

# UK risk tolerance assessment frameworks for FCA-regulated wealth advisory

Risk profiling for UK wealth management requires three distinct assessments—attitude to risk, capacity for loss, and need to take risk—with **capacity for loss typically acting as the limiting factor** rather than psychological willingness. Oxford Risk's psychometric methodology, used by firms managing over **£1 trillion in assets**, exemplifies the shift toward behavioral finance approaches that measure composure alongside traditional risk tolerance. The FCA's regulatory framework, anchored by COBS 9.2 and guidance document FG11/5, mandates that firms separately assess these pillars and document how investment recommendations align with all three. With Targeted Support rules (COBS 9B) taking effect in April 2026, segment-level risk assessment introduces new compliance considerations for automated and AI-driven advice.

## Oxford Risk's psychometric approach measures willingness, capacity, and composure separately

Oxford Risk, founded as an Oxford University spin-out in 2002 and relaunched commercially in 2017, takes a behavioral finance approach fundamentally different from revealed-preference methodologies. The firm explicitly rejects asking clients to choose between complex risk-return trade-offs, arguing that such questions test mathematical ability rather than true risk preferences.

The **psychometric questionnaire** uses Likert scales (Strongly Disagree to Strongly Agree) designed to elicit emotional gut responses rather than analytical calculations. Example questions include: "My friends would say that I am cautious," "Even if I could get high returns, I would prefer not to invest my money in something that might decline in value," and "Maximising long-term investments is my goal, and I would be willing to accept dramatic, short-term drops in value to achieve this."

Oxford Risk outputs scores on either a **5-category scale** (Low, Medium-Low, Medium, Medium-High, High) or a **7-category scale** (Very Low through Very High), with underlying continuous scores that enable precise calculations. A 10-question version yields raw scores of 10-50, mapped as follows: 10-17 (Lower risk), 18-25 (Lower to medium), 26-33 (Medium), 34-41 (Medium to higher), and 42-50 (Higher risk).

The methodology's critical innovation is calculating a **Suitable Risk Level (SRL)** that combines multiple factors:  $SRL = \text{Risk Tolerance} \times \text{Risk Capacity}$ . This approach recognizes that when risk capacity is high (substantial non-investible assets like property or future earnings), investible assets can take more risk because overall wealth is diversified. Oxford Risk data shows **only 40% of clients** have risk tolerance scores matching their final

SRL—meaning reliance solely on attitude to risk produces inappropriate recommendations 60% of the time.

**Composure measurement** assesses short-term emotional reactions to market volatility, distinct from long-term intellectual risk tolerance. Clients receive Low, Medium, or High composure ratings:

- **Low composure:** SRL is "dampened" by up to 25% relative to risk tolerance; clients may panic-sell during downturns
- **Medium composure:** Occasional worry during stressed periods; standard adjustment
- **High composure:** Unaffected by temporary fluctuations; may need reminders to monitor portfolio

Oxford Risk estimates the **average investor loses 3% of returns annually** due to emotionally-driven short-term decisions—a behavioral gap that composure measurement helps advisers address through proactive communication during volatile periods.

## FCA regulations require three-pillar assessment under COBS 9.2 and 9A

The regulatory foundation for risk profiling sits in COBS 9.2.1R, which requires firms to "take reasonable steps to ensure that a personal recommendation, or decision to trade, is suitable for its customer." COBS 9.2.2R specifies the information firms must obtain, including the client's "preferences regarding risk taking" and "risk profile."

**FG11/5**, the FCA's principal guidance document on risk profiling published in March 2011, introduced the concept of assessing "the risk a customer is willing and able to take"—explicitly separating psychological willingness from financial ability. The guidance defines capacity for loss as: "the customer's ability to absorb falls in the value of their investment. If any loss of capital would have a materially detrimental effect on their standard of living, this should be taken into account in assessing the risk that they are able to take."

For MiFID business, **COBS 9A.2.1R** requires recommendations to be "suitable for the client and, in particular, in accordance with the client's risk tolerance and ability to bear losses." Suitability reports under COBS 9A.3.2R(4) must explain how recommendations align with the client's attitude to risk and capacity for loss, investment term, and knowledge/experience.

**Critical FG11/5 findings** from the FSA's review of 366 cases revealed that 9 of 11 risk-profiling tools had weaknesses producing flawed outputs. Poor practices identified include:

- Using 1-10 scales without clear definitions of what each number means
- Questions assuming high financial/mathematical ability
- Bundling ATR, CFL, investment term, and age into a single output with arbitrary weightings
- Emotive category descriptions ("progressive," "realistic," "motivated")
- Failing to filter out customers unsuitable for any investment risk

Good practice involves a two-stage approach: provisional rating from a validated tool, followed by adviser discussion to validate the output and resolve any inconsistencies.

