

Federal Pre-Budget Submission

Submitted by the Toronto Financial Services Alliance

January 29, 2010



Executive Summary

The Canadian financial sector has earned a well-deserved reputation for stability and soundness in the face of recent turbulent financial market developments. It is an important contributor to the country, accounting for 6.8% of Canada's Gross Domestic Product and over 4% of total employment. The Toronto Financial Services Alliance (TFSA) and our stakeholders believe that we need to be proactive to nurture this industry to ensure its ongoing health and capitalize on opportunities for leadership and growth.

In keeping with this theme, we would like to focus this submission on some key aspects of the work that the financial sector undertook last year in cooperation with the governments of Canada, Ontario and Toronto, that culminated in the Boston Consulting Group's report "Partnership and Action - Mobilizing Toronto's Financial Sector for Global Advantage". That report provides a good roadmap for initiatives that would take advantage of the sector's strong global reputation and enhance its role as an engine of economic growth. The initiatives that we would like to focus on are:

Establishing the leading Global Institute for Integrative Risk Management: The financial crisis has raised to the surface a critical need to re-evaluate how risk is recognized, analyzed and managed. Canada and the Toronto Region in particular are distinctly well suited to act as a location for a global Institute for Integrative Risk Management as a centre of this activity.

Ensuring the financial sector is a core component of economic development at all orders of government: Historically, the focus of both federal and provincial governments has been primarily on regulating the financial services industry. We recommend that each order of government designate functions with dedicated resources to actively work on an agenda to include the sector as a focal area of economic development activity. These functions should be distinct from the regulatory functions within governments, with an explicit mandate to support the growth of the industry.

Establishment of a Common Securities Regulator (CSR): Canada is the only major industrialized country without some form of a national securities regulator. A single regulator would enhance Canada's competitiveness in global capital markets and make capital market regulation more consistent and efficient across the country.

Harmonization of provincial sales tax with the federal GST: The TFSA supports the harmonization initiative but feels it is time to critically review the way in which GST/HST is applied to products and services within the financial sector. The current structure as applied to the financial sector does not achieve all of the objectives. We recognize the imperative to implement the HST, however, would very much appreciate a formal timeline to review treatment of financial services.

Enhancing the attractiveness of Canada as a location for financial services activity and jobs:

Canada has earned a well deserved reputation for its safe, sound and high quality financial institutions at the same time that Canada has achieved a good reputation for its government and regulatory infrastructure. There are, however, a number of policy obstacles that impede both the delivery of financial services from Canada to the rest of the world as well as impede the efficient delivery of financial services in Canada. The TFSA believes that all levels of government should work conscientiously to eliminate these obstacles.



Positioning Toronto as the North American Centre for Islamic Finance:

With a growing Canadian Muslim community, a strong and innovative financial sector and the need for alternative financing products and services, there is every reason to believe that Toronto could emerge as a North American centre for Islamic finance. In order for this objective to be realized we must ensure that our tax system ensures a level playing field for both conventional and alternative forms of financial activity.

Who We Are

The TFSA is a public/private initiative representing around 40 organizations involved in the financial sector. Its mandate is to enhance and promote the competitiveness of Toronto as a premier North American financial services centre and in the top ten globally. It was created in 2001 by the City of Toronto in partnership with the financial services industry, and with the support of the federal and provincial governments. Our supporters also include academic institutions and major providers of legal, accounting, consulting and human resources services to the financial sector. While our goals are focused locally, building awareness of the industry and its contribution to the city's economy, the positive effect of such advocacy is felt nationally. Helping the financial sector become even more efficient and competitive has positive economic benefits that spread across the country. As we have seen from international economic events, a country cannot have a strong economy without a strong financial sector. In working to strengthen the financial sector, we are contributing to a stronger economy right across the country.

