



Financial Services Commission

Bulletin

Fee Strategy and Fee Proposals

FINANCIAL SERVICES COMMISSION BULLETIN Fee Strategy and Proposals for the Financial Services Commission

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A. Introduction

The Financial Services Commission (“FSC”) is an integrated regulatory agency which combines the former Securities Commission, the former Office of the Superintendent of Insurance and Unit Trusts and a new pension funds authority. The FSC is governed by the *Financial Services Commission Act, 2001* and other enabling legislation and its mandate is to protect users of financial services in the areas of insurance, securities and pensions by fostering the integrity, stability and health of the financial sector.

The agency commenced operations during August 2001 and currently supervises the life insurance industry, the general insurance industry and the securities industry. Supervision of the pension sector has not yet commenced and awaits the passage of appropriate legislation and the development of supporting regulations. The FSC is, however, currently conducting developmental work with respect to supervision of the pension sector.

The FSC must incur staffing and other operating costs in order to meet its mandate. Because the FSC is intended to be financially independent from government it has been empowered to impose fees on regulated entities. Although the FSC currently levies a variety of fees it has previously not established a formal fee policy which would allow it to raise sufficient funds to meet its mandate.

It is the position of the FSC that a fair and equitable fee policy can only be established after there has been consultation with those who will be required to pay the fees. The FSC presented proposals on how the FSC intends to raise the funds necessary to meet its mandate in discussion papers which formed the basis of consultations with industry associations and entities representing the entities directly affected by the proposals.

The purpose of this bulletin is to provide information on the fee strategy, fee principles and specific fee proposals which the FSC is now proceeding to implement.

B. Fee Strategy and Principles

The FSC has developed seven principles which form the basis for its fee strategy. These were circulated to industry in the form of a Discussion Note and written responses were received from six industry associations. A summary of the principles and industry responses is as follows.

1. Full Cost Recovery – The FSC should operate, in the long term, on a full cost recovery basis. The FSC is intended to perform its functions in an independent and impartial manner. One important aspect of independence requires that the FSC be self financing on a sustained basis. Furthermore, given its mandate, the FSC benefits the consumers of general insurance, life insurance, securities and pension services and the providers of these services by increasing stability and confidence in the industries it supervises. Therefore, it should be those industries, rather than the taxpayer at large, that should fully fund the operations of the FSC. In accordance with this principle, however, the FSC should not seek to collect revenue in excess of its costs on a continuous basis.

There was acceptance by four industry respondents that the FSC should fully fund its operational expenses from fees levied on supervised industries. Two respondents, however, indicated that government (taxpayer) subsidies should be provided.

2. Revenue Based on Regulatory Effort - FSC revenue from different industry sectors should be based on regulatory effort. This suggests that industry sectors that require higher levels of regulatory effort resulting in higher FSC costs should be required to pay higher fees. In other words, there should ordinarily be no cross subsidization among different industries. Similarly, within a given industry it is generally accepted that larger companies typically require more regulatory effort than smaller companies with the implication being that larger companies should generally pay higher fees.

Although there was general agreement regarding this principle, three respondents indicated that there may be some difficulty in applying this principle from a practical perspective.

3. Revenue Stability - FSC revenue should be stable over time. As the FSC matures its expenditure should become relatively stable and be influenced primarily by inflation, the growth of the various financial services industry sectors and productivity gains in the operation of the FSC. As a result, it is beneficial for the FSC to have a stable source of revenue. Reliance on a volatile revenue source which has both windfall gains and windfall losses may result in an inefficient system of regulation. Regulated entities also benefit from stability and reasonable certainty with respect to their fee costs.

There was a general acceptance by all respondents that stability of revenue was beneficial to both the FSC and industry.

