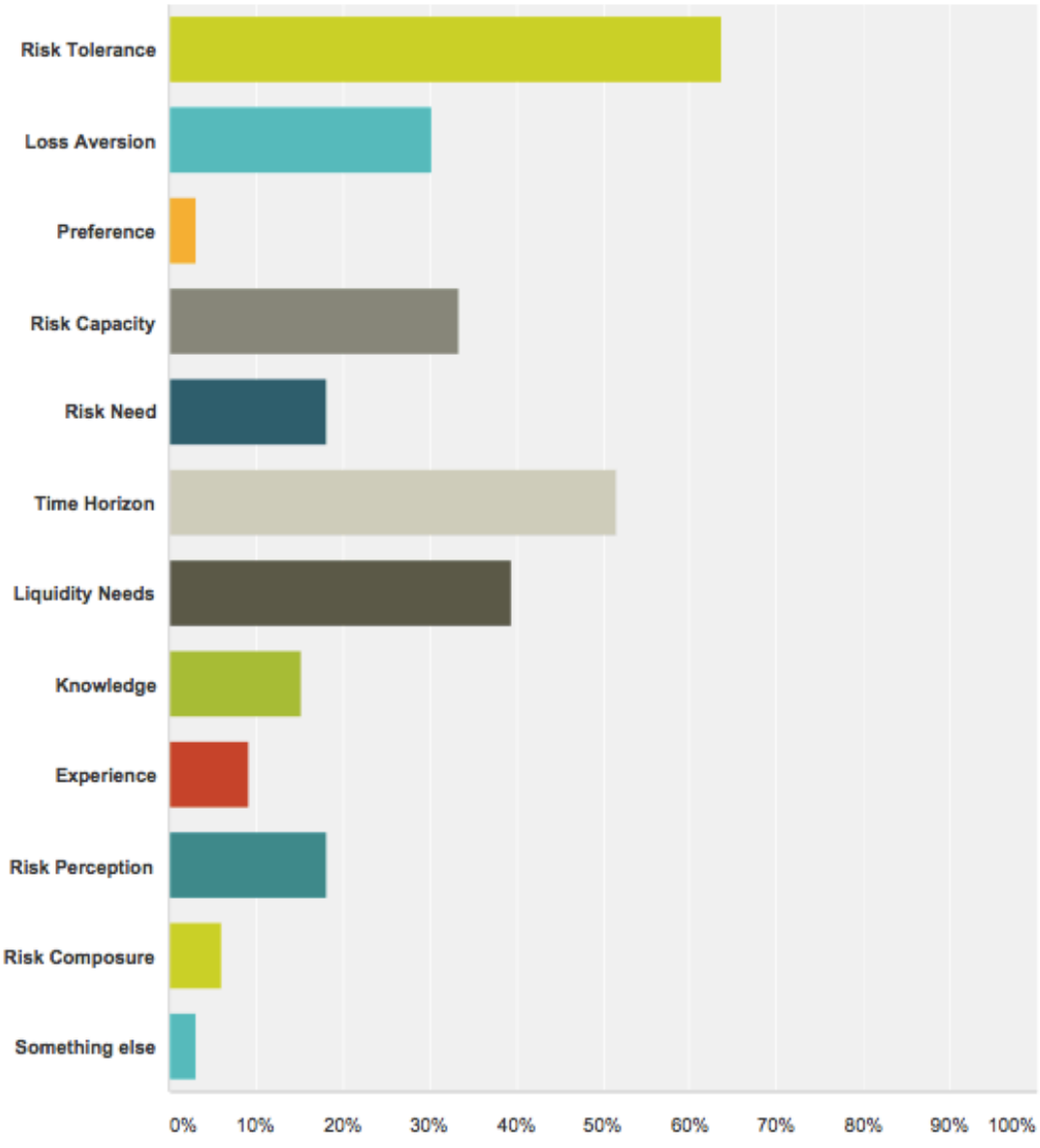
Q6 Scenario 3: Rank the top 3 factors that would influence your assessment in this scenario.

Answered: 50 Skipped: 0



Q7 Scenario 4: Rank the top 3 factors that would influence your assessment in this scenario.

Answered: 33 Skipped: 17



Q8 Scenario 5: Rank the top 3 factors that would influence your assessment in this scenario.

Answered: 50 Skipped: 0