TFSA | TORONTO FINANCIAL SERVICES ALLIANCE

2012 Federal Pre-Budget Submission

Toronto Financial Services Alliance

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The Toronto Financial Services Alliance (TFSA) welcomes the opportunity to submit our views regarding the 2012 Federal Budget. We are a unique public-private partnership with the mandate to enhance and promote the competitiveness of Toronto as a global financial services centre. We represent approximately 55 major organizations including domestic and international financial institutions, national industry associations and supporting law firms, IT specialists, accounting firms, and educational institutions.

The financial services sector is one of the largest contributors to the Canadian economy, employing over one million people[1]. The TFSA's mandate and reach provides us with a valuable perspective on the role the financial sector plays in promoting economic growth and prosperity for all of Canada, and a deep understanding of the critical factors for the industry's continued success.

Toronto is quickly becoming a prominent global financial services centre. The city has managed to move into the top 10 of both indices responsible for reporting on global financial services centers as noted by both *The Banker* and the *Global Financial Center's Index.* A recent report by Moody's predicts that Toronto will surpass London in financial services employment by 2017[2]. Among its assets, Toronto currently boasts:

- Two of the 15 largest global life insurers;
- Five of the world's 50 largest banks;
- The third-largest stock exchange in North America and the eighth-largest in the world;
- Four of the top 100 global pension funds;
- Operations of seven of the top 10 largest global hedge fund administrators; and
- Four of the five largest investment management firms in Canada.

The financial services sector in Toronto is also supported by a critical mass of legal, accounting, technology, and other support services that come together to finance projects and contribute to Canada's GDP across multiple sectors.

The TFSA strategy for growing the industry, involves a multi-year, multi-pronged approach that relies upon effective integration and on-going support between various government bodies and the private sector. Specific tactics include an increased focus on international marketing, shared intelligence across economic development agencies, a more targeted jobs attraction effort, the establishment of an expanded investment attraction team and a renewed focus on cross-industry policy issues.

The strategy provides direct support for those areas or hubs where it has been identified that Canada has a competitive advantage over other jurisdictions:

- Risk management;
- Metals, mining, energy and clean-tech financing;
- Retirement financing and asset management; and
- Skilled financial services IT and operations.

[1] http://investincanada.gc.ca/download/840.pdf
[2] MOODY'S ANALYTICS / Regional Financial Review / November 2011

The TFSA appreciates the support the federal government has provided for this strategy, particularly its financial support for the Global Risk Institute in Financial Services.

In order to maintain Canada’s strengths in these areas and develop new competitive hubs, an important part of the TFSA strategy also focuses on growing the talent pipeline, to ensure that we have an on-going source of resources, and are effectively aligning skills to future job requirements of the industry. Included in the work done in this area is:

- International talent attraction (e.g. TFSA-hosted “Destination Toronto” last fall in New York where more than 100 people working in New York’s financial services sector came to learn about career opportunities in Toronto);
- Surveys of financial services firms to identify current and future talent needs; and
- Advisory roles on new curriculum development to ensure talent are available to meet industry needs.

The talent development work of the TFSA through its Centre of Excellence in Financial Services Education (CoE) has been singled out by the World Economic Forum as a global model for its adoption of a multi-stakeholder collaboration approach to sector development and talent mobility.

In order to deliver on all of its strategic goals, partnering with the government is critical in assisting our mandate to grow the Toronto region as a global financial services hub, thus attracting investment and more highly-skilled jobs for Canadians. Working with a consortium of our members, we have outlined some of the key success factors for the continued growth of the industry. We look forward to continuing to work with the government on many of the issues outlined in this submission.

Regulatory Environment

Canada’s financial services sector is well regulated and offers many examples of global best practices. Our strong and stable financial institutions, markets, and infrastructure allow businesses to make investment decisions with confidence. Canada’s regulatory stability is a prized asset internationally for investment attraction, employment, and growth in financial services.

