

**TORONTO FINANCIAL SERVICES ALLIANCE**

**REVIEW OF THE FEDERAL FINANCIAL SECTOR  
FRAMEWORK**

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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.

For more information about the TFSA, please visit: [www.tfsa.ca](http://www.tfsa.ca)

## **Executive Summary**

TFSA welcomes the opportunity to present this submission and participate in the review of Canada’s federal financial sector framework. TFSA has been a leading voice for the Toronto region’s financial services sector, and a contributor to policy development at all levels of government. Serving as 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.

As former Bank of Canada Governor David Dodge has noted, Canada’s financial services sector plays a vital role in the nation’s 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.<sup>1</sup>

By design, the sunset provisions in various federal statutes presents a critical opportunity to review and ensure that the legislative and regulatory framework of Canada’s financial system is strong, efficient, and effective – both in terms of enabling the Canadian economy to expand and create employment, but also in terms of the growth of the financial services sector itself.

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<sup>1</sup> David Dodge. Financial Regulation and Efficiency: Trade-offs in the Post-Financial Crisis Era. C.D. Howe Institute. January 29, 2015.

The recommendations contained in this submission focus on three areas:

- Encouraging the *growth* of Canada's financial services sector (companies, employment, innovation) should be made one of the *core* policy objectives for this review and to guide future policy-making (in addition to the other core principles of stability, utility and efficiency). Growth principles can be supported by strengthening policy collaboration between government and industry and by enhancing the regulatory development process;
- Policy makers should pay close attention and work with industry to capitalize on emerging opportunities and trends, including areas such as fintech, the internationalization of the Chinese currency, and the growth of Islamic Finance; and,
- Other initiatives would also strengthen Canada's financial services sector. Priority areas include: tax reform, implementation of the Cooperative Capital Markets Regulatory System, and the expanded use of Public-Private Partnerships.

## **Economic Importance of Canada and Toronto's Financial Services Sector**

Canada's financial services sector is a critical component of the Canadian economy in terms of growth, job creation, and international trade – in addition to serving as the catalyst for the entire Canadian economy. The sector's employment, financial results, and international trade and investment performance outpaced the average for **all** sectors in the Canadian economy over the past decade. As of 2014, the sector directly accounted for almost 800,000 jobs nationally, and almost 7 per cent of Canadian GDP. Despite the significant impacts of the Global Recession of 2008-09 to the world economy, sector employment in Canada's financial service sector has actually risen by more than 15 per cent since 2004.

Looking externally, Canada's financial services sector accounts for 20 per cent of 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.<sup>2</sup>

### ***Toronto: An International Centre of Finance***

The strength of Canada's financial services sector is further enhanced by Toronto's place as a key global centre for international finance, which has been reinforced by global rankings such as *The Banker* magazine and the *Global Financial Centres Index (GFCI)*.

Toronto is now the second largest financial centre in North America by employment. Financial services directly employed more than 250,000 people in Toronto in 2014, which represents 8.1 per cent of the metro area's total employment, up from 7.1 per cent in 2004. In addition, the sector indirectly employed more than 100,000 people in the metro area. Nationally, Toronto's financial sector directly and indirectly supported more than 460,000 jobs.

With financial services accounting for 8.1 per cent of the region's employment, Toronto's proportional reliance on financial services is even higher than that in major global financial centres such as London and New York.

All major Canadian centres have posted significant increases in employment since 2002, with Toronto's financial services sector increasing by more than one-third while major U.S. financial centres have all seen their employment shrink.

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<sup>2</sup> Michael Burt. An Engine for Growth: 2015 Report Card on Canada and Toronto's Financial Services Sector. The Conference Board of Canada. November 2015.