Introduction

The Toronto Financial Services Alliance (TFSA) welcomes the opportunity to once again submit our views regarding this Pre-Budget Consultation. We would like to focus this submission on some key aspects of the work that the financial sector undertook last year in cooperation with the governments of Canada, Ontario and Toronto, that culminated in the Boston Consulting Group's report "Partnership and Action - Mobilizing Toronto's Financial Sector for Global Advantage". That report 1 provides a good roadmap for initiatives that would take advantage of the sector's strong global reputation and enhance its role as an engine of economic growth.

Many observers have commented upon the strength of the Canadian banking sector in particular and the financial sector more generally. From President Obama to Prime Minister Harper, and from Governor of the Bank of Canada Mark Carney to former Governor of the Federal Reserve Paul Volcker, all have commented positively on the sector's superior performance during these challenging times. Undeniably, Canadian financial institutions were affected by the turmoil in the capital markets; however, in one of the most turbulent times in history, they have been able to maintain solid levels of capitalization and, unlike their counterparts in most G7 countries, have not required capital injections from the government. Most of them have also been able to generate positive earnings and all have served their customers without interruption. For the second year in a row, the World Economic Forum has ranked the Canadian banking system as the safest and soundest in the world. And, three Canadian life insurers, two of them headquartered in Toronto, are ranked in the top 10 life insurers in the world.

It is particularly auspicious that this reputation for stability is associated with one of the most important sectors of the economy. The financial services sector is one of the largest sectors in the Canadian economy. The industry employs over 760,000 Canadians directly, representing over 4% of total employment, at wages and salaries well above the national average. Moreover, the

-

¹ http://www.tfsa.ca/



industry relies upon, and supports, a number of ancillary, high value-added services that are important contributors to the economy in their own right. In the Greater Toronto Area, the financial sector creates approximately one indirect job for every direct job. In Canada, the financial sector accounts for 6.8% of GDP, up from 4% twenty years earlier.

The TFSA and its partners believe that now is an opportune time to be proactive and take stock of the strengths and weaknesses of our financial services industry, develop a strategy to ensure its ongoing health and capitalize on opportunities for growth. At the same time, we recognize that turbulence experienced by global financial markets will lead to some regulatory and supervisory response to diminish the likelihood of its reoccurrence. Within this context, we believe that Canada can make a unique contribution to promoting future stability of the global financial system.

What follows are some key initiatives that would enhance the sector's contribution to the Canadian economy as well as promote the stability of the global financial system.

1. Establishing the leading Global Institute for Integrative Risk Management

The financial crisis has highlighted a critical need for governments, regulators and financial institutions to re-evaluate how they recognize, analyze and manage risk. That re-evaluation is occurring at multiple levels – from choices managers make based on metrics and information from quantitative models; to the accountability and incentive models at top levels of firm governance; to the understanding of systemic risks inherent in the global economy.

There is a unique and timely opportunity for Toronto, Ontario and Canada to play a major role in this emerging global risk management arena, particularly as a centre for leading edge research and education. We propose the creation of an institute, designed to serve a distinct need emerging in the world financial services forum. The focus of such a unique institute would be to provide integrative thinking across multiple risk management disciplines, including (but not limited to) regulation, governance, actuarial science, asset and liability management, leadership behaviour and accountability. The institute would function both as the world's leading think tank (i.e. conduct and publish leading edge research; convene global conferences), as well as an educational institution providing education and training (for academics, industry managers, executives, boards of governors, and regulators).

The proposed institute would perform five key functions: conduct research and produce publications; host international forums and conferences; provide industry and executive education and training; deliver graduate student education and provide consulting and advisory services to governments, regulators and industry.

Canada and the Toronto region in particular are uniquely well suited to act as a location for such a centre for several reasons including a concentration of well-respected industry leaders, recognition of the Canadian regulatory framework as a model around the world, international accessibility and the existence of a strong academic and expert community.

The proposed model for a Global Institute for Integrative Risk Management leverages each of these advantages. We support the creation of an independent institute, based in Toronto and governed and managed by a joint board composed of members from industry, academic institutions and senior regulatory bodies. The institute would be a collaborative effort between the federal and provincial governments and the private sector. The institute would be jointly funded by the public and private sectors.



