TFSA | TORONTO FINANCIAL SERVICES ALLIANCE

2016 Federal Pre-Budget Submission

Toronto Financial Services Alliance

January 2016

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About the Toronto Financial Services Alliance (TFSA)

The Toronto Financial Services Alliance (TFSA) is a unique, public–private partnership dedicated to growing the Toronto region's financial services cluster and building it as a "top ten" global financial services centre. Established in 2001, TFSA is a collaboration involving three levels of government, the financial services industry and academia. Working collaboratively with industry and government, we build international awareness of the advantages offered by the Toronto region and we work with financial services companies from around the world that are exploring business opportunities in Toronto. TFSA leads an integrated strategy focusing on the areas of growth, international reputation, and competitiveness. Financial services have been a major source of growth for the entire Canadian economy. For example:

- The sector's employment, financial results, and international trade and investment performance outpaced the average for **all** sectors over the past decade.

- The sector directly accounted for 4.4 per cent of Canadian employment in 2014 (at 780,000 jobs) and for 6.8 per cent of Canadian GDP. Employment in the sector has risen by 15.4 per cent since 2004.

- The sector accounts for 20 per cent of Canada's foreign affiliate sales, 26 per cent of the net profits generated by the private sector, and 52 per cent of the stock of outward Foreign Direct Investment (FDI) undertaken by Canadian firms.[1]

The TFSA is a catalyst for collaboration between the public and private sectors. Our mandate and membership provide us with a valuable perspective on the role the financial services sector plays in creating economic growth, jobs, investment and prosperity. We look forward to continuing to work with the Government on the issues outlined in this submission.

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[1] Michael Burt. An Engine for Growth: 2015 Report Card on Canada and Toronto's Financial Services Sector. The Conference Board of Canada. November 2015.

A Regulatory Environment that Supports Growth

The financial services sector plays a vital role in the Canadian economy as a healthy economy cannot exist without a healthy financial system. Efficient financial markets and institutions are critical to growing incomes and prosperity. The purpose of the financial system is to facilitate investment allocation, risk allocation, liquidity preference and lifetime consumption as these functions contribute to economic growth.[2]

Canadian and international regulators are implementing new regulatory reforms that are intended to ensure that the financial services sector performs its vital economic functions while maintaining overall economic stability. However, many of these reforms are presenting challenges that may hinder the competitiveness and growth of the sector and the economy. As noted by the former Governor of the Bank of Canada, financial regulators need to balance the goal of creating stable markets with the need for allocative efficiency, a key contributor to economic and income growth.[3]

An analysis by the C.D. Howe Institute noted that "the goals of public policy with respect to the financial sector should thus be to establish the legislative, legal and regulatory frameworks that enable the financial system to carry out its allocative functions effectively. Canada has a robust financial system, which benefits from strong principles-based regulatory oversight and open channels of communication between market participants and regulators. The challenge in this respect is finding a way to not stifle growth and efficiency in the process of promoting financial system stability." [4]

[2] David Dodge. Financial Regulation and Efficiency: Trade-offs in the Post-Financial Crisis Era. C.D. Howe Institute. January 29, 2015.
[3] Ibid
[4] The Future of Financial Services: Competition and Growth. C.D. Howe Institute. June 17th, 2015.

Recommendations

- Canada has a robust financial system and a sound regulatory environment but regulatory policy should support economic growth and competition as well as stability.

- Recent and ongoing regulatory reforms should be evaluated based on their effectiveness as measured by outcomes.

- The development of regulatory policy should incorporate research and stakeholder consultation that focuses on the linkages and effects on the real economy, the potential impact of un-level playing fields globally, and an assessment of any unintended consequences.

The Importance of International Trade and Investment

International trade and investment are key in growing both the financial services sector and the Canadian economy. Trade is equivalent in value to more than 60 per cent of Canada's GDP and exports are directly linked to one in five Canadian jobs. Access to international markets increases employment, investment and competitiveness.

The financial services sector is one of the most globally oriented sectors in the Canadian economy. For example:

- Canadian-based providers of financial services are among the top foreign investors in the financial sector in absolute terms, ranking only behind the United States, the United Kingdom, France and Switzerland.[5]

- 52 per cent of Canada's stock of outward foreign direct investments (FDI) is attributable to the financial services sector, up from 35 per cent in 2000. This is the largest percentage of any sector in the economy.