4. Contingency Reserve Fund – The FSC, for reasons of operational stability, should be allowed to build a contingency reserve fund. The closure of a regulatory agency for even a short period of time due to a funding shortfall could have catastrophic results. For this reason, it was proposed that the FSC be allowed to build a contingency reserve fund as a cushion to protect itself against years of below normal fee revenue or years of higher than normal expenditure. It was proposed that the FSC initially set fees at full cost recovery plus 10 percent until it has established a contingency reserve fund which approximates fifty percent of annual expenditure. Once this target has been reached, it was proposed that fee levels reflect cost recovery only and that fee levels be reduced if the contingency reserve fund exceeds its predetermined level.

The majority of industry respondents **did not agree** with this principle. It was argued that if the FSC set its fees in a proper manner, a reserve fund should not be required. In addition, it was suggested that any short term financial shortfall of the FSC should be funded by government.

5. Ease of Understanding and Simplicity of Administration - To the extent possible, the formulae used to determine FSC fees should be straight forward and easy to understand by both the FSC and those paying the fees. Ease of understanding will help ensure that those paying the fees can be satisfied that fees are being levied in a fair and equitable manner. In addition, the processes used by the FSC to determine fee levels and to collect fees should be relatively simple and straight forward so that FSC administration costs can be minimized.

There was a general acceptance of this principle by all respondents.

6. Ease of Verification - To the extent possible, the parameters on which fees are based should be easy to verify by the FSC. For example, if it is decided that fees in the life insurance sector are to be based on premiums or alternatively on assets, the premiums or assets used as the fee determination base should be those reported in the financial statements of each company to the extent possible. The fact that such statements are subject to independent audit and scrutiny will help ensure that everyone is treated in an equitable manner. Similarly those paying the fees should be provided with sufficient information to verify that the FSC is, in fact, levying fees at an appropriate level. In this context, the FSC proposes that it report its fee collections once each year as part of its independently audited financial statements. These statements are publicly available and must be submitted to the Minister for tabling in parliament.

There was a general acceptance of this principle by all respondents.

7. Predetermined Review Dates - A periodic review should be made with respect to the fee policy of the FSC. As conditions change, it may be necessary to adjust specific fees either upward or downward or make changes in fee policy. In this context, it was

proposed that the FSC undertake a review of its fee policy at least every 2 years and that each review be accompanied by consultation with those affected.

Although all respondents agreed that there should be regular review dates, one respondent felt that these should be conducted on an annual basis.

As a result of the responses from industry, the FSC has adopted six of the seven principles. The exception is the contingency reserve fund principle where the FSC was prepared to withdraw this principle pending further analysis.

C. FSC Costs and Cost Allocation

The principle of full cost recovery implies that the FSC must set fees at a sufficient level to recover its costs. Furthermore, the regulatory effort principle implies that the FSC must devise a technique to allocate its costs among various industry sectors including general insurance, life insurance, securities and pensions.

A cost allocation model has been developed to perform the cost allocation function and was applied to the proposed FSC budget for 2003/04. The model divides FSC costs into three categories:

- direct staffing costs for FSC employees performing supervisory and regulatory activities which total \$120.6 million or 58 percent of the FSC budget of \$212.4 million;
- direct staffing costs for FSC employees performing a support function (e.g. accounting function, personnel function, IT function) which total \$41.6 million or 19 percent of the total FSC budget; and,
- overhead costs including maintenance, utilities, travel and other costs which total \$50.1 million or 23 percent of the total FSC budget.

The cost allocation model consists of four steps.

1. Allocate each budgeted staff member and their salary and benefits to one of the four industry sectors or to the support function based on the work done by the employee. For some employees this is relatively simple. For example, employees that work in the Securities Division are 100 percent allocated to the securities industry sector. For other employees the allocation is more difficult. For example, employees in the Examinations and Investigations Division perform the examination and investigation functions for more than one industry sector. These employees were allocated to various sectors based on the percent of time worked as estimated by Division Heads. The allocation of FSC staff among industry sectors is shown in Table 1.
2. Determine total direct staffing costs for each of the four industry sectors and the support function.