The financial sector recognizes that regulatory stability and certainty promote growth, and will continue to work with governments and regulators to find the appropriate balance between risk management, the retention of international competitiveness and execution effectiveness.

There has been a flurry of regulatory reform in the wake of the economic crisis. While it is important both to reform and to keep current with global regulatory requirements, the current pace and volume of regulatory requirements is significantly stressing the sector’s capacity to adequately assess and properly implement them.

In a relatively short period of time, the sector is currently complying with many regulations dealing with capital and solvency requirements, liquidity rules, market structure, systemic risk, and investor protection. A small list of examples would include the Basel capital framework, resolution and recovery plans ("living wills"), the designation of systemically important financial institutions (SIFIs), and central clearing requirements for certain financial instruments.

In addition, the financial sector is also complying with, or will need to comply with, the adoption of new tax rules and international accounting standards; U.S regulatory and tax requirements under Dodd-Frank and the Foreign Account Tax Compliance Act (FATCA); and protocols and guidelines for compensation, data protection and privacy.

The unprecedented volume of changes drives several potential issues:

- It is introducing a new source of risk, namely a regulatory risk. There is a need for the industry and regulators to have an opportunity to assess the longer term implications or possible unintended consequences of the new requirements; and

- Increased compliance burden and regulatory uncertainty could be impacting on the sector's ability to grow at precisely the time when Canadian institutions have an opportunity to make major global gains. Financial services play an important role in the economy by intermediating capital between savers and users of capital – entrepreneurs, businesses and borrowers. Compliance burden and regulatory uncertainty could also start to negatively impact the ability of the industry to efficiently provide savers with investments and provide sources of capital to those who need it. Appropriate regulation should ensure that this intermediation function is stable and efficient.

<u>Recommendations:</u>

- Our current regulatory system has proved its worth during the economic crisis. Changes to address particular concerns or to meet international obligations must not fundamentally alter that foundation.

- Regulatory initiatives must be risk based and take into account the many other regulatory initiatives.

- Time must be taken to assess new regulatory requirements to ensure that longer term implications are better understood before new rules are layered on top.

- New requirements must be also be assessed according to their impact on the growth of sector jobs in Canada and other costs.

- Regulators and government departments should establish formal staff secondments with the private sector. This exchange would allow private sector staff to attain a more granular understanding of the challenges that regulators need to address and would acquaint public sector staff with the realities of being a financial practitioner.

- Given the additional regulatory requirements on the sector, all government regulations impacting the financial services sector should have a mandatory five-year review.

Single Securities Regulator

The federal government is to be congratulated for its strong leadership and its significant efforts to resolve this long-standing issue. Unfortunately, the Supreme Court‘s recent decision leaves Canada as the only major developed country without a unified approach to securities regulation. The decision was a significant setback to a proposed scheme that would have delivered a workable framework. The lack of a single securities regulator puts Canada at a competitive disadvantage in a world where financial regulation is becoming more harmonized and increasingly global. The multiplicity of securities regulators in Canada and the resulting costs to businesses are tangible impediments to attracting international businesses to Canada.

Recommendations:

- The federal government should continue its leadership and work with the provinces to establish a cooperative national securities regulatory framework.

Debt Reduction and a Competitive Tax System

Canada’s fiscal position is one of the strongest in the world and it is vital that the federal government continues to maintain its solid fiscal advantage. In light of the current global economic uncertainty, Canada must ensure it has strong public finances to provide the flexibility to respond to new economic developments. At a minimum, the federal government should adhere to its current target of a balanced budget by 2015-16 and reiterate its commitment to begin lowering the debt-to-GDP ratio by 2013-14. To meet these goals, the federal government should continue to place particular emphasis on generating savings from operating expenses and improving productivity, while at the same time examining the relevance and effectiveness of programs.

The federal government’s fiscal position has been one of the underpinnings that have allowed it to undertake tax reform that has led to growth and investment. This tax reform has included reductions in the corporate income tax rate and the harmonization of the Goods and Services Tax (GST) in several provinces. The federal government has made tremendous strides in helping to turn Canada into a competitive tax jurisdiction for job-creating business investment. However, there are still areas that need to be addressed.