Such an institute would be led by a small, high-calibre permanent staff; it would drive an independent research and academic agenda, fund independent research and academic chairs, host scholars-in-residence and bring together financial leaders from around the world to provide focused executive and regulatory education. In addition, the institute would have a strong virtual component and would draw on the offerings, physical settings and faculty of its academic partners from across Canada. The concept of the institute has been discussed and tested with more than 100 industry executives and leaders in the financial services and academic communities and has elicited strong support.

Benefits to Canada

The benefits to Canada of the proposed institute are broad:

- Raise Toronto and Canada's profile in financial services: Canada's financial services
 industry is in the global spotlight given our performance through the financial crisis. Creating
 the proposed institute would build on our existing reputation and create a lasting legacy,
 building Canada's global brand. In addition, attracting senior executives and risk managers
 from around the world to Toronto will further raise Toronto's profile as an important financial
 services centre, making it easier to attract talent and investment.
- Bolster the research of risk management: The proposed institute would define best practices for both public policy and industry practice. Complexity in assessing and managing risk in the financial services industry will only increase; industry leaders and regulators must be equipped to address this challenge. This will result in safer financial institutions that will serve the interests of all Canadians. In addition, continuous learning for both regulators and financial institutions in Canada will lead to a better result in terms of addressing future challenges – for example, future stress-testing would be more robust and more easily handled by both OSFI and by the nation's financial services industry.
- Create a lasting pipeline of risk management talent: Financial institutions and regulators have a perpetual need for professionals equipped to think and act strategically in managing risk. A strong, well-trained talent base in industry, the central bank and regulatory bodies will position Canada as a leader in the field of risk management; the conduit for new talent from around the world should help to expose Canadian risk managers to new and different perspectives, and help reduce the risk of future financial crises occurring.
- Create economic benefits: The proposed institute will strengthen Canadian financial
 institutions and create jobs in Canada. In addition, a risk management centre of expertise will
 not only encourage major international firms to consider locating risk functions here, but may
 also foster the creation of new, innovative start-up companies. Finally, the institute would
 create academic and administrative jobs and bring hundreds of people to Toronto for education
 and training, and could be the catalyst for attracting international financial conferences to
 Toronto.
- Permanently enhance Canada's influence in the global regulatory arena: Canada's strong reputation has bolstered its weight amongst the global financial regulatory community. We believe that Canada effectively "punches above its weight" within this environment. The creation of a body of risk management expertise could add a degree of permanence to that reputation and in the process ensure that the Canadian perspective continues to have a prominent role in the evolution of global financial regulatory regimes.



Funding model

The proposed institute will require public and private funding sources. It may also generate a small amount of revenue earned through consulting and courses. The annual budget for the institute is envisioned in the \$6-7 million range; this is similar to other analogous institutes, most notably, the Centre for International Governance Innovation in Waterloo. Initial government one-time funding, from both the provincial and federal governments, could be provided to be drawn down over 8-10 years. This endowment could specifically be used to cover a component of the institute's operations, with the private sector contributing as well. It is estimated that a federal government commitment of \$10 to 20 million would provide a substantial foundation for the success of this initiative. Additional funds would be raised from the private sector. Alternatively, the federal government could sponsor a research chair(s) in partnership with private sector partners. Detailed work on the design of the institute is being developed by a committee of industry and academic representatives with risk expertise.

2. Ensuring financial services is a core component of economic development across all orders of government

A stark difference between Toronto and other jurisdictions where financial services are a major contributor to the economy is the role played by government. Governments everywhere have created supervisory bodies to regulate the sector. In most international financial centres, governments have also designated resources to support the growth and development of the sector. But Canada has not, even though governments at all levels explicitly support the development of other sectors, for example manufacturing, agriculture, tourism, film, and oil and gas.