3. Allocate staffing costs for the support function to each of the four industry sectors in proportion to that sector's direct staffing costs.
4. Allocate overhead costs to each industry sector in proportion to the total staffing costs of the sector.

The results of the cost allocation model are shown in Table 2. The table indicates that the securities sector generates the largest FSC expenditure (\$71.5 million) followed by general insurance (\$65.2 million), life insurance (\$46.9 million) and pensions (\$28.8 million). The total cost estimates for each industry sector are the fee targets that must be achieved if the FSC is to meet full cost recovery. At the current time, the FSC has no authority to levy fees on the pensions sector and must recover these costs from other sources.

Table 1: Estimated FSC Staff Time Allocation by Sector (% of total)

FSC Division	Life Insurance (%)	General Insurance (%)	Securities (%)	Pensions (%)	Support (%)	Total (%)
Executive Director	0	0	0	0	100	100
Examination and Investigations	27	40	33	0	0	100
Insurance	33	67	0	0	0	100
Securities	0	0	100	0	0	100
Pensions	0	0	0	100	0	100
Actuarial	50	50	0	0	0	100
Legal	18	13	44	10	15	100
Registration	32	22	26	20	0	100
Other Corporate Services	0	0	0	0	100	100

Note: Staff Allocation time estimates were provided by Division Heads based on actual work performed in previous years and expectations for 2003/04.

Table 2: Estimate of 2003/2004 Costs by Industry Sector (\$ millions)

	Life Ins.	General Ins.	Securities	Pensions	Total
Direct staff costs	26.6	37.0	40.6	16.3	120.6
Support staff costs	9.2	12.8	14.0	5.6	41.6
Total staff costs	35.8	49.8	54.6	22.0	162.2
Overhead costs	11.1	15.4	16.9	6.8	50.1
Total costs	46.9	65.2	71.5	28.8	212.4

D. Analysis of Existing Fees and Proposed Fees

1. Insurance Industry

(a) Life Insurance Industry Description

There are seven life insurance companies registered to conduct business in Jamaica. As at September 30, 2002, life insurance companies conducting business in Jamaica had assets of \$36.5 billion. At the time of developing these proposals it was forecast that the industry would report net income (after tax) of \$2.0 billion during the 2002 fiscal year. All companies are reported to be in a profitable position.

(b) Existing Fees – Life Insurance Companies

At the current time, the FSC levies the following fees on life insurance companies:

- A renewal fee of 0.75 percent of gross first year premiums except for employee benefit products where the fee is 0.35 percent of gross premiums;
- \$5,000 for the filing of the annual return;
- \$3,000 for the filing of each quarterly return; and,
- Miscellaneous fees for product approvals etc.

These fees were expected to have generated approximately \$14.3 million in revenue during 2002/03.

The FSC also levies registration and renewal fees on life insurance intermediaries including sales representatives, agents and brokers. These fees were expected to have generated approximately \$2.0 million in revenue during 2002/03.

The fee system currently employed by the FSC does not appear appropriate when examined in the context of several of the fee principles that have been established.

- It was estimated in Section C of this bulletin that FSC supervisory costs for the life insurance industry will total \$46.9 million in 2003/2004. Forecast fee revenue from life insurance companies and intermediaries of \$16.3 million for 2002/03 suggests that significant increases in revenue will be required if the full cost recovery principle is to be met.
- An examination of the distribution of 2002/03 fee payments by companies indicates that 3 companies pay 85 percent of the fees. Moreover, there does not appear to be much correlation between fee levels and company size. Clearly, the distribution of fee revenue among life insurance companies does not bear any relationship to regulatory effort.
- The filing fees levied by the FSC must be paid by companies on five separate occasions and renewal fees are paid on a quarterly basis, based on quarterly financial results. An approach that determined an annual fee would greatly

- reduce administration costs for both the FSC and companies and be consistent with the ease of administration principle.
- It is unlikely that the fee payments can be easily verified as to their accuracy. The fees for life insurance companies are based on first year premiums which are not generally reported in the financial statements of a company. In addition, the fees are based on quarterly unaudited company estimates. A year-end reconciliation and audit would likely be difficult and costly. An approach which levied a fee based on information contained in the company's audited financial statements would allow the FSC to achieve the ease of verification principle.

