

# OSC's proposed fee model draws industry's ire

*A proposal to charge fees based on historical data means firms' payments will be based on previous highs*

■ BY JAMES LANGTON

**F**INANCIAL SERVICES firms constantly complain about the costs of regulation, as they pay a big price to ensure that they're in compliance with the rules. And while the fees they pay to regulators represent a small part of total costs, these fees are also despised. Little wonder, then, that there's much bleating about the Ontario Securities Commission's plan to change its fee model, a step that some say will saddle dealers with higher costs at a time when they can least afford it.

This past October, the OSC proposed a revision to its fee model that is designed to match its revenue to expenses better. (In recent years, the OSC has persistently found itself with large surpluses; as a result, it announced it would rebate about \$22 million to financial services firms and issuers for past fees that had contributed to the inflated surplus.)

On the face of proposal, the securities industry should be pleased with changes that are meant to curtail these large fee surpluses and return the spoils of past overcharging to the firms that footed the bills. But things are never that straightforward. Indeed, whenever fee schedules and calculation methods are altered, someone is sure to feel hard done by — and to cry foul as a result.

In this case, the biggest objection that various industry factions have with the regulator's plan is its

proposed move to calculating these charges from historical data rather than levying certain fees based on forecasts.

Currently, a reporting issuer is charged a market participation fee based on its market capitalization for its current fiscal year, while dealers and fund managers are charged according to their annual revenue. Under the proposed changes, these fees would instead be based on a firm's market cap or revenue at the end of its most recent fiscal year prior to Jan. 1, 2008. "The proposed changes eliminate the need to forecast market conditions in determining the fees," the OSC explains in its proposal.

Also, by relying on actual data rather than predictions to set certain fees, the regulator expects to be more accurate in its revenue calculations and, therefore, less likely to generate large surpluses (or suffer significant shortfalls).

In theory, the idea is a good one. But for some in the industry, the change is coming at precisely the wrong time — in the midst of a financial crisis that has knocked down the value of many firms significantly. Firms have already seen their balance sheets decimated, earning power eroded and credibility whacked. They don't want to have to face regulatory fees calculated on the basis of their pre-2008 glory days.

Although most industry firms and trade associations that submitted comments on the proposed

rule change don't necessarily argue against the concept of setting fees on an historical basis, they object to the timing of this move.

For example, although the **Investment Industry Association of Canada** comment letter concedes that the new calculation method would make regulatory revenue more predictable, it also says the IIAC is "very concerned about the timing of this decision and the effect that this will have on market participants in this already challenging time."

The IIAC letter says the pre-2008 fiscal year represents a market peak. As a result, the regulator will be setting its fees based on a high point in the market at a time when firms are having to slash expenses in response to both a financial services industry downturn and an economic crisis.

"In the past year, the unprecedented severity of the downturn in the markets has put considerable economic pressure on market participants, resulting in significant cutbacks and, in many cases, downsizing of operations and staff," the IIAC letter notes, adding that it is not clear how severe this crisis will be or how long it will last.

"The proposed changes to the fee model at this time," the letter warns, "will lock in substantial fee increases for a two-year cycle, during which the industry will be facing considerable financial challenges."

There's a similar concern among fund managers. The **Investment**

**Funds Institute of Canada's** comment says that the idea of moving to historical data to determine certain fees may make sense when markets stabilize, but that it would be "inappropriate" to lock in fees based on pre-crisis data.

"IFIC members' revenue declined significantly in 2008 and the OSC's proposed reference fiscal year does not reflect the current reality because it requires market participants to pay participation fees based on revenue earned at the peak of the market cycle," IFIC's letter says, adding that tying fees to firms' results in good times also runs the risk of continuing to generate significant surpluses.