Currently, all three orders of Canadian government are more open and willing to expand their economic development strategies to include a much more prominent role for financial services. There are several indicators of recent momentum in this direction including: a Federal Finance Minister-led trade mission to China in August 2009 which focused on promoting the Canadian financial services sector; capital tax and corporate tax reforms by Ontario, which will significantly benefit most corporations, including many firms in the financial sector; creation of a "Centre of Excellence in Financial Services Education" to help maintain and build the Toronto Region's financial services talent pool; and the publicly stated intent of City of Toronto's Invest Toronto to grow financial services as a top priority.

The TFSA recommends that all levels of government designate offices with dedicated resources to actively work on an agenda to support economic development of the financial services industry. These functions should be distinct from the regulatory functions within government, and their explicit mandate should be to support growth of the industry by:

- Promoting the industry internationally and attracting international investment
- Developing policy that supports industry growth, competitiveness and innovation; creating a more streamlined, clear process to address key policy issues and dialogue with industry
- Investing in building the talent base required to fulfill the needs of the industry
- Supporting publicly and championing the industry at the highest political levels

Coordination between various orders of government and different government departments is often a challenge. Successful international financial centres have managed this coordination through a clear governance structure and by ownership and accountability for success by senior elected



officials. The designation of a dedicated function within each level of government to work with industry will enhance coordination and support growth of Canada's financial services industry.

3. Establishment of a Common Securities Regulator (CSR)

The Canadian securities industry plays a vital role in the national economy by enabling businesses to access capital and by providing investment opportunities for the Canadian public. Effective regulation of capital markets is crucial; lack of confidence in these markets can have economic repercussions when participants withdraw from them. Canada is the only major industrialized country without some form of a national securities regulator. Canada's patchwork arrangement of 13 different securities regulators puts this country at a competitive disadvantage internationally and makes doing business in domestic markets more complicated and more expensive for all participants and it harms Canada's reputation for a strong regulatory structure for the financial sector. A single regulator would enhance Canada's competitiveness in global capital markets and make capital market regulation more consistent and efficient across the country. A common regulator would also facilitate enhanced compliance and enforcement which would reinforce Canada's otherwise strong reputation for excellence in financial regulation.

Both Ontario and the federal government have been strong supporters of a national regulator for many years and we applaud the efforts of the federal finance minister to resolve this long-standing issue. Both governments have appointed bodies to investigate the benefits of a new structure for securities regulation and both currently work cooperatively in the Canadian Securities Regulator Transition Office.

Given the fact that Toronto is the heart of the Canadian capital market and the location of most securities trading, there is a strong and compelling rationale for the bulk of the regulatory expertise to be located in Toronto with presence across the country. It seems only logical, therefore, for the Toronto office to also be the headquarters.

The federal government together with Ontario and the city of Toronto strongly favour a common securities regulator. A number of other provinces and territories are now also actively participating in the initiative to create a Canadian Securities Regulator and there is also considerable support in the financial industry for a common securities regulator. The TFSA urges the government to continue its efforts to facilitate the establishment of a common securities regulator.

4. Harmonization of provincial sales tax with the federal GST

The TFSA supports an efficient tax system. Such a tax system is neutral in its treatment of different sectors of the economy and it does not distort economic and financial decisions. Consumer decisions should be based on price and quality, not on differential tax treatment. Business decisions with respect to the way in which production is organized or the inputs that are purchased should not be distorted by the tax system. The TFSA is also a strong supporter of a tax system that supports productivity enhancement. Greater productivity will improve the competitiveness of Canadian firms and increase the standard of living of Canadian families.

The decision by the Canadian and Ontario governments to harmonize the GST with the provincial sales tax is an important step in achieving the kind of tax system described above and hence the TFSA supports the decision by both governments. The harmonized tax will reduce distortions and enhance productivity by substantially decreasing the marginal effective tax rate on investments in Ontario.