(c) General Insurance Industry Description

There are fourteen general insurance companies registered to conduct business in Jamaica. As at September 30, 2002, general insurance companies had assets of \$20.0 billion. At the time of developing these proposals net income (after tax) for the year ended December 31, 2002 was forecast to be \$1.8 billion. All companies are reported to be in a profitable position.

(d) Existing Fees – General Insurance Companies

At the current time, the FSC levies the following fees on general insurance companies:

- A renewal fee of 0.75 percent of gross premiums for all classes of insurance except sickness and health insurance where the fee is 0.35 percent of gross premiums;
- \$5,000 for the filing of the annual return;
- \$3,000 for the filing of each quarterly return; and,
- Miscellaneous fees for product approvals etc.

These fees were expected to have generated approximately \$98.9 million in revenue during 2002/03.

The FSC also levies registration and renewal fees on associations of underwriters and general insurance intermediaries including sales representatives, agents and brokers. These fees were expected to have generated approximately \$2.0 million in revenue during 2002/03.

The existing fee structure for the general insurance industry is largely compatible with the fee principles established by the FSC. The fee revenue generated is more than sufficient to recover FSC costs of supervision. In fact, it was estimated in Section C of this bulletin that 2003/04 supervision costs for the general insurance industry will only total \$65.2 million, significantly less than forecast fee revenue for 2002/03.

The fees appear to be roughly in accordance with the regulatory effort principle. The largest four companies in terms of assets pay 46 percent of the fees, the middle five companies pay 38 percent and the smallest 5 companies pay 16 percent. The majority of

fee revenue is derived from a fee which is based on gross premiums written and can be verified from independently audited financial statements. Although the collection and administration of the fee is somewhat complex, the process could be simplified without too much difficulty.

However, the general insurance industry has argued that the existing fee structure is not suitable due to the fact that it yields revenue in excess of regulatory costs and because it is based on gross premiums. Gross premiums are quite volatile and are influenced by the price of reinsurance. In the last several years, reinsurance prices have increased significantly. The general insurance industry argues, with some justification, that reinsurance prices have very little impact on regulatory effort and therefore should not be used as a basis for deriving FSC fee revenue. This problem can be resolved by using an alternative base on which to levy fees and specifying fee parameters that are consistent with the cost recovery principle.

(e) Insurance Industry Fee Proposal

It is proposed that the current FSC fees set out in the previous section for life insurance companies be replaced by an annual renewal fee which is based on assets. Under this approach each life insurance company would be required to pay the greater of:

- a minimum annual fee of \$1 million; or
- an annual fee based on a fee rate of 14 basis points on its first \$5 billion in assets, 7 basis points on its second \$5 billion in assets and 4 basis points on assets over \$10 billion.

A proposal for the general insurance industry that is consistent with that proposed for the life industry is one where each general insurance company would be required to pay an annual renewal fee equivalent to the greater of:

- a minimum annual fee of \$1 million; or
- 37 basis points on its first \$1 billion in assets, 27 basis points on its second \$1 billion in assets, 17 basis points on its third \$1 billion in assets and 7 basis points on any assets over \$4 billion.

Intermediaries, including agents, brokers and sales representatives would continue to pay the existing annual registration and renewal fee.

An anomaly in the existing fee structure relating to associations of underwriters is being modified. An association of underwriters would be required to pay an annual renewal fee equivalent to the greater of \$0.5 million or the sum of 10 basis points on its first \$500 million of gross premiums and 5 basis points on gross premiums in excess of \$500 million.

The impact of this fee proposal on insurance companies is shown in Table 3. For purposes of the table, the 21 insurance companies registered to conduct business in

Jamaica have been grouped into 4 “quartiles” based on asset size. The “largest quartile” consists of the 5 companies with the largest asset base, while the “smallest quartile” consists of the 6 companies with the smallest asset base. The second and third quartiles each contain 5 companies based on asset size.

