

# **PENSION SECTOR COST RECOVERY PROPOSAL**

## **PROPOSAL**

The Financial Services Commission of Ontario (FSCO) is proposing to implement an assessment process to ensure FSCO's expenditures for the pension sector are fully recovered.

## **GENERAL BACKGROUND**

FSCO was established in July 1998 under the *Financial Services Commission of Ontario Act, 1997* (FSCO Act). FSCO is committed to improving regulatory effectiveness and efficiency of resource utilization. One of FSCO's objectives is to have full cost recovery from each of the regulated sectors. FSCO's operations and branches are divided into "cost centres" for financial and administrative purposes. For cost centres whose time and budgets are dedicated 100% to a given sector, their entire costs are assigned to that sector. Where cost centres perform activities that relate to more than one sector, the costs are allocated to the appropriate sectors.

Section 25 of the FSCO Act states that the Lieutenant Governor in Council may assess the FSCO regulated sectors with respect to all expenses and expenditures that the Ministry, the Commission and the Tribunal have incurred and made in respect to that sector.

## FSCO's Current Pension Sector Cost Recovery

Currently, the cost of regulating the pension sector in Ontario is recovered solely through fees set by the Minister of Finance and published in the Minister's Schedule of Fees under the *Pension Benefits Act*. At the present time, most of the fees are generated by the Annual Information Return (AIR) fee, however, there is no certainty that these fees would cover the entire cost of the sector in any given year since AIR fees are based on a flat rate per member and former member. As a result of the fixed nature of these fees, costs may be over- or under-recovered in any given year. FSCO has no authority to credit pension plans with any amounts collected through fees in excess of costs. Conversely, no means exists for collecting under-recovered amounts from pension plans. Shortfalls are made up from the Consolidated Revenue Fund of the Government while surpluses are paid into it.

## Proposed Pension Sector Cost Recovery Process

The proposed new assessment process would ensure that FSCO generates neither a surplus nor a shortfall with respect to pension sector costs.

In order to determine pension sector costs, FSCO proposes calculating the full expenditures for the sector, then subtracting the fees and charging the remaining amount through an assessment.

FSCO is accountable to the Government through a number of mechanisms that are described later in this paper.

The proposed new cost recovery process retains the current AIR fee structure as a base assessment for each plan based on the current AIR fees. **The only noteworthy changes to the current process are to collect the current AIR fees through an assessment rather than the AIR and to have an assessment adjustment assigning shortfalls/surpluses on a pro rata basis to the base assessment.**

This paper describes the proposed new process and invites comments from pension stakeholders on the proposal.

Comments may be made by **August 18, 2006** to the attention of:

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## **FSCO's COST RECOVERY PRINCIPLES**

The proposed pension cost recovery process has been developed in accordance with the following FSCO cost recovery principles:

**Cost recovery will not exceed forecasted expenditures for each sector and FSCO will be accountable for the efficiency and quality of the services delivered.**

**Cost recovery will be fair and reflect the use of FSCO resources.**

**Cost recovery will enable reasonable predictability of regulatory costs.**

**Cost recovery will be simple to administer.**

**Cost recovery will be flexible and easily modified.**

### Accountability

Each year, FSCO must obtain its spending authority through the Government budgetary process. Spending authority is granted based on closely monitored organizational needs and Government priorities.

FSCO also reports quarterly to the Government on the status of its spending.

Under Section 14 of the FSCO Act, the Office of the Auditor General shall examine annually the accounts and financial transactions of the Commission. The audited financial statements are published in FSCO's annual report.

Finally, each year FSCO must send to the Minister of Finance and publish in the Ontario Gazette a Statement of Priorities for the coming year. As part of that document, FSCO provides its stakeholders with a Report Back on the initiatives and projects for the previous year.

## **PROPOSED NEW COST RECOVERY PROCESS**

The AIR fee structure, based on plan membership with a rate of \$6.15 per member and \$4.25 per former member, coupled with a minimum charge of \$250 per pension plan and a maximum charge of \$75,000 per pension plan, has proven to be fair and reflects the use of FSCO resources. FSCO allocates about 80-85% of its pension resources to defined benefit (DB) plans and approximately 15-20% to defined contribution (DC) plans. These percentages generally correspond to the amount of fees generated by DB plans (about 80%) and DC plans (about 20%).

Furthermore, the AIR fee structure based on plan membership has proven to be a good proxy for a user-pay system. This is because there is a strong, positive correlation between membership, activity based transactions, and fees. Generally, plans with a higher membership generate more transactions, and the higher the plan membership, the higher the AIR fees (assessments).

FSCO would be using the same membership data as appeared on the latest AIR prepared by the pension plan administrator.

Under the proposed assessment process, pension plans would continue to file their AIR six months following the end of the plan's fiscal year for DC plans, and nine months following the end of the fiscal year for DB plans.

The total amount to be assessed would be the pension sector cost for FSCO's previous fiscal year less the aggregate of all fees (e.g. plan registration fees) collected during the fiscal year. This is the net pension sector cost.

The assessment as proposed would be done in two parts. First, FSCO would calculate a base assessment at the rate of \$6.15 per member plus \$4.25 per former member, subject to a minimum of \$250 and a maximum of \$75,000 (the pension plan membership would be taken from the latest AIR). FSCO would then compare the amount calculated by the base assessment with the net pension sector cost. If the net pension sector cost is greater or less than the base assessment, an assessment adjustment would be used to calculate the additional amount to be recovered or credited. The adjustment would be based on each plan's pro rata share of the base assessment.

Beginning in **September 2008**, FSCO proposes sending to each pension plan administrator an assessment that would be payable within 30 days. The assessment for each plan would indicate the base assessment and the assessment adjustment. The assessment would be for FSCO's costs in the previous fiscal year.

### Example

For both DB and DC plans, the assessment would be calculated as follows, based on the following assumptions for a given fiscal year:

The net pension sector cost is \$9.9 million.

The base assessment raises \$9 million from the pension sector.

There is a shortfall of \$900,000 (\$9.9 million - \$9 million).

The % shortfall is 10% (\$900,000/\$9 million). Therefore each plan would be required to pay an assessment adjustment of 10% over their base assessment.

If Plan A, based on its membership, is assessed the minimum base assessment of \$250, then Plan A's total assessment would be \$275 (\$250 plus an assessment adjustment of \$25).

If Plan B, based on its membership, is assessed the base assessment of \$17,500, then Plan B's total assessment would be \$19,250 (17,500 plus an assessment adjustment of \$1,750).

If Plan C, based on its membership, is assessed the maximum base assessment of \$75,000, then Plan C's total assessment would be \$82,500 (\$75,000 plus an assessment adjustment of \$7,500)

Similarly, if it is assumed that the pension sector cost was only \$8.1 million, the base assessment would generate a surplus of \$900,000 or 10%.

Then Plan A's total assessment would be \$225 (\$250 minus an assessment adjustment of \$25).

Then Plan B's total assessment would be \$15,750 (17,500 minus an assessment adjustment of \$1,750).

Then Plan C's total assessment would be \$67,500 (\$75,000 minus an assessment adjustment of \$7,500).

## **TRANSITION**

The proposed process would begin with FSCO's 2007-08 fiscal year. That would mean that pension plans with a fiscal year end after March 31, 2007 would no longer remit an AIR fee with their AIR return.

If implemented, the transition to the cost recovery process will be communicated to the pension sector and will be posted on FSCO's website.

### Next Steps

Following the close of the comment period, FSCO will evaluate all submissions.

Following this evaluation, if FSCO determines to proceed with the proposal, FSCO will seek Government approval to implement this assessment process.