## Industry risk rating scales differ by provider but typically use 1-10 or 1-7 ranges

UK wealth advisers predominantly use **1-10 risk scales**, while regulatory frameworks (UCITS SRRI and PRIIPs SRI) use **1-7 scales**. These scales measure different things: client risk profiles assess psychological and financial characteristics, while product ratings measure investment volatility.

**Defaqto risk ratings** (1-10) use Hymans Robertson strategic asset allocations as benchmarks, combining historic volatility, forecast future volatility via stochastic modelling, and qualitative portfolio manager discussions. The rating takes the higher of historic or forecast volatility. Approximately 30% of UK advisers use Defaqto ratings, with 70% citing them in fund selection criteria.

**Distribution Technology (Dynamic Planner)** also operates on a 1-10 scale. Originally partnered with Oxford Risk questionnaires, DT now uses proprietary psychometric questions developed with the Cambridge Psychometrics Centre and Henley Business School. The platform processes over **£3 billion in annual investment recommendations** and maps 1,000+ investments from 100+ asset managers to risk profiles.

**EValue** uses a 1-10 scale with Value at Risk (VaR) methodology for accumulation portfolios and Income at Risk (IaR) for decumulation. Their forward-looking approach considers time horizons of 5, 10, 15, 20, and 25 years—recognizing that risk characteristics change with investment duration.

**FinaMetrica** (now Morningstar) produces a 0-100 risk tolerance score mapped to 7 risk groups. Unlike Oxford Risk's multi-factor approach, FinaMetrica measures purely psychological risk tolerance without directly assessing capacity for loss. The tool has generated over 1 million profiles across 20+ countries.

**PRIIPs Summary Risk Indicator** (1-7) is mandatory for packaged retail products and combines Market Risk Measure (calculated via VaR Equivalent Volatility using Cornish-Fisher methodology) with Credit Risk Measure. The forward-looking VaR approach often produces lower scores than the backward-looking UCITS SRRI for identical funds.

Rough mapping between scales: UK 1-10 scores of 1-2 correspond to SRI 1-2 (Very Low), 3-5 to SRI 3-4 (Low-Medium), 6-7 to SRI 5 (Medium), and 8-10 to SRI 6-7 (Medium-High to High).

## When pillars conflict, capacity for loss typically governs the recommendation

The three pillars interact in ways that commonly require prioritization. A **misconception persists** that attitude to risk trumps other factors—in reality, capacity for loss more frequently acts as the limiter.

**Scenario: High ATR, Low CFL.** The recommendation should align with the lower capacity regardless of psychological willingness. The client must understand their financial circumstances limit risk-taking even if they feel comfortable with volatility.

**Scenario: Low ATR, High CFL.** The FCA is explicit: risk level should **not** be increased based solely on high capacity. If the client's "need to take risk" requires higher returns than their ATR allows, advisers must first discuss alternatives—changing timescales, saving more, retiring later, or scaling back objectives.

**Scenario: High Need, Low ATR/CFL.** If capacity cannot sustain potential losses, the firm must explain that desired goals "cannot realistically be met." Only if the client demonstrates both capacity and informed willingness—documented after detailed discussion—should higher-risk recommendations proceed.

Former FCA technical specialist Rory Percival has noted that advisers should **not ask clients** what their capacity for loss is—"clients will always get the wrong answer." Capacity is an objective calculation based on total wealth, income stability, dependents, emergency funds, debt levels, and years to retirement.

The FCA's Retirement Income Advice review (TR24/1, 2024) emphasizes that both ATR and CFL **likely change at retirement** and require reassessment. Risk tolerance in decumulation "can be inherently different" from accumulation, particularly given sequence-of-returns risk where early losses compound dramatically.

## **Edge cases require documented adjustments beyond standard risk profiling**

**Vulnerable customers** under FCA guidance FG21/1 sit on a spectrum of risk driven by health conditions, life events (bereavement, job loss), low resilience, and capability limitations. Consumer Duty requires firms to design support meeting vulnerability needs, use clearer communications, allow more time for decisions, and reassess ATR more frequently. Vulnerability can affect both the client's capacity to understand risk and their emotional responses to losses.

**Couples with different risk tolerances** present particular challenges. Research shows gender-based differences in risk aversion, and couples may have genuinely different financial experiences shaping preferences. Best practice involves assessing each spouse separately (avoiding social influence), focusing on shared goals rather than abstract risk preferences, and using household capacity for loss as the anchor for joint assets. The "why" behind each partner's position often reveals knowledge gaps rather than true preference differences.

**Business owners with concentrated wealth**—averaging 80% of total wealth in their business—require adjusted assessment. Their personal investment portfolio may need more

conservative positioning to offset single-asset concentration. Standard questionnaires rarely capture this context adequately. Advisers should consider how correlated business performance is with broader markets, exit timeline certainty, and personal guarantees on business debt.