One such area is the way in which financial services are treated under the Harmonized Sales Tax (HST). The TFSA supports the decision by the Canadian and Ontario governments to harmonize the GST, however the historical decision to treat financial services differently from other goods and services, continues to be a concern for the industry.

Specifically, the current structure of the GST/HST as applied to the financial sector does not meet the tax objectives of efficiency, productivity, and neutrality. The current structure creates economic distortions that reverberate through the economy and make tax administration challenging, thus having a direct impact on growth and investment.

As well, the TFSA appreciates the challenges the government faces in applying the GST to a sector as complex as financial services, but the frequency and scope of retroactive amendments to tax legislation is having an impact on Canada's international brand. The Economist noted that the GST/HST has "*resulted in legal punishment of Canada's financial sector for nearly 15 years that would not be countenanced in the US and other G7 countries. And it makes Canada uncompetitive…Canada's financial system may be the strongest in the G7 but it is badly in need of tax reform*[3]*."*

In addition to the HST, there are other areas of taxation that are impacting Toronto's competitiveness and international brand. Current federal tax legislation designates Montreal and Vancouver as international financial centres but excludes Toronto. This federal designation is not consistent with Toronto being clearly recognized globally as the leading financial centre in Canada and one of the top centres internationally.

Another issue is the continued application of the Part VI capital tax to financial institutions and the fact that the Part VI tax rate has not been reduced in parallel with recent reductions in the corporate income tax rate. The Part VI tax, which applies only to financial institutions, is unfair and counterproductive since it penalizes financial institutions for raising capital and increasing their financial strength. The Part I corporate income tax rate has been reduced over the last few years from 28% to 15% with no corresponding reduction in the Part VI capital tax rate. Since the Part VI capital tax is a minimum tax, the minimum taxable income required to avoid Part VI tax has increased by over 70% since 2000, making it increasingly difficult for financial institutions to fully offset their Part VI tax liability with corporate income tax in the face of wide fluctuations in taxable income, due to economic and business circumstances.

Lastly, the current tax treatment of Corporate Groups and various issues reviewed by the Advisory Panel on Canada's System of International Taxation are also impacting the international competitiveness of the financial sector.

Recommendations:

- At a minimum, the federal government should meet the current target for balancing the budget by 2015-16.

- In cooperation with the financial sector, the current GST/HST treatment of financial services should be formally reviewed to ensure greater tax neutrality, simpler administration, reduced definitional complexity, and increased productivity and competitiveness.

[3]Economist Intelligence Unit. Canada financing: A hidden tax danger. September 23rd, 2010

- Before changes to the GST/HST treatment of financial services are adopted, there should be an appropriate level of consultation with the sector and a transition/phase-in period.

- Federal tax legislation should also recognize Toronto's status as an international financial centre and thus contribute to Toronto's already strong global brand.

- The Part VI capital tax rate on financial institutions should be eliminated, or at a minimum, the tax rate should be reduced consistent with recent reductions in the corporate income tax rate.

- As Canada is the only country in the G-8 without a consolidated tax reporting mechanism, the federal government should introduce a comprehensive group taxation regime to improve international tax competitiveness.

- The federal government should continue to implement the recommendations of the Advisory Panel on Canada's System of International Taxation.

<u>Pooled Registered Pension Plans (PRPPs)</u>

The TFSA is supportive of federal legislation that would permit the creation of Pooled Registered Pension Plans (PRPPs) in Canada. Canada's pension system is already among the strongest in the world and the introduction of PRPPs will help to ensure that this advantage does not erode. In particular, PRPPs will offer new retirement savings options for self-employed Canadians and individuals who work for smaller companies.

Toronto's world-leading private-sector financial expertise can contribute significantly to meeting the need identified by government to provide affordable pension options for all Canadians. Canada's pension funds, the largest of which are headquartered in Toronto, and the Toronto financial sector's recognized strength in asset management have been identified among the top reasons that Toronto stands out as a global financial services hub. If implemented appropriately, PPRPs will be beneficial for both consumers and the financial industry.