- Canadian exports of financial services have more than tripled since 1999. Financial services are Canada's largest and fastest-growing source of services exports.

- In 2014, more than a third of the combined revenues from Canada's five largest banks were from the U.S. and other international markets.

- Manulife Financial and Sun Life Financial generated 76 and 56 per cent of their revenues from countries other than Canada.

[5] Daniel Schwanen, Dan Ciuriak, and Jeremy Kronick. Opening up New Trade Routes for Financial Services: Canada's Priorities. Commentary No. 442. C.D. Howe Institute.

- Canada’s pension funds continue to expand their international presence. Foreign investments accounted for 31.5 per cent of their total portfolio in 2014, up from 18.8 per cent in 2000.

- TMX Group also has a significant foreign presence, with approximately 30 per cent of revenues coming from international business.[6]

Canada should continue to pursue new free trade and investment agreements, especially with key emerging markets. A recent study by the C.D. Howe Institute, *Opening up New Trade Routes for Financial Services: Canada's Priorities*, noted significant economic benefits to the financial sector and the Canadian economy from various existing and potential free trade and investment agreements.

Recommendation:

- The TFSA strongly encourages the Federal Government to ratify free trade and investment agreements such as the Canada-EU Comprehensive Economic and Trade Agreement (CETA) and the Trans-Pacific Partnership (TPP); and to launch a thorough consultation process with the Canadian private sector for new agreement negotiations with important markets such as China and India.

[6] Michael Burt. An Engine for Growth: 2015 Report Card on Canada and Toronto’s Financial Services Sector. The Conference Board of Canada. November 2015.

Tax Reform to Promote Growth

The financial services sector is proud of its significant contribution to Canada's economy and revenue base but there are specific tax reforms the Federal Government should consider that would increase the competitiveness of the sector and promote investment and job creation.

The financial sector is a significant contributor to Canada's public finances with the sector accounting for 23.5 per cent of corporate tax revenue on average, and this does not even include capital taxes and insurance premiums. Furthermore, the average tax rate as a percentage of taxable income facing the financial sector is significantly higher than for the non-financial sector, and the sector bears the highest marginal effective tax rate of any sector in the economy.[7]

A recent paper titled, *Tax Policy Options for Promoting Economic Growth and Job Creation by Leveraging a Strong Financial Services Sector*, outlines specific tax policy reforms that will help promote additional investment and employment. For example, research has shown that a 10 per cent increase in the cost of capital, due to an increase in the marginal effective tax rate or other factors which affect the cost of capital, leads to a 7 to 10 per cent reduction in investment in the long run.

The recommendations cited below should be seriously considered by the Federal Government in order to strengthen the competitiveness of the financial sector and increase investment and job creation.

[7] Jack Mintz and Angelo Nikolakakis. Tax Policy Options for Promoting Economic Growth and Job Creation by Leveraging a Strong Financial Services Sector. University of Calgary School of Public Policy and EY. January 2016.

Recommendations:

- Lower the gap in marginal effective tax rates between the financial and non-financial sector by reducing capital taxes applicable only to financial firms.

- Reform the application of the GST/HST as it applies to the financial services sector to ensure greater tax neutrality, simpler administration, reduced definitional complexity, and increased productivity and competitiveness.

- Implement reforms to the capital gains taxation regime that will enhance economic efficiency and support growth and job creation in the small business and “knowledge intensive” sectors. Reforms could be modelled after programs such as the UK Enterprise Investment Scheme.

- Reform Canada’s international tax rules applicable to non-residents and Canada’s so-called Foreign Accrual Property Income (FAPI rules) to facilitate, or at least not interfere with, growth and job creation.

- To support innovation and small business investment, implement reforms to existing programs such as the Scientific Research and Experimental Development program.

- With respect to the OECD Base Erosion and Profit Shifting (BEPS) proposals, the Federal Government should proceed with strong caution. After thorough consultations with stakeholders, the Government should only make evidence-based policy choices with a view to balancing tax integrity with competitiveness.

Investing in Infrastructure

Canada's infrastructure deficit is widely cited by experts to be in the hundreds of billions, a large portion of which is concentrated at the municipal level. Infrastructure needs include a backlog of unfunded (or underfunded) public transit and transportation projects in congested regions, aging legacy infrastructure such as water and wastewater that is nearing the end of its life-term, and trade-enabling infrastructure such as airports and ports.