The historical decision to treat financial services differently from other goods and services, by making financial services tax exempt, means that the producers of tax-exempt financial services do not receive a tax credit on the tax paid on inputs, resulting in increased costs of financial services for consumers and businesses. Consequently, Ontarians will not enjoy the full benefits of an efficient tax system when it comes to their purchase of financial services. Nor will all Canadians enjoy the fruits of a more productive financial sector.

In addition, the harmonized tax will not treat all financial products equally and hence will alter the relative costs to consumers of different financial products. Moreover, the transition to the new system has some negative and unintended consequences for certain sectors such as the property and casualty insurance industry because of its retroactive impact.

The TFSA believes that an important second step to creating an efficient tax system is to review the manner in which financial services are subject to the GST/HST. The objectives of the GST and the HST (namely efficiency, productivity, neutrality) are sound. However, the current structure as applied to the financial sector does not achieve all of these objectives. We recognize the imperative to implement the HST, however, we would very much appreciate a formal timeline to review the treatment of financial services and to deal with any acknowledged unintended consequences.

5. Enhancing the attractiveness of Canada as a location for financial services activity and jobs

Financial services are highly mobile. They can be produced from anywhere in the world and can be purchased from institutions that reside far away. Canada has earned a well deserved reputation for its safe, sound and high quality financial institutions at the same time that Canada has achieved a good reputation for its government and regulatory infrastructure, with of course the one notable exception referred to above.

There are, however, a number of policy obstacles that impede both the delivery of financial services from Canada to the rest of the world as well as impede the efficient delivery of financial services in Canada. Both sets of obstacles need to be addressed since it is difficult to create an efficient outward looking industry without first being able to efficiently serve the domestic market. The TFSA believes that all levels of government should work conscientiously to eliminate those obstacles.

There are numerous ways in which Canadian laws make it difficult or impossible for Canadian financial service providers to export their services to customers outside Canada. Restrictive withholding tax rules discourage the location of management jobs in Canada for international joint ventures. FAPI rules discourage Canadian fund managers from expanding internationally. Income tax rules discourage the provision of financial services to non-Canadians directly from Canada because of the possibility that the recipient of those services would be subject to Canadian tax. The lack of a mutual recognition framework between Canada and the United States makes it difficult for Canadian firms to do business with American institutional clients.

There are also a number of impediments that make it difficult to serve the Canadian market efficiently. These are due largely to the lack of harmonization of provincial regulation as well as the tendency to over-regulate parts of the financial sector, not so much for prudential reasons but more to impose economic regulation that replaces market competition.

We understand that all of these regulatory and tax measures have been put in place for a reason and the obstacles they pose for the financial sector are sometimes inadvertent. We have recommended above that governments actively support the growth of the financial sector as part of



an economic development strategy and create specific offices and devote resources to doing so. The identification and elimination of these obstacles would be an obvious part of the mandates of such offices.

6. Positioning Toronto as the North American Centre for Islamic Finance

The TFSA Islamic Finance Working Group (IFWG) has completed a draft report entitled "Making Toronto the North American Centre for Islamic Finance: Challenges and Opportunities" The report provides a brief overview of the principles of Islamic finance including the role that Islamic commercial law has played in helping to shape many of the fundamental concepts of modern Western commercial law, its history in Canada and key regulatory and taxation challenges.

For Islamic finance to flourish there must be certainty both with respect to the taxation of retail and institutional financial activities. TFSA is now developing various policy options with respect to taxation, both income and commodity. Our report will be circulated to governments and key stakeholders when complete. We encourage the federal government to examine ways to facilitate the provision of such alternative financing products and to ensure that they can be treated on an equal basis with other financial activities.

Conclusion

The TFSA appreciates this opportunity to present our views on how to enhance the competitiveness of the financial sector in Canada. We believe that it is an opportune time to be proactive to ensure the sector's ongoing health, capitalize on opportunities for growth and create more jobs. We call upon the federal government to be an active partner with the TFSA and our stakeholders to participate in the strategy that will enable Toronto and Canada's financial sector to become one of the top ten global hubs.