CONDUCTING A RISK CONTROL REVIEW

Help your clients understand the role of risk control in a portfolio

CUNA MUTUAL GROUP

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NEW RULES AND NEW OPPORTUNITIES

You have always worked to deliver what's right for your clients. However, today's world of new rules and regulations undoubtedly means new ways of doing business. Many of the regulatory changes will impact your process for assessing needs and making recommendations in a client's best interest. But whether performing a regular portfolio review for an existing client or working with an investor for the first time, the new rules provide new opportunities.

One of the most important opportunities surrounds advice on when to simply manage portfolio risk and when to truly control that risk. By incorporating a risk control review into your planning process, you can evaluate needs and make recommendations that can help clients take control of their financial future.

This easy guide lets you integrate the all-important risk control review into your practice.

1 ASSESS the Role of Risk Control

Your clients' comfort with risk is one thing. What's needed to achieve their goals may be quite different. That's why it's important to evaluate risk in the context of your clients' stated goals.

Along with your client discussions, your assessment process may include a questionnaire, planning software, and other data-gathering tools.

Use this grid to quickly compile all these various inputs and help gauge the overall need for risk control.

CONTROL RISK — MANAGE RISK

Goals: Have your clients described their goals with a focus on growth or on asset preservation? Did they express a desire to protect principal?

Preservation — Growth

Time Horizon: How soon before your clients need to draw from their portfolios to fund their goals? Is retirement or a major purchase looming?

Shorter horizon — Longer horizon

Income: Are your clients relying on savings to generate a substantial portion of their retirement income?

Generate income — Grow wealth

Capacity: What are your clients' capacity for risk? Do they have a modest portfolio they can't afford to lose?

Smaller portfolio — Larger portfolio

Attitude: How do your clients describe their willingness to take risks? Is risk exciting to them, or is it something they hope to avoid?

Exciting — Concerning

Tolerance: As you discuss potential risk/reward scenarios, how do your clients react to the possibility of dramatic market volatility?

Low tolerance — High tolerance

Behavior: Research shows tolerance for risk is highly dependent on the situation; how did your clients respond to recent volatile markets?

Worry — Confidence

Decisions: Have your clients expressed regret about past decisions that have not turned out as expected?

Regret — Acceptance

Experience: How much investment experience do your clients have? Have they been investing in the market for many years?

Beginner — Experienced

Knowledge: How knowledgeable are your clients about risk and return? Do they understand different types of investments and how they work?

Limited knowledge — Very knowledgeable

Rates: Have your clients expressed concerns about low fixed rates? Do they worry about what interest rate hikes might do to bond prices?

Rate worries — Little concern

Inflation: Do your clients worry about loss of purchasing power over time? Do they want to ensure portfolio returns keep up with rising costs?

Inflation worries — Little concern

Outlook: How do your clients describe their expectations for the future? More optimistic, or worried about what the future might hold?

Pessimistic — Optimistic

History: Have your clients taken significant risks in the past? Made major changes in their jobs or personal life? Comfortable with big financial decisions?

Risk averse — Risk taker

Attention: How much attention do your clients pay to their investment portfolios? Do they frequently check balances in times of market volatility?

Attentive — Relaxed

Insurance: Do your clients describe owning insurance as an important responsibility, and do they have significant amounts of insurance?

More insurance — Less insurance

Longevity: Do your clients talk about life expectancy and family longevity? Have they expressed concern about running out of money?

Longevity concerns — Little anxiety

Health: Are your clients worried about their health and the costs of future medical needs or long-term care?

Health worries — Little concern

Perspective: When your clients talk about the future, do they talk about how savings can help provide the freedom or security to relax and enjoy life?

Security — Freedom

Scoring: Have you used a financial planning tool to quantify risk as part of your standard process? If so, where did your clients' scores fall?

0 — 100

Summarize the results of this assessment for your client, and highlight where the client falls on the range of needing to control versus manage risk.