**Clients with defined benefit pensions** have materially higher risk capacity because DB pensions provide bond-like guaranteed income covering essential spending. The remaining portfolio can potentially invest more aggressively since the DB "floor" protects living standards regardless of investment performance. However, advisers must not conflate pension security with willingness to take risk elsewhere.

**When to refuse to act on client's stated preference:** The FCA's insistent client guidance requires clear advice, explicit communication that actions are "against your advice," and documented warnings about risks. If facilitating the transaction would breach suitability rules or Consumer Duty obligations, firms should refuse. The FCA has noted that "excessive numbers of insistent clients suggest advice wasn't sufficiently clear"—34% of insistent client pension transfer cases were found unsuitable in FCA review.

## FCA enforcement reveals persistent failures in capacity assessment and documentation

Major enforcement actions illustrate systemic failures:

- **AXA Wealth Services:** £1.8 million penalty for failing to ensure advice was suitable and deficient compliance monitoring under COBS 9.2.1R(2), 9.2.2R, and 9.4.7R
- **Pembrokeshire Mortgage Centre (BSPS):** £2.3 million penalty where 93% of clients were advised to transfer DB pensions with "misleading and unclear" suitability reports and the same SIPP recommended to 96% of customers
- **CFP Management:** Combined penalties over £670,000 plus bans for a flawed advice model with 90%+ of pension transfer recommendations failing FCA standards

The FCA's thematic reviews compound these findings. TR14/5 (2014) found 73% of firms failed disclosure requirements. TR16/1 (2016) identified incorrect risk profiling as one of three root causes for poor outcomes. TR24/1 (2024) found 11% of retirement advice files had suitability concerns and 22% had material information gaps.

**Record-keeping requirements** under COBS 9.5 mandate minimum 5-year retention for most suitability records, with pension transfer documentation retained indefinitely. Firms must record all information gathered, completed risk questionnaires, any conflicting responses and how resolved, final agreed risk profiles, rationale for deviations from tool outputs, and evidence that portfolios match risk profiles.

**Consumer Duty** (PRIN 2A, effective July 2023) overlays enhanced requirements including demonstrable good outcomes, outcome monitoring with annual Board assessment, and action plans addressing identified risks. Risk profiling must result in good outcomes—not just regulatory compliance.

# **Targeted Support introduces segment-level risk assessment from April 2026**

**COBS 9B**, effective 6 April 2026 under PS25/22, creates a middle ground between guidance and full personal recommendations. Standard suitability requirements in COBS 9 and 9A do **not** apply to Targeted Support—instead, firms must be satisfied on "reasonable grounds" that ready-made suggestions are suitable for an individual in the defined consumer segment.

**Segment definition** requires specifying "including characteristics" (positive target market criteria) and "excluding characteristics" (negative criteria that would render suggestions unsuitable). Risk tolerance can function as a defining characteristic: segments might be defined for "investors comfortable with medium volatility" or exclude those with "risk tolerance outside defined range."

Key distinctions from individual advice:

- Suitability assessed at **segment level**, not individual level
- No requirement for fact-finding as extensive as COBS 9/9A
- Firms pre-define consumer segments with common characteristics
- Must identify excluding characteristics and exit routes to alternative support
- Segments must be "sufficiently granular" but not "overly individualised"

**Automated risk profiling** for robo-advice remains subject to full COBS 9/9A suitability standards—the FCA's 2018 multi-firm review confirmed "the same regulatory standards apply to automated advisory services as to traditional advice." Issues identified include firms not asking about knowledge/experience, over-reliance on self-identification of vulnerability, and inadequate understanding of third-party algorithm limitations.

Documentation for automated systems requires algorithm methodology records, validation processes, limitation identification, audit trails of decision pathways, and evidence of outcome monitoring. Consumer Duty adds requirements for testing actual versus expected outcomes with Board reporting on automated service results.

## **Conclusion**

UK risk tolerance assessment operates within a sophisticated regulatory framework that explicitly separates psychological willingness from financial ability and required returns. Oxford Risk's composure measurement represents an important evolution—recognizing that clients who intellectually accept risk may still panic-sell during volatility, costing an estimated 3% of annual returns. The April 2026 Targeted Support framework will allow segment-level risk assessment for common financial situations, but full personal recommendations remain subject to the three-pillar approach where capacity for loss frequently overrides stated preferences. Firms' persistent enforcement failures—particularly around capacity assessment and templated suitability reports—underscore that compliance requires genuine individual analysis, not checkbox exercises. The most defensible approach combines validated psychometric tools with adviser discussion, explicit capacity calculations, and documentation that demonstrates how all three pillars informed the final recommendation.