The table indicates that the insurance industry fee proposal is revenue neutral relative to the existing fee schedule. In fact, based on the fee forecasts presented in the table, a slight fee reduction in total insurance company fees from \$112 million in 2002/03 to \$108 million in 2003/04 is expected. A detailed analysis of each company indicates that 8 companies will experience fee payment increases and 13 companies will have decreased fee payments as a result of the proposal.

Table 3: Fee Indicators for Insurance Industry

Indicator	Largest quartile	Second quartile	Third quartile	Smallest quartile	Total
A. Assets					
Assets \$ Millions	33,642	12,762	6,399	3,508	56,311
Assets % of total	59.7	22.7	11.4	6.2	100.0
B. Income					
Net Income \$ Millions	1,793	1,245	431	339	3,808
Net Income % of Total	47.1	32.7	11.3	8.9	100.0
C. 2002/03 Fees					
Fees \$Millions	12.9	46.4	37.3	15.6	112.2
Fees % of Total	11.5	41.4	33.2	13.9	100.0
Fees as % of Income	0.7	3.7	8.7	4.6	2.9
Fees to assets (bp's)	3.8	36.4	58.2	44.5	20.0
D. Proposed Fees 2003/04					
Fees \$Millions	40.1	32.7	22.3	13.1	108.2
Fees % of Total	37.1	30.2	20.6	12.1	100.0
Fees as % of Income	2.2	2.6	5.1	3.8	2.8
Fees to assets (bp's)	11.9	25.6	34.8	37.3	19.2

Notes: 1. Quartiles are based on company assets as at September 30, 2002. 2. Income is for the year ended December 31, 2002 as reported in companies' unaudited financial statements. Income for two companies was forecast based on results for the nine month period ended September 30, 2002. 3. Fees for 2002/03 were forecast based on fee payments for the first two quarters of the 2002/03 fiscal year.

Although ability to pay was not put forward as an FSC principle, it is generally regarded as important with respect to the collection of any fee imposed by a government entity. Ability to pay is typically measured by comparing the fee payment to income.

Table 3 indicates that the burden of current FSC fees falls heaviest on third quartile and smallest quartile companies. These companies pay an average of 8.7 percent and 4.6 percent of their annual income for FSC fees respectively. By contrast, companies in the largest quartile, on average, pay FSC fees equivalent to less than one percent of income.

Under the proposed fee schedule, companies in the third and smallest quartile continue to have the heaviest fee burden relative to income. However, compared to the current situation, the burden is significantly reduced and shifted somewhat to larger companies. Clearly, on the basis of ability to pay, the proposed fee schedule is superior to the existing fee schedule.

The fee schedule also appears to satisfy each of the fee principles adopted by the FSC.

The annual fee is based on company assets and the fee rates have been set to generate sufficient revenue to meet FSC operating costs for the life insurance industry and the general insurance industry. The full cost recovery principle has been met and there is no cross subsidization between the life and general segments of the industry.

The fee rates are set so that larger companies pay higher fees than smaller companies although the average fee rate declines with company size. This is consistent with the principle of regulatory effort.

If each company required an equal amount of regulatory effort, it would imply that each of the four company “quartiles” shown in Table 3 would pay 25 percent of total fees. However, it is generally accepted that larger companies require higher amounts of regulatory effort. This suggests that the largest and second quartile companies shown in the Table should therefore make fee payments in excess of 25 percent of total payments and third and smallest quartile companies should make fee payments of less than 25 percent of total payments. Although there are no set rules in this regard, given the distribution of assets among Jamaican insurance companies it would appear that a reasonable payment distribution consistent with the principle of regulatory effort might have companies in the first quartile paying 35 percent of fees, companies in the second quartile paying 30 percent of fees, companies in the third quartile paying 20 percent of fees and companies in the fourth quartile paying 15 percent of fees.