2 HIGHLIGHT Key Risks

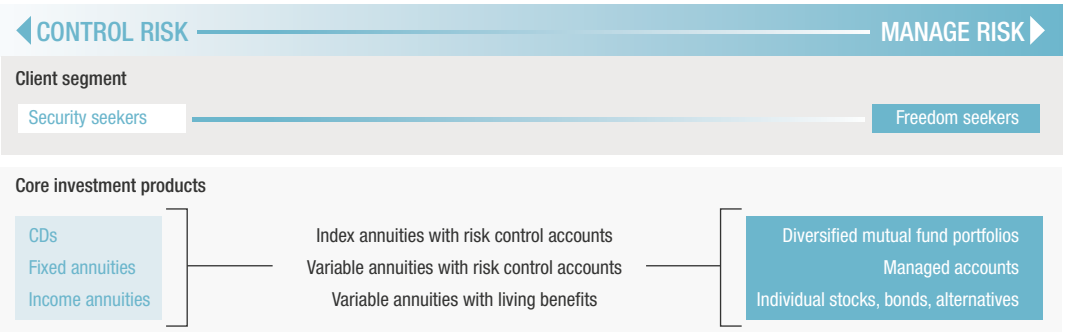
Clients hear about many financial risks. As part of your review, identify the specific risks you want to discuss and ways to control them.

- [ ] **Market risk** of fluctuating returns that cause worry and stress and force investors to the sidelines
- [ ] **Tail risk** of a “black swan” event with devastating investment consequences
- [ ] **Drawdown risk** that the negative side of standard deviation will occur near or in retirement and make it difficult to recoup losses
- [ ] **Interest rate risk** that a portfolio weighted toward bonds will face losses as rates rise
- [ ] **Liquidity risk** that it will be difficult (or impossible) to sell at a fair price when funds are needed
- [ ] **Credit risk** that a company or government entity behind a fixed-income investment will be unable to pay
- [ ] **Longevity risk** of outliving assets
- [ ] **Sequence of returns risk** that poor performance will deal a blow to a portfolio early in retirement and compound the impact of withdrawals
- [ ] **Allocation risk** that a portfolio is too heavily weighted to safe, low-rate investments with little growth potential
- [ ] **Withdrawal risk** of taking distributions at an unsustainable rate
- [ ] **Inflation risk** that investment income won’t keep up with rising costs
- [ ] **Timing risk** that an unexpected event like job loss will shift the time horizon and force sale of investments at a loss
- [ ] **Health care risk** that investments will be needed to cover expensive medical or long-term care costs
- [ ] **Taxation risk** of changing regulations or missteps that cause unintended tax consequences
- [ ] **Concentration risk** of allocating a large part of a portfolio to one company, sector, or country
- [ ] **Foreign investment risk** of geopolitical or other events that negatively impact performance
- [ ] **Benefit risk** that expected employer or government retirement benefits will face future reductions
- [ ] **Legacy risk** that intentions are not realized because of inadequate beneficiary designations or estate plans

3 EVALUATE Options and Make Recommendations

While you certainly sell products to clients, it may be even more powerful to think of yourself as purchasing products on their behalf. Which investment products can deliver the level of risk control that fits your client's needs? Can one product's value or performance be replicated or improved upon with an alternative? These are the questions to ask as you consider products that may offer the appropriate level of risk control.

Provide a clear explanation of your investment recommendations and show how they can help control or manage risk. Leverage your product materials and sales tools to tell the story.



4 EDUCATE on Fees as Part of Your Rationale

Analysis of fees and charges is a critical part of making recommendations, and many would argue fees are the single biggest determinant of investment performance. Therefore, it's important to consider all the costs that may apply:

- Platform or contract fees, sometimes listed as mortality, expense and administrative (M&E&A) fees
- Annual service charges
- Underlying fund or subaccount fees
- Additional fees, including any 12b-1 fees, rider charges, custodial fees, inactive account fees, etc.
- Surrender charges or market value adjustments for early withdrawals

Certain products—like fixed or index annuities—don't charge explicit fees. You may also want to educate clients on how costs for these products are often built into the process of determining current interest rates and caps. Also remember the 401(k) rollover decision is a special case. Before you make this recommendation, carefully discuss this decision with clients, and be certain they understand the cost and benefit trade-offs of rolling into an IRA versus keeping assets in the 401(k) plan.

As part of your recommendations, ensure your client understands the "all-in" costs of owning any investment product and the trade-offs that may be involved.

Demonstrating the power of risk control

Where possible, use your financial planning tool to demonstrate how your recommended portfolio allocation aligns with the client's target level of risk. For example, when proposing use of a product with guaranteed limits on loss, show the impact of adding that investment into the portfolio.