The federal, provincial and territorial governments should work closely with the industry, employers, and other stakeholders to ensure that PRPPs are introduced in a way that will encourage widespread adoption, which is in the interests of all Canadians as they approach retirement age.

<u>Recommendations:</u>

- In order to reduce compliance costs and maximize participation, the federal government and provinces should work together to ensure uniformity, integration and portability between provinces.

- Effective protection rules for investors, employers, and providers need to be incorporated into the PRPP framework but these rules should be flexible enough to encourage innovation, efficiency and affordability.

- The tax treatment of PRPPs should be consistent with other pension products and retirement savings vehicles so as to encourage increased savings as opposed to simply reallocating existing resources.

- The PRPP should remain a voluntary offering so that Canadians may choose to contribute to the pension or retirement savings vehicle that is best suited for their individual needs.

- Government support for increasing the financial literacy of Canadians is a vital tool to ensuring greater participation rates in the PRPP and other registered retirement savings vehicles.

Attracting/Retaining Investment in the Financial Services Sector

The global financial crisis has driven international financial services firms to ensure that they are maximizing their resources by locating jobs in the most attractive regions, from both a talent and cost perspective. Canada's effective management through the crisis justifiably continues to win us admiration internationally. The attention we are receiving on the global stage provides an unprecedented opportunity to market the country as a preferred location to set up operations.

Financial services are a highly mobile industry, with the ability to move jobs easily across borders. The need to both attract new jobs, as well as retain those that we have, should continue to be a priority for all levels of government.

The TFSA continues to work closely with various departments in the federal government in identifying the latest sector trends, key areas of growth, and factors relevant to considering the Toronto region as a location to invest. There has been joint participation with the federal government in many successful international events, conferences, and forums to promote Toronto as a global financial hub.

Recommendations:

- The financial services industry traditionally has received marketing support from the Department of Foreign Affairs and International Trade (DFAIT) and others, and we are pleased that, as of 2012, there are now dedicated resources aimed at promoting this critical sector. On an on-going basis, this support should be well integrated with the economic development efforts of the provinces and the regions, to ensure that we are all effectively leveraging our individual marketing and promotional efforts.

- To maximize job attraction efforts, we need to focus both on attracting new companies from outside of our borders, but also work to ensure that those companies that already have a presence in the region are incented to stay and expand their local labour force. To help realize this goal, we are very supportive of the efforts of DFAIT's trade commissioner service to make domestic sales calls (investment aftercare) a formal part of their investment attraction mandate and would recommend broadening this effort as much as possible.

- Due to their locations around the world, trade commissioners and diplomatic staff, are a valuable source of local market intelligence and identification of potential leads. Similarly, the TFSA offers a broad network of contacts in the Toronto industry and can play the role of liaison between the federal government and local industry leaders on initiatives to encourage investment in the Toronto region. Moving forward throughout 2012 and beyond, we recommend that we continue to strengthen and formalize the ties between DFAIT and TFSA, and ensure that there is a proactive sharing of information through monthly meetings and shared databases.

- Recently, in order to attract more investment to Canada, the federal government has committed new resources and programs to research, marketing, and international collaborations to bolster the country's brand. Programs such as the *Financial Times Global Investment Series* help to identify successful strategies to attract investment and should be renewed and expanded into other foreign markets. Financial services should be a focus sector for the program and various international financial services centres should be targeted.

Attracting Professional Talent

The critical role that talent plays in economic growth and development cannot be understated. One of the key strengths Canada, and particularly the Ontario region, currently offers as an attraction to locate financial sector jobs here is our diverse talent base. In order to ensure that we maintain this advantage, we need to both grow the talent base domestically and work to attract foreign skilled workers into Canada. One way to do that is to ensure access to timely information on the supply and demand of talent across the country.