The current FSC fee structure is not consistent with the regulatory effort principle. Companies in the “largest quartile” pay only 11.5 percent of total fees and appear to receive a large element of cross subsidization from companies in the second and third quartiles. In fact, “largest quartile” companies pay lower fees on average than companies in the “smallest quartile”.

The proposed fee structure changes the fee burden significantly and appears to be quite reasonable in the context of the regulatory effort principle. Under the proposed fee structure, the largest companies are forecast to pay 37.1 percent or slightly in excess of the 35 percent target. The smallest companies pay 12.1 percent of fees or slightly less than the 15 percent target.

Clearly, on the basis of the regulatory effort principle, the proposed fee structure is superior to the existing fee structure.

The proposed fee schedule appears consistent with the revenue stability principle. Provided that increases in company assets over time are similar to increases in FSC operating costs, fee rates will not have to be continually increased once the FSC's expense base has been stabilised. Moreover, unlike the existing situation fee revenue will not be influenced by the volatility of the reinsurance market under the proposed fee schedule.

Under the proposed fee model, the FSC will determine the asset base of each company from its filed financial statements (due on March 31) and send each company a fee invoice for the next year. For cash flow reasons, the FSC will allow companies to pay the fee invoice in four quarterly installments. This approach is consistent with the ease of understanding and simplicity of administration principle.

Because the fee base (i.e. assets) is routinely reported in the independently audited financial statements of each insurance company, it will allow for ease of verification.

The new fee schedule is expected to come into effect before October 2003.

2. Securities Industry

(a) Industry Description

At the time of developing these proposals there were 58 securities dealer companies and 20 individual dealers not associated with a company registered to conduct securities business in Jamaica. As at September 30, 2002 the industry had total assets of \$286 billion. For purposes of this bulletin, total assets are defined as the sum of the company's on balance sheet assets and funds under management, which includes collective investment schemes (mutual funds and unit trusts) but excludes the assets of certain entities.

The entities whose assets have been excluded (referred to in this bulletin as "excluded entities") include commercial banks, life insurance companies, pension funds and pension fund managers, and three other companies that do not provide securities market services to the public. Commercial Banks have been temporarily excluded because their "securities assets" were until recently co-mingled with their "banking assets". Life insurance companies are excluded because they already pay fees to the FSC and the pension industry is expected to pay separate fees when they become supervised by the FSC.

At the time of developing these proposals net income (after tax) for the securities dealers was forecasted at \$5.2 billion for 2002, excluding the net income of the excluded entities.

(b) Existing Fees

At the current time, the FSC levies fees on the securities industry as shown in Table 4. These fees were expected to have generated approximately \$28.6 million in revenue during 2002/03 of which \$22.8 million was anticipated to come from the dealer companies as shown in Table 5.

The major weakness of the existing fee schedule is that it generates insufficient revenue in the context of the FSC full cost recovery principle. As indicated in Section C of this bulletin, FSC costs associated with the securities industry are estimated at \$71.5 million for 2003/04. Significant fee increases will be required if FSC full cost recovery is to be achieved. In addition, the current fee structure levies numerous small documentation fees that result in higher than necessary administration costs for both the FSC and the industry.

Table 4: Securities Industry Fee Schedule for 2002/3

Types of Fees	Existing Fees
REGISTRATION	
Dealer	
<i>Individual</i>	\$120,000
<i>Company</i>	\$120,000
<i>Representative</i>	\$16,000
<i>Company Branch</i>	\$8,000
Investment Adviser	
<i>Individual</i>	\$90,000
<i>Company</i>	\$90,000
<i>Representative</i>	\$8,000
<i>Company Branch</i>	\$4,000
Responsible Officer	\$50,000
Documentation	
<i>Applications for Licensing & Registration</i>	\$5,000
<i>Amendment to Registration Information</i>	\$2,000
<i>Quarterly Financial Statements</i>	\$3,000
<i>All Other Filings (including annual)</i>	\$5,000
Mutual Funds	US\$5,000
Jamaica Stock Exchange	0.08% of value of daily trade
JCSD	5% of transaction revenue
Commercial Paper	\$8 for every \$100,000

Table 5: Fee Estimates for Securities Industry (\$ million)

Dealers Total Assets	Number of Dealer Companies	Total (Aggregate) Assets	Forecast Fees 2002/3	Proposed Fees ¹ 2003/4
0 to \$2 billion	39	20,611	13.0	13.9
\$2 billion to \$15 billion	11	87,168	5.2	24.6
\$15 billion +	8	178,512	4.6	26.7
Total Securities Dealers	58	286,269	22.8	65.2
Other Fees ²			5.8	6.0
Total		286,269	28.6	71.2

Note 1: Proposed fees are 5 basis points on the first \$2 billion of assets, 2 basis points on the next \$13 billion of assets, 0.02 basis points on assets over \$15 billion with a minimum fee of \$170,000. **Note 2:** Other fees include JSE, JCSD, Mutual Funds, Commercial Paper and Individual Dealers.

(c) Fee Proposal

It is proposed that the current FSC fee schedule for annual renewal fees payable by dealer companies, responsible officers and dealer's representatives be replaced by an annual supervision fee where each dealer company is required to pay the greater of:

- a minimum annual fee of \$170,000; or
- 5 basis points on the first \$2 billion of assets, 2 basis points on the next \$13 billion of assets and 0.02 basis point on assets over \$15 billion.

Note that the minimum fee requirement is equivalent to the annual renewal fee currently paid by a dealer and its responsible officer (\$120,000 and \$50,000 respectively). Documentation fees would also be removed except for application fees and fees for amendments to registration information. In addition, fees for JSE, JCSD, mutual funds, unit trusts, commercial paper and individual dealers would remain unchanged. Finally, for purposes of these proposals it is assumed that excluded entities will pay the minimum fee of \$170,000.

Table 6 presents an analysis of the implications of the proposed fees compared to the current fee schedule. For purposes of the table, dealers are divided into four quartiles based on asset size. The smallest quartile consists of the 15 excluded entities. The third quartile includes 15 dealers with assets of up to \$1.3 billion; the second quartile includes 14 dealers with assets ranging from \$1.3 billion to \$3.7 billion; and, the largest quartile includes 14 dealers with assets of over \$3.7 billion.

As can be seen from the table, fee payment increases for dealers are significant, increasing from \$22.8 million in 2002/03 to \$65.2 million in 2003/04 under the proposed fee schedule. Note, however, that the fee increases proposed are most significant for those with the greatest ability to pay. In fact, on average, dealers in the smallest and third quartile will pay less under the proposed fee structure than under the current fee structure.

Nevertheless, in terms of ability to pay, the proposed fee structure favors larger companies. For companies in the largest quartile, fees represent 1.14 percent of income.

This increases to 1.32 percent of income for companies in the second quartile and 2.22 percent of income for companies in the third quartile.

There are some who might argue that the fee increases will pose an unacceptably large burden on the securities industry. However, this argument fails to recognize that for dealer companies as a whole, the proposed fees represent 1.26 percent of annual after tax income. This is very modest compared to the insurance industry, where existing fees are equivalent to almost 3 percent of insurance company annual after tax income.

Table 6: Fee Indicators for Securities Industry

Indicator	Largest Quartile	Second Quartile	Third Quartile	Smallest Quartile	Total
A. Assets					
Assets \$ Million	248,990	31,924	5,377	-	286,291
Assets % of Total	86.97	11.15	1.88	-	100.00
B. Income					
Net Income \$ Million	3,948	1,056	166	-	5,170
Net Income % of Total	76.36	20.43	3.21	-	100.00
C. 2002/03 Fees					
Fees \$ Million	6.93	5.78	4.32	5.75	22.78
Fees % of Total	30.42	25.37	18.96	25.24	100.00
Fees as % of Income	0.18	0.55	2.60	-	0.44
Fees to assets (bp's)	0.28	1.81	8.03	-	0.80
D. Proposed Fees 2003/04					
Fees \$ Million	44.96	13.95	3.69	2.55	65.15
Fees % of Total	69.01	21.41	5.66	3.91	100.00
Fees as % of Income	1.14	1.32	2.22	-	1.26
Fees to assets (bp's)	2.77	6.71	10.53	-	3.49

The fee proposal also appears to generally satisfy each of the fee principles adopted by the FSC.