The role of metrics

For most investors, risk tolerance is less about the numbers and more about emotion. While risk metrics like standard deviation and the Sharpe ratio may be helpful to reference when making recommendations, they're unlikely to provide a sense of control in volatile markets. Traditional metrics assume investors adhere to their chosen allocation strategy. But emotional reactions and attempts at market timing may lead the average investor to underperform.

Peer rankings present another challenge. While perhaps useful to supplement your review, peer rankings of performance may show less long-term predictive value. Analyze data to determine top-ranking equity funds from year to year to demonstrate the likelihood of consistent gains.

Use caution when relying heavily on peer rankings or traditional risk metrics as a foundation for your recommendations. Instead, you may wish to emphasize performance against benchmarks and highlight the power of risk control in the portfolio to help combat human nature.

5 **PROVIDE** Your Commitment

Part of completing a risk control review is setting expectations for how you will regularly review and measure results. Before you close, set expectations with your client for ongoing communications and schedule your next appointment.

Close any review with a reminder of your commitment for ongoing service.

THE POWER OF INVESTOR CONFIDENCE

Three key barriers often stand in the way of a client's financial confidence. To close your risk control review, it can be powerful to ensure you've addressed each of these:

1. Investment complexity – Have you carefully explained investment risks and your product recommendations? Your guidance can help ensure your client knows the reasons for purchase and exactly what to expect.
2. Fear of loss – Have you described the degree of risk control offered by each investment in your client's plan? Make sure clients understand the ways their retirement portfolios are protected from potential loss.
3. Easy access – By working with you, clients have taken an important step to access financial advice. Have you discussed the compensation you receive for your services and demonstrated the value you provide? Conducting a risk control review is a powerful way to do just that.

Contact the CUNA Mutual Annuity Solutions Desk at **877.345.GROW (4769), option 1** to learn more about risk control products and the importance of a risk control review.

TARGET THOSE WHO NEED YOU MOST

New clients can benefit from a risk control review, and a regular evaluation of your existing clients' portfolios is an important part of your process. As you build and execute a marketing plan, consider opportunities to target specific client segments for a review:

Money on the sidelines — Risk-averse clients fearing loss of principal who keep a large part of their portfolios in CDs or savings accounts. A review can help ensure these clients know how to control risk rather than simply avoid it.

Older clients with older accounts — Investors who may have simply fallen into the habit of maintaining allocations even while their risk attitude has grown more conservative over time. A review allows you to evaluate and "de-risk" these portfolios, where appropriate, by adding guaranteed limits on loss.

Low-performing portfolios — Those with mutual fund accounts where performance has fallen short of goals. These clients may be using traditional diversification weighted to cash or fixed income to manage risk and avoid the possibility of dramatic stock market losses. A review could help determine if these portfolios are appropriately positioned and introduce solutions that limit downside risk while still participating in upside potential.

High-performing portfolios — Investors where the bull market meant attractive gains. A risk control review could discuss options to protect gains for those concerned about further volatility.

Required minimum distributions — Clients over age 72 relying on withdrawals from their IRAs for income. RMDs can fluctuate dramatically year to year based on market movement. These clients may benefit from learning how to control the risk of market volatility or how to guarantee RMDs by converting account value into a steady stream of lifetime income.

Non-qualified funds — Those frustrated by taxes triggered when reallocating or rebalancing standard mutual fund accounts. Tax-deferred annuities add another dimension to the risk control story—one that can combine both control of market loss and the timing of taxes.

Deferred annuities — Clients with in-force annuities who may have forgotten a key benefit—namely, the ability to convert contract value to a guaranteed income. A risk control review offers the chance to discuss the possible benefits of annuitization.

Multiple accounts — Those with a "fragmented" portfolio who may benefit from a more holistic approach to professional money management. A review helps you educate clients on the potential value of consolidating assets for breakpoints, new options, and convenience.

Next-generation planning — Investors with identified legacy goals. These clients are often highly motivated to control risk and increase the likelihood of passing on their intended financial legacy.

Life change — Clients going through a significant change in job, health, family, or relationship status. Major changes in life circumstance mean taking stock and rethinking future plans. Performing a risk control review at these times is a key responsibility.

Call us at **877.345.GROW (4769), option 1** for help establishing a risk control marketing campaign within your client management system.

IMPORTANT DISCLOSURES

Annuities are long-term insurance products designed for retirement purposes. Clients should consider a variable annuity's investment objectives, risks, charges and expenses carefully before investing. The prospectus contains this and other information. Encourage clients to read it carefully.

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