Toronto's financial and other large employment sectors would benefit from a decrease in congestion that adversely impacts the movement of goods and people. Investing in public transit and other critical infrastructure boosts economic productivity and growth by helping relieve urban congestion (which according to C.D. Howe already costs Toronto nearly $11 billion in lost productivity annually),[8] supporting emerging innovation corridors (e.g. Toronto-Kitchener-Waterloo), nurturing economic sectors with export potential (e.g. infrastructure/engineering sector), improving the attractiveness of Canada as a place to invest, and helping businesses access foreign markets.

Canada's proven Public-Private-Partnership (P3) models of alternative financing, procurement and delivery, including the model used in Ontario, is ideal for large and complex infrastructure investment projects. This model should be leveraged where possible to ensure on-time, on-budget delivery of projects and a transfer of related risks from the public to the private sector. Canada benefits from the presence of world-leading pension funds and life insurers in Toronto that have deep expertise and experience in such investments, which help them match their obligations to pensioners and insured families.

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[8] The C.D. Howe Institute, Cars, Congestion and Costs: A New Approach to Evaluating Government Infrastructure Investment, July 11, 2013.

Recommendations:

- Working with provinces and municipalities, including Ontario and the Toronto Region, the Federal Government should continue to undertake needed infrastructure investments with a focus on critical infrastructure such as transit, transportation, and trade.

- The P3 model delivers infrastructure projects on-time and on-budget, and transfers associated risks to Canadian private sector entities best equipped to manage and minimize such risks. The Federal Government should expand and leverage the use of P3 models, notably models already employed in provinces such as Ontario.

Canada as the North American Hub for Islamic Finance

Globally, Islamic finance assets grew at double-digit rates during the past decade from approximately US$200 billion in 2003 to an estimated US$1.8 trillion in 2014.[9] Canada, and especially Toronto, has great potential to become the North American leader in Islamic finance. Canada has a large and growing Muslim population (proportionately larger than the U.S. as it is expected to rise to 3 million, or 6.6 per cent of the population, by 2030); a sound economy and stable political environment; a wealth of assets that are conducive to Islamic finance; traditionally strong risk management skills; and an effective regime of regulation and supervision.[10] Canadian life insurers are already active in Islamic financial services internationally in markets such as Malaysia and Indonesia.

A recent study by Thomson Reuters, *Canada Islamic Finance Outlook 2016*, highlighted Canada's potential as a hub for Islamic finance and some of the opportunities for the Canadian market. Specifically, the study noted potential Canadian demand to support Shariah-compliant mortgages of US$17.7 billion and an Islamic fund market of over US$2 billion.[11] The study also noted the significant opportunity for Canadian governments to access foreign sources of capital through the *sukuk*, or Islamic bond, market. Recently, governments such as the UK, Luxembourg, and Hong Kong have accessed the Islamic bond market which also has helped promote these jurisdictions as hubs for Islamic finance. The G-20 has also noted the potential of the Islamic bond market for infrastructure financing.[12]

Recommendations:

- Similar to other jurisdictions such as the UK, Luxembourg, and Hong Kong; the Federal Government should consider issuing a sovereign Islamic bond.

- The Federal Government should continue to work with the TFSA and the financial sector to help promote Canada as a hub for Islamic finance.

[9] International Monetary Fund. The IMF and Islamic Finance.
[10] Thomson Reuters. Canada Islamic Finance Outlook 2016. December 2015.
[11] Ibid
[12] Bernardo Vizcaino. G20 Sets Sights on Sukuk for Infrastructure Financing. Thomson Reuters Zawya. March 17, 2015.

Other Issues

Temporary Foreign Worker Program

- The recruitment of highly skilled international talent contributes to Toronto's stature as a global financial services centre but changes to the Temporary Foreign Worker Program (TFWP) are continuing to make recruitment practices more difficult, costly, and time consuming. These changes are having a negative impact on the ability of financial services firms to recruit senior executives or talent with specialized knowledge. The government should amend the TFWP to meet the unique needs of sectors such as financial services which recruit a small number of global executives that are critical to boosting the economic development of a region.

Cooperative Capital Markets Regulator

- The TFSA continues to strongly support the initiative to create a Cooperative Capital Markets Regulator (CCMR) as Canada is the only industrialized country without one. We continue to support the Federal Government's efforts to have all provincial governments put in place legislation enacting a CCMR as soon as possible.