Ensuring an on-going pipeline of talent is critical to both growing and maintaining the industry, as research has shown that there will be a shortage of talent in key parts of the financial services sector in the coming years. To deliver on this challenge, we need to work with all levels of government to maximize our collective resources.

As part of its mandate to enhance the talent advantage of the region, the TFSA established the Centre of Excellence in Financial Services Education (CoE) in 2009. The CoE is currently working on strengthening the domestic talent base through liaising with diverse stakeholders such as employers and educational institutions, as well as pursuing strategies to attract internationally-educated professionals.

Key findings in this work suggest that more needs to be done:

- By governments and stakeholders to collect data on the educational qualifications and skills sets of new graduates and newcomers;
- By educational institutions to align courses and programs to the needs of the industry;
- To provide job seekers with deeper insights into the career opportunities and required skill sets for the financial services sector; and
- To make it easier for internationally-trained financial professionals to integrate into the financial services sector (newcomers and expatriates have the knowledge and skills but do not have access to current networks).

Recommendations:

- The Department of Foreign Affairs (DFAIT) is implementing a coordinated promotion of Canada's educational institutions designed to attract a high calibre of international student to the region. This initiative should more clearly identify the specific strengths of Canadian educational institutions and their role in effectively preparing students for meaningful careers in economically important sectors such as financial services.
- The federal government should create a central database that consolidates data on the number of post-secondary graduates and their educational background. This would facilitate the identification of the talent supply for sectors such as financial services.
- The federal government should place increased emphasis on approving applications from individuals applying under the foreign skilled worker category who have the critical qualifications and experience needed by sectors such as the financial services sector.

Positioning Toronto as the North American Centre for Islamic Finance

The Islamic financing market represents a tremendous opportunity for Canada's financial sector with Islamic banking assets reaching US$1.1 trillion in 2012, a significant jump of 33% from their 2010 level[4]. Canada is well positioned to attract additional investment from countries where Islamic finance is becoming an important alternative to conventional finance, with Toronto well positioned to become the North American centre for Islamic finance.

Asian economies such as Malaysia and Indonesia and the countries of the Gulf Co-Operation Council (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE) are at the forefront of the development of Islamic finance. Many of these jurisdictions are of strategic importance to Canada from a trade and investment standpoint, and a willingness to accommodate structures that are widely utilized in Islamic finance will facilitate attracting additional trade and investment opportunities for Canada and the Canadian financial industry.

[4] Ernst & Young World Islamic Banking Competitiveness Report 2011

Other Western jurisdictions, including the U.K., Ireland, France, Singapore and Australia have taken steps or are in the process of making changes to their respective legislative and/or regulatory frameworks to create a level playing field between conventional and Islamic finance. London, U.K. has already successfully positioned itself as a global centre for Islamic finance and attracted significant investment as a result.

The TFSA has created an Islamic Finance Working Group (IFWG) and the IFWG has done some of the initial policy work to identify issues and options to level the playing field with conventional finance. There are a number of proposed changes to federal and provincial legislation that would help level the playing field, thus allowing governments and private sector participants to take full advantage of Islamic finance in Canada.

Recommendations:

- The federal government should review the income tax treatment of Islamic finance so as to clarify: (i) Islamic deposit products; (ii) Islamic non-mortgage and mortgage lending transactions; and (iii) Islamic bond structures.

- The federal government should review the GST/HST treatment of Islamic finance so as to clarify: (i) Islamic deposit products (ii) Islamic non-mortgage and mortgage lending transactions (iii) Islamic bonds; and (iv) Islamic insurance. In general, definitions in several sections of the *Excise Tax Act* (e.g. "financial instrument", “financial service", "insurer" and "financial institution") should be reviewed to accommodate Islamic finance products.

Conclusion

The TFSA congratulates the federal government on their work to date on strengthening the Canadian economy. The federal government has provided a strong foundation and partnership for our strategy of growing the financial services sector and attracting new investment and jobs for all Canadians. The TFSA and the financial services sector continue to look forward to working closely with the federal government to ensure a strong and global financial services sector.