## Responses to Consultation Questions

**How well does the financial sector framework currently balance trade-offs between the three core policy objectives of stability, efficiency and utility?**

### ***Growth as a Clearly Defined Policy Objective***

In the aftermath of the 2008-09 Global Recession, and considering the significant measures taken by numerous countries and international bodies to address systemic challenges and regulatory gaps, Canadians can take great pride that Canada's financial services system remains strong, efficient and effective. This review and consultation process presents an important opportunity to examine whether Canada's federal legislative and regulatory framework for the financial services system continues to effectively support Canada's economy and individual Canadians. It also presents an opportunity to look further ahead and take important measures to grow Canada's economy, and the financial services sector itself.

Finance Canada's consultation paper clearly states that there are three core policy objectives that guide federal financial sector policy and frame this review:

- **stability:** the sector is safe, sound and resilient in the face of stress;
- **efficiency:** the sector provides competitively priced products and services, and passes efficiency gains to customers, accommodates innovation, and effectively contributes to economic growth;
- **utility:** the sector meets the financial needs of an array of consumers, including businesses, individuals and families, and the interests of consumers are protected.<sup>3</sup>

TFSA supports each of these policy objectives – they have been the guiding principles that have built the strong, effective, and efficient system that Canadians rely on, and have made Canada one of the soundest financial systems in the world, according to the World Economic Forum.<sup>4</sup> However, the frame of this review should incorporate a critical opportunity that others abroad have long recognized, which is the important contribution made by the financial services sector as a mechanism for growth, innovation and job creation *in and of itself*. In short, we respectfully suggest that this is the one core policy objective that should be explicitly included in this review, and which must guide future policy-making.

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<sup>3</sup> Department of Finance Canada. "Supporting a Strong and Growing Economy: Positioning Canada's Financial Sector for the Future." August 26, 2016.

<sup>4</sup> World Economic Forum. *The Global Competitiveness Report 2016-2017*.

Canada's financial services sector is not simply the mechanism that allows the rest of the Canadian economy to flourish, for Canadians to buy and sell goods to each other, and companies to invest and grow their businesses. Canada's financial services sector is a critical component of the Canadian economy in its own right. Numerous countries have recognized the importance of their financial services sector as an engine of growth and job creation, and have made this a core policy objective to guide policy-making. Lastly, Canada's reputation and ranking among peer global centres of finance presents a unique and bold opportunity to make Toronto – in partnership with the other three financial centres of Montreal, Vancouver and Calgary – a key centre for international finance.

### *Continuing to Strengthen Collaboration between Government and Industry*

Balancing the role of the financial services sector for the broader economy, while ensuring that the sector remains a centre of growth, innovation and job creation, has been a guiding principle for policy makers in numerous jurisdictions such as the UK, Singapore, Hong Kong, Dubai and others.

The UK Government is a good example. Financial services policy-making in the UK today is essentially guided by two key strategic goals:

“The first [is] to ensure that the UK's financial services are properly regulated...[a]nd the second [is] to cement the UK's position as a world leader in financial services.”<sup>5</sup>

To further this objective, as part of the reforms introduced following the Global Recession, the UK Government created the Financial Services Trade and Investment Board (FSTIB) in 2013. The Board is made up of experts from both government and industry, and its role is to ensure that “the UK's global financial centre becomes even stronger.” The UK Government has used the FSTIB to “identify areas of high growth potential in financial services, and coordinate commercial and policy action.”<sup>6</sup>

The work program for the Board has been impressive, both in terms of collaboration between government and industry, and with respect to the breadth of policy areas requiring industry and government policy making. While specific to the UK, it is helpful to outline the work program of the FSTIB as it demonstrates the comprehensiveness of the approach the UK government has taken to not only ensure the financial system is appropriately regulated, but is recognized as a centre of growth, innovation, and job creation (please see Table 1 below).

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<sup>5</sup> HM Treasury. “Financial Services Trade and Investment Board: Annual Report 2014-2015. March 2015, p. 3.

<sup>6</sup> HM Treasury. “Financial Services Trade and Investment Board: Annual Report 2014-2015. March 2015, pp. 3, 7.

