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Do Indian HNW clients really understand risk?

"EVEN THOUGH ISSUERS HAVE BEEN RATED TRIPLE A AT TIMES, IT'S TAKEN LESS THAN A WEEK TO BE DOWNGRADED FROM A TRIPLE A TO A D"

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What are the risks that clients should be aware of today?
The risks the client should be aware of depends on the asset class in which they are investing. When we talk about equity risk, on the one hand you are targeting much higher returns, but on the other hand there is significant volatility in an asset class like equities. You may have periods where markets may do extremely well, while other periods where the market does not do well at all, and that's the type of volatility to be aware of.

On the fixed-income side, there are really two types of risk. One which we've seen blow up very recently is credit risk. Even though issuers have been rated triple A at times, it's taken less than a week to be downgraded from a triple A to a D. On the other side, clients have to be aware that there is liquidity risk which exists in many of these fixed-income instruments. You cannot just exit at any point of time without taking a significant haircut, especially when you have decided to invest for a certain period of time.

How do you think about suitability?
Suitability actually comes in a two levels. One is at a client level and what that means is you have to understand what life stage the client is at. If approaching retirement, the client is looking at products to protect capital. But if looking at growth products, then you are ready to accept a level of volatility for longer term returns.

The second level is people who do diligence on the products. We look at the suitability of how a product is actually created. What types of covenants are there? What type of cover is there? What is the track record of a manager where the funds are being recommended?

You can have product suitability or you can have client suitability, and both the things have to be taken into account when one actually does some sort of recommendation.

There have been some issues recently - what's the problem?

Recently the issues have been more around the credit risk environment, considering that a couple of sectors are going through significant stress. Mainly the real estate sector as well as the NBFC sector. You have seen delays in payments, as well as payments which have not come in, specifically in the real estate space.

Again you come back to the whole suitability question. You cannot expect a product which gives you 20% return and the other product which is giving you 8% return to have similar risk characteristics.

When investors look at their objectives, they need to understand that returns, liquidity and risk are all embedded into the final solution. Across the return spectrum, you cannot get a similar type of risk and return for an 8% product versus a 20% product. You need to read the fine print, understand the type of collateral cover when you are investing into a fixed income security. And understand what your risk profile is, and then only go in for subscription.

What's the role of the adviser?

The role of the advisor becomes very, very important. At times, people have made statements about the client deciding what he wants and everything being available, but that's where the advisor becomes important. Not from a purpose of doing the initial due diligence and understanding suitability, but also actually in understanding the product life cycle - what is happening to the investment in question.

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That's why the role of the advisor becomes quite pertinent, both at the level of due diligence, understanding suitability, and then maintenance of the product and monitoring at regular intervals. ■