The annual fee is based on company assets and assets under administration and the fee rates have been set to generate sufficient revenue to meet FSC operating costs for the securities industry. The full cost recovery principle is therefore satisfied.

The fee rates have been set so that larger companies pay higher fees than smaller companies although the average fee rate declines with company size. This is consistent with the principle of regulatory effort.

It is evident from Table 6 that the assets in the securities industry are largely skewed toward the largest quartile and that the industry is much more concentrated than is the insurance industry. The distribution of assets in the securities industry is such that the fourteen largest companies administer 87 percent of assets. This suggests that a significant proportion of regulatory effort must be devoted to these companies.

Based on this asset distribution, a reasonable distribution of regulatory costs and fee payments for the largest, second, third and smallest quartiles consistent with the principle of regulatory effort might be 65 percent, 20 percent, 10 percent and 5 percent respectively. The information presented in Table 6 clearly demonstrates that the proposed fee schedule is superior to the existing fee schedule in terms of the regulatory effort principle.

Provided that increases in company assets and assets under administration over time are similar to increases in FSC operating costs, fee rates will not have to be continually increased once the FSC's expense base has been stabilised. This is consistent with the revenue stability principle. However, should deviations occur, the proposed fee review every two years will ensure that deviations are only temporary.

Each year the FSC will determine the total assets from regulatory filings (including the C1 Form) for December 31. The assets of each dealer will include the assets of unit trusts and mutual funds managed by the dealer. In the FSC's proposal it would send the company a fee invoice for the next year. For cash flow reasons the FSC would have allowed payments to be paid in four quarterly installments. This approach, as well as the elimination of some documentation fees, is consistent with the ease of understanding and simplicity of administration principle. The relevant industry associations supported this approach. However, in order to make such a change the Securities Act, which specifies how license renewal fees should be paid, would have to be amended. Therefore, until the Securities Act is next amended, the payment of the license renewal fee will be payable annually on or before the anniversary of the grant of license in each case.

Removal of the annual renewal fee for dealer's representatives cannot be removed without amendment of the statute. This fee will therefore remain unchanged. However, in order to remain as close as possible to the original proposals the FSC is proposing to allow any payments by licensees during the previous twelve months for dealer's representatives to be offset against the amount calculated for the dealer's annual renewal fee.

Finally, because the fee base (assets) is part of the normal regulatory reporting to the FSC, it will allow for ease of verification.

The new fee structure is expected to come into effect for license renewals during the month of September 2003.

E. Conclusion

It has been recognized that the FSC is still in a start up mode. As a result, a significant amount of developmental work must still be completed and this developmental work may require some extraordinary short term expenditure. Furthermore, the framework for supervision of the pensions sector has yet to be completed and the FSC currently has no authority to levy fees and charges related to this sector.

It must also be recognized that an existing fee schedule is already in place. However, there are some problems associated with the existing fee schedule. It is the view of the FSC that the proposals described in this bulletin go some distance with respect to the elimination of current problems, although it is recognized that a transition process may be required.

The FSC has welcomed the responsiveness of affected parties to its proposals for consultation and believes that the fee strategy and proposals have been improved as a result. It expects that the strategy, principles and specific structures for fees and charges will be modified over time in light of experience and changing circumstances at the FSC and in the industries that it regulates.

Regulations to give effect to the new fee structure are expected to be promulgated in the near future.

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Please direct any questions or comments in relation to this bulletin to:

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