**Table 1: The UK Financial Services Trade and Investment Board (FSTIB)  
– Work Program (2014-2016)**

The FSTIB work program currently includes the following areas of collaboration between government and industry:

1. **RMB internationalisation:** To develop London as the global hub for Renminbi (RMB) business outside China and support the internationalisation of RMB by the Chinese authorities;
2. **Investment management strategy:** To make the UK one of the world's most competitive places for the Investment Management industry;
3. **Islamic finance:** To develop the UK as a global centre for Islamic finance;
4. **UK trade policy:** To work with the European Commission to increase the access of UK firms to overseas markets, and promote greater coherence and consistency in financial regulation through the EU's trade negotiations with our key trading partners;
5. **Insurance growth action plan:** To grow the market share of UK insurers in high growth economies in Asia and Latin America; and to attract inward investment – both insurance capital and jobs – to the UK market;
6. **Emerging capital markets:** To support emerging markets in developing deep and well-regulated capital markets;
7. **Financial technology:** To map the UK Fintech sector and identify and pursue high value trade and investment opportunities;
8. **Back and middle office:** To develop the UK's capacity to provide back and middle office functions for international financial services firms; including banks;
9. **UK as a hub for finance raising:** To promote the UK as a prime destination for international firms to raise finance;
10. **India-UK Financial Partnership:** Establish close ties and deepen financial cooperation between the financial centres of India and the UK;
11. **Infrastructure finance:** To further develop the UK as a centre for the financing of infrastructure projects overseas.

*Source: HM Treasury. "Financial Services Trade and Investment Board: Annual Report 2014-2015". March 2015, page 11.*

Canada's financial services sector plays an active and constructive role in providing policy input on numerous federal and provincial policy matters, and certainly the Canadian financial services framework. TFSA in particular has taken an active and strategic role, serving as a catalyst for collaboration between the public and private sectors.



In a similar way, numerous departments and agencies of the Federal Government that are a part of the legislative, regulatory and oversight of Canada's financial services system often seek policy input and counsel from TFSA and other sector leaders. The dialogue between industry and government has generally been positive but the formalized approach taken by the UK, and other countries, can serve as a model. A model that brings policy makers and industry leaders together to set agendas and work cooperatively to grow the industry, entrench consultation and encourage policy input in Canada.

An example of a potential area of collaboration between government and the financial services industry concerns risks to financial stability and the wider economy. For instance, Canada's property & casualty insurance industry has documented that a tail-risk mega-earthquake could overwhelm the industry's financial resources and cause widespread insolvencies among insurers. This initial shock could trigger system-wide financial contagion, because surviving insurers would be assessed by the Property and Casualty Insurance Compensation Corporation (PACICC) to honor a portion of the claims of the insurers that failed, weakening the capital position of survivors and potentially generating more failures – i.e. a domino effect.

Canada's property & casualty insurance industry is advocating for a last-resort federal emergency backstop and reforms to PACICC to address this systemic risk. These industry initiatives have the support of Canada's former chief financial regulator, who in a recent CD Howe Institute report argued that "there is a strong case for establishing a Federal Government/industry backstop arrangement to deal with such an uninsurable catastrophic risk" and advocated for "enhancements to the existing survivor-pay, private-sector insurance industry compensation system to lessen accentuating impacts from a crisis event."

## *A Regulatory Environment that Supports Growth*

Canadian and international regulators are implementing new 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 Dodge has noted, 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.<sup>7</sup>

A report by the C.D. Howe Institute affirms this view: “[T]he 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.”<sup>8</sup>

A recent paper by Jacqueline Coolidge and Jack Mintz discuss the potential value of introducing an improved approach for Regulatory-Impact Analysis (RIA) in Canada based on lessons from Europe and the United States.<sup>9</sup> As cited in the Coolidge paper, the recommendations noted below should be considered to ensure that regulations are developed to minimize administrative and compliance costs as well as unintended effects.

### **TFSA Recommendations:**

- The Federal review of Canada’s federal financial sector framework should be broadened to include a **fourth** core policy objective, and to guide future federal policy-making. The fourth core policy objective must be that policy-making fosters growth, innovation and job creation in Canada’s financial services sector, so that Canada can maintain and grow its stature as a centre for global finance.
- Formalizing the role and engagement that industry and stakeholders have to provide policy input, similar to the FSBIT in the UK, is an opportunity to ensure that the financial services sector in Canada can contribute to policy development, and that policy makers can obtain early feedback on approaches and mechanisms. Formalizing engagement will help to ensure

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<sup>7</sup> David Dodge. Financial Regulation and Efficiency: Trade-offs in the Post-Financial Crisis Era. C.D. Howe Institute. January 29, 2015.

<sup>8</sup> The Future of Financial Services: Competition and Growth. C.D. Howe Institute. June 17th, 2015.

<sup>9</sup> Jacqueline Coolidge and Jack Mintz. Getting Financial Regulations Right: Avoiding Unintended Effects. The School of Public Policy, University of Calgary. October 2016.

that industry and government can identify opportunities to grow the sector collectively that require both industry and policy measures.

- As noted in the Coolidge paper, Canada could strengthen the regulatory development process by considering the following:
  - A framework of minimum requirements to assess whether a regulation is beneficial.
  - Consultation with parties to estimate costs, unintended effects and to help understand the benefits of regulation.
  - Transparency, so all can see the entire RIA process, and regulators can hear from all interested stakeholders.
  - Post-evaluation that is made public.
  - A joint federal-provincial approach to regulatory-impact analysis to encourage harmonization and improved RIA processes at the provincial level.
  - A requirement for regular “sunsetting” provisions requiring that all regulations be subject to periodic review before being either re-authorized, revised, or eliminated.

## **Responses to Consultation Questions**

### **Are there lessons that could be learned from other jurisdictions to inform how to address emerging trends and challenges?**

Canada's stable regulatory environment and strong financial services sector has been a strong asset in attracting jobs and investment. However, the Toronto region finds itself operating in an increasingly competitive market where other international financial centers are targeting groups of high growth companies to invest in their cities and regions. This increased competition, combined with the relative maturity of the Canadian financial services market, has made it imperative that we identify, develop, promote and grow new specialized areas of strength. Some potential key areas are financial technology, the internalization of the Chinese currency, and Islamic Finance.

### ***Fintech: An Opportunity to make Canada a Global Leader***

There is no doubt that the financial sector is going through change. Innovation has always been a part of the evolution of the financial sector and new technologies are an underlying factor contributing to change. However, there are some fundamental differences today that are working together and impacting the pace and breadth of change within the global financial ecosystem. Some of these factors include: new nimble players, higher expectations from retail and corporate clients for greater access, efficiency and transparency and the onset of transformative new technologies.

Some of these emerging trends are being driven by consumers while others are the result of the introduction of transformative technologies (such as blockchain and cloud computing). A diverse range of companies, from Canadian financial institutions to established global technology giants, to smaller fintech firms are engaged in areas such as peer-to-peer lending, payments and on-line (robo) advice. Other trends such as the use of distributed ledger technologies (DLT) or blockchain have wider application and have the potential to alter the way governments interact with its citizens and how financial institutions manage their entire enterprise workflow. Another notable trend is the proliferation of digital currencies such as Bitcoin. It should be noted that the banks are collaborating with fintech firms and this is yielding new innovative possibilities.

As with most new technologies, the full extent of future uses and potential risks is not entirely clear and in the case of every new technology the question is not whether the technology is 'in and of itself' a good thing or a bad thing. The questions are: what is the application of the technology? for what purpose? and applied in what way and with what safeguards?

The comments below cover how jurisdictions around the world are approaching innovation and focus on three main areas. The first section focuses on the need for government leadership to help expedite and provide a structure to facilitate

innovation. The second section discusses some of the collaborative efforts taking shape among the varied stakeholders to understand the applications of these new technologies and emerging trends. Finally, the third section examines the importance of governance and standards.

### *Government Involvement in Fintech*

Innovation sometimes implies a lack of precedence and when there is not a roadