

TREASURY EXECUTIVE MINUTE

Minute No.
10/3716

30 November 2010

Assistant Treasurer and Minister for Financial Services and Superannuation cc: Deputy Prime Minister and Treasurer

POLICY OPTIONS FOR ANNUAL RENEWAL OF FINANCIAL ADVICE (OPT-IN)

Timing: At your discretion

Recommendation/Issue:

- That you note this briefing on potential design features of the annual renewal policy as part of the *Future of Financial Advice* Reforms.

Noted

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KEY POINTS

- As was announced by your predecessor in April, the *Future of Financial Advice* (FOFA) reforms include a prospective requirement for retail financial advice clients to agree to fees and to annually renew (by opting-in) to an adviser's continued services.
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- The rationale for the policy is to ensure that advisers do not charge ongoing, open-ended fees where the client is receiving little or no service. It also empowers clients that are receiving an ongoing service to reconsider whether they are receiving value for money.
 - Although the financial planning industry has been supportive of the general thrust of the FOFA reforms, the opt-in policy has been widely opposed on the basis that it will impose costs on advisers for arguably little benefit. s47C
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- s22

Contact Officer:

Ext:

Manager
Financial Services Taskforce Unit

ADDITIONAL INFORMATION

Background

- As was announced by your predecessor in April, the FOFA reforms include a prospective requirement for retail financial advice clients to agree to fees and to annually renew (by opting-in) to an adviser's continued services.
 - The rationale for the policy is to ensure that advisers do not charge ongoing, open-ended, asset-based (or otherwise) fees where clients are receiving little or no service.
 - It also empowers clients that are receiving an ongoing service to reconsider whether they are getting value for money.

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s47C p 3-10

FUTURE OF FINANCIAL ADVICE

ANNUAL OPT-IN REQUIREMENT – ISSUES FOR DISCUSSION

19 November 2010

PROPOSED REFORM

As was announced by the Government on 26 April 2010, the *Future of Financial Advice* reforms will include a prospective requirement for retail clients to agree to advice fees and to annually renew (by opting in) to an adviser's continued services.¹

ISSUES FOR CONSIDERATION BY THE CONSULTATION GROUP

Issue 1 – Should there be a grace period

A question which has arisen in regard to how the opt-in policy will work is exactly when the 'annual' renewal will first be required. Arguably, at the start of a new engagement, a client has considered the service being offered and the fees charged, and therefore the chance of client inertia leading to fees being charged for no service are lower. For the first year or more, opt-in may be redundant. From this, two things must be determined. First, should an initial grace period apply, and second, how long should a grace period be.

Question 1.1 Should there be a grace period before opt-in applies?

Question 1.2 If yes, what is the criteria upon which the length of time should be determined?

Issue 2 – Application to non-ongoing contracts

Exactly how opt-in will apply to pre-agreed fixed-term contracts is also an issue not unrelated to whether a grace period should apply for new contracts.

The policy objective is to require a client opt-in to ongoing (open-ended) fees. Some have argued, for example, that a new contract between an adviser and client with an agreed duration of three years would not be assisted by an annual opt-in requirement and that, in addition, such contracts already include an ability to 'opt-out' at any time.

Arguably, the same principle can be applied to a contract with an agreed duration of four, or even five years. Whether opt-in should not apply to fixed-term/finite contracts is an issue for debate, including how long exempt contracts could run for.

Question 2.1 Should opt-in apply to fixed-term contracts? If not, how could we discourage the use of long-term, fixed-term contracts as a way of avoiding the policy objectives of opt-in?

Question 2.2 If not, what is the acceptable length for a contract to be eligible for the exemption?

Issue 3 – Precise requirement of 'annual' renewal

A key detail of the opt-in reform is exactly when advisers would be required to secure 'annual' renewal. This could be administered in a very strict way. For example, it could be a requirement that in order to charge ongoing fees, advisers must get client consent to those ongoing fees within 12 months of the last renewal or of the initial contract being agreed. Alternatively, the policy could

¹ The scope of opt-in covers personal advice and related ongoing fees for managed investments and superannuation. It is envisaged that this obligation will also apply to risk products. Issues associated with how it would apply to risk products will be examined in 1H2011.

FUTURE OF FINANCIAL ADVICE

ANNUAL OPT-IN REQUIREMENT – ISSUES FOR DISCUSSION

19 November 2010

be administered more flexibly. For example, it could be a requirement that the annual notice be sent within 12 months of the last renewal, but with some leeway of a number of months regarding when the notice must be sent and when the client must agree.

Another alternative model would be one where the adviser has full flexibility to determine when during a given year renewal should be obtained from the client. An example of this could be that an adviser, in order to charge ongoing fees, must obtain a renewal from the client at least once every calendar year (or financial year), but the precise point in time would be at the sole discretion of the adviser or the practice. For example, if this was done on a calendar year basis, and client agreement was last renewed in January 2010, renewal would not be required until December 2011 at the latest. How this is managed would be at the discretion of the practice, but leaving things until the end of the renewal period would be a risky strategy. Therefore prudent practices would most likely seek renewal at the same time every year, but this would not be forced through a prescriptive requirement, and would presumably be an unobtrusive requirement for those undertaking best practice client reviews on an annual basis.

Question 3.1 What are your views on the options?

Question 3.2 Are there any other alternatives?

Issue 4 – Methods to opt-in

A significant issue is the method by which advisers can get clients to opt-in. Methods might range from a minimalist requirement whereby an adviser, who by being in regular contact with a client in any case, obtains verbal confirmation from the client that they are happy with the advice relationship, to the more onerous requirement of requiring the client to sign a consent form every year to agree to the fee-for-service arrangement.

Question 4.1 What methods would the industry use to actively retain clients by getting them to opt-in? Please outline how this would differ from contact that advisers have with clients now?

Question 4.2 Are there any concerns with making the process too flexible/informal? For example, if there is no requirement that the adviser retains a written record then there is no evidentiary proof if a dispute arises in the future over opt-in and liability.