It's not just the proposed change in calculation methodology that has some market players upset; the regulator is also planning to alter the rates firms pay, lowering some fees and effectively raising others. Late payment rates would go down, but certain activity fees would go up (the cost of reviewing a prospectus for example); market participation fees are also set to rise. (In fact, the participation fee rates aren't increasing, per se, but in the past, the OSC has reduced these fees using some of its accumulated surplus; it now plans to halt that practice.)

This aspect of the OSC proposal is also sparking complaints. The IIAC letter indicates that it is concerned about the possibility of higher participation fees. The IIAC calculates that the effect of proposed changes to participation fees will be an in-

crease in fees paid of at least 55% for reporting issuers and between 11% and 25% for registrants and unregistered fund managers.

"These increases are significant and could be problematic for various participants, even during strong economic cycles," the IIAC warns. "Under the current market conditions, imposing such increases may tip the balance to make certain transactions and operations not feasible, which, on a larger scale, will extend and exacerbate the economic difficulties facing the industry."

One firm that expects to see its fees go up as a result of the proposed changes is Winnipeg-based **IGM Financial Inc.** Its comment on the proposal indicates that IGM and its various subsidiaries collectively paid about \$1.5 million in regulatory fees in the most recent year, which, the letter points out, amounts to about 2% of the OSC's total revenue for the year. Under the new fee model, IGM calculates, its fee bill will rise by 14% — almost entirely due to revisions to the rates.

"We are having some difficulty reconciling a 14% increase in our OSC fees concurrent with your increasing surplus," the IGM letter says, noting that the OSC now has a reserve fund of \$20 million and that the latter's revenue has outpaced expenditures by almost \$50 million in the past three years.

Other firms are similarly miffed. Toronto's **Invesco Trimark Ltd.**'s letter points out that the mutual fund industry is already under "significant

pressure” to reduce fund operating expenses; although the industry has been able to cut expenses in many areas, regulatory costs keep rising: “Many firms regulated by the OSC are freezing salaries and new hires; some are even cutting staff outright. As such, it is difficult for us to comprehend why our regulator seeks to increase its fees in order to achieve the opposite result at this time.”

Moreover, the letter says, although Trimark would normally suggest an alternative when objecting to a regulatory proposal, it can’t imagine one in this case: “The timing of this particular proposal is

so poor, given the current state of the markets, that we cannot offer any alternative suggestions other than [abandoning the proposed rule and maintaining the current fee model] until such time as capital markets recover.”

Not only are financial services firms bothered by the content and timing of the proposed revisions to the OSC fee model, which could see them paying higher fees at a particularly precarious time, some are also questioning the details of plans to return some of the existing surplus — estimated at \$49 million for the fiscal year ending March 31,

2009 — to the industry.

Under the OSC’s proposal, \$6 million would be refunded to registered firms and \$16 million to issuers; \$4 million would be devoted to keeping issuers’ fees at 2006 levels; and \$23 million is to be set aside to accommodate the revenue shortfall that’s expected when registration reform is implemented.

IFIC’s comment letter objects to both the apportionment of the surplus between registered firms and issuers and to the plan to retain almost half of the surplus for whenever registration reform is adopted.

Regarding the former, IFIC notes

that registrants pay a higher portion of these fees, yet that they are due to get only about a quarter of the refund. As for the latter, IFIC questions why the OSC doesn’t return this money to the industry as well.

“Respectfully, we fail to understand why the OSC deems it necessary to retain any portion of its surplus for these purposes,” the IFIC letter says, “when it has already set aside a \$20-million reserve ‘as an operating contingency for revenue shortfalls or unexpected expenses.’”

Indeed, the industry would generally like to see regulators become

more careful with their pennies. The IIAC letter suggests that perhaps the OSC could tighten its belt a bit to avoid fee increases in the current environment.

“Market participants are all making difficult decisions to determine where they can trim budgets and enhance efficiencies,” the IIAC says, calling on the OSC to “provide leadership” by revealing details of its budgeting process and scrapping any changes to its fee model that would result in higher direct regulatory costs. **IE**

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