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Make sure you and your adviser are on the same page

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A nervous client called financial planner Rona Birenbaum recently to ask about fleeing the stock market.

She talked him down by reminding him that his portfolio was designed to withstand volatile times like these. And then, to document this, she e-mailed him a copy of his investment policy statement, or IPS.

An IPS puts a client's needs and objectives in writing, Ms. Birenbaum said. "It says this is how much downside I can take as an investor, this is a reasonable return expectation, this is my asset mix."

Investors, ask your adviser for an IPS if you don't already have one. Advisers, consider the IPS as a way of demonstrating your understanding of clients' needs.

"I think they're fundamentally important," said Kathleen Clough, associate portfolio manager at PWL Capital in Toronto. "From my perspective, it basically says to the client, 'Here's how we're going to manage your money.' "

There's no standard format for an IPS, but they typically cover such factors as:

Risk tolerance: Where you say how much of a stock market decline you can live with.

Rate of return goals: The annual average return required to fulfill the financial plan your adviser should have produced for you.

Mix of assets: The blend of stocks, bonds and cash that you will follow in all types of market conditions.

Time horizon: When you expect to move from accumulating money to living off it.

Ms. Birenbaum's client was prompted to think about selling after hearing from another adviser who was prospecting for new customers. This adviser had sent out an e-mail explaining a strategy of lightening up on exposure to the stock market in anticipation of more declines ahead. This is what unnerved the client to the point where he wanted to sell his stock market exposure.

The response from Ms. Birenbaum was to refer back to the client's IPS, which outlined an investing approach that was designed specifically for stock market gyrations such as we've seen lately. It called for the client, who was relatively new to her firm, to use dollar-cost averaging to move gradually into the stock markets. In fact, the client was only about 45 per cent exposed to stocks at the time the market fell and had a substantial amount of cash still to be invested in stocks.

Stephen Horan, an expert on standards of practice for advisers, said an IPS can be particularly useful during volatile periods for financial markets. "It becomes a reference for responding to investor angst," he said. " It provides a very steady hand on the rudder."

Mr. Horan works out of the Charlottesville, Va., office of the CFA Institute, a global organization for people who have earned the elite Chartered Financial Analyst designation. CFA standards call for advisers to produce an investment policy statement as part of the process of getting to know a new client.

Clients should expect to be interviewed thoroughly as part of the process in which an adviser prepares an IPS, Mr. Horan said. The adviser will ideally pose a series of questions to the client rather than relying on a fill-in-the-blank template.

"Filling out a perfunctory risk-tolerance questionnaire is not an investment policy statement," he said.

Ms. Birenbaum said she and her clients have a detailed discussion about the IPS before it's completed to make sure that risk tolerance and expected rate of return line up. For example, a client might say she can accept losses of no more than 10 per cent over one year, but she wants an annual average return of 8 per cent. In this case, either the client would have to accept more risk, or she has to lower her return expectations. Once completed, the IPS is signed by the adviser and client, who receives a copy.

In the past, advisers were encouraged to use the IPS as a marketing edge that indicated a high level of service to clients. "Now, people are talking about an IPS in terms of, 'This is really going to help you and your clients make better decisions during times of market upheaval,'" Ms. Birenbaum said. "I think it has a lot to do with the fact that we've had back to back bouts of volatility since 2008."

Why isn't the IPS used universally? "It's more work, and it's not mandated," she said.

If you're interviewing potential advisers, a question to add to your list is: Do you provide investment policy statements for your clients? A positive answer is a good indication you're dealing with an adviser who acts professionally.

Clients who don't have an IPS should just request it from their adviser. "Asking for one is not at all pretentious or confrontational," the CFA Institute's Mr. Horan said.

Bear in mind that the economic realities of the advisory business may be a factor here. If your account is on the small side, say less than $25,000 to $50,000, your adviser may not feel he or she is being paid enough to warrant the time required to produce an IPS. It costs nothing to ask, though.

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Your portfolio's master plan

Investment policy statements are used by advisers to document the investing approach they will use for clients. Here's an edited example of an IPS used by financial planner Rona Birenbaum for a husband and wife who were new clients. The husband is 51, the wife is 46.

Introduction and Summary

This Investment Policy Statement (IPS) is meant to provide clarity and guidance in the decision making process for your investment portfolio. This IPS was developed following discussions with you and from the responses that you provided. The IPS is intended to be a "living" document and will change over time as your needs and circumstances change. It will undergo a formal review annually.

Investment Situation and Objectives

This section outlines your current financial position, current portfolio status, your primary financial objective, and your overall investment knowledge.

Current Investment Portfolio

Your joint non-registered account is managed by ABC. It is an all equity portfolio that has performed very poorly over the past 10 years. Over the past 10 years the portfolio has declined by $20,000, and all the while you have had to pay tax on dividends and interest realized within the portfolio. Jane has money in a non-registered account at XYZ invested in a money market fund. Over the past year the fund has returned 0.38 per cent. This is well below most high yield interest accounts available in the marketplace. These funds are earmarked for your home renovation. Your RRSP accounts are held at XYZ. They are invested in a variety of bonds (maturities three to 23 years), a few bond funds, some money market funds and a small position in the Templeton Growth Fund.

Primary Investment Objective

Your primary objective is to grow the original investment through capital appreciation.

Investment Knowledge

Your investment knowledge appears to be average. P | BA | **A** | AA | EX

Your Risk Tolerance

Jane's risk tolerance is low-moderate. A temporary decline up to 10 per cent is acceptable to you but a decline beyond a one-year period would concern you. Ideally you would like positive returns each year. John's risk tolerance is moderate. A temporary decline of more than 10 per cent is acceptable to you because you understand that in order to generate growth in the portfolio, more volatile investments like stocks are required. A decline in the value of your portfolio over a two year period would be a concern for you and ideally you would like to experience positive returns each year.

Time Horizon/Liquidity

You have a dependable and certain income flow; your income and expenditures pattern is expected to remain stable over time and you don't plan to use this investment to supplement your income prior to reaching your retirement goal. Furthermore, you may be able to invest more money over time. You plan to retire around age 60. This suggests that the portfolio should hold investments with a medium time horizon. Furthermore, you may be able to invest more money over time. You plan to retire around age 60. This suggests that the portfolio should hold investments with a medium time horizon as well as a long term focus of 15+ years.

Rate of Return Expectation

John seeks a rate of return of 8 to 10 per cent on average over a number of years. Jane would like to experience a 5-per-cent return each and every year. You understand that volatility is a fact of life when striving for returns that exceed GICs, however, you are uncomfortable with volatility.

A portfolio structured to achieve 8 to 10 per cent on average over a number of years would require a majority of the portfolio be invested in equities. An equity-focused portfolio has volatility characteristics that are outside of your risk tolerance and frankly, would not be suitable given that you are approaching retirement. In addition, it is likely that equity returns will be muted over the next 10 years as the global economy digests the recent economic crisis. Striving for a higher return will compromise your principal preservation objectives. Positioning yourself too conservatively will result in you not achieving your retirement income objective. There will be pockets of growth that will generate higher than average returns, however, these opportunities will carry much higher risk and volatility characteristics. As such, you should expect an average return in the 5 to 6 per cent range over a number of years going forward.

Investment Mix

Current Open Account Mix	
Cash	23%
Fixed Income	0%
Equities	77%

Recommended Open Account Mix (neutral)	
Cash/fixed income	50%
Equities	50%

John's Current RRSP Account Mix	
Cash	23%
Fixed Income	74%
Equities	3%

Recommended RRSP Mix (neutral)	
Cash/fixed income	50%
Equities	50%

Jane's Current RRSP Account Mix	
Cash	11%
Fixed Income	82%
Equities	7%

Recommended RRSP Mix (neutral)	
Cash/fixed income	60%
Equities	40%

Market Conditions

The asset mix should be rebalanced based on changing market conditions and/or changing personal circumstances.

Roles and Responsibilities

Your Portfolio Design

I, your adviser, will be responsible for researching and presenting investment alternatives for fixed income, equity and alternative investment products. While you will take my research and suggestions concerning the portfolio into consideration, you will make all final decisions based on your own judgment.

Your responsibilities as our client

Your responsibility is to ensure that we are fully informed at all times of any material change in circumstances that may warrant a portfolio review.

INVESTMENT AUTHORIZATION

I agree with the information provided and the recommendation-for-action statement of investment policy. I understand that this statement does not guarantee the attainment of any fixed rate of return on my investment. I agree to provide notification of any change in my financial situation, and accept responsibility to ensure notification regarding changes in investment policy.

John Doe

Jane Doe

Rona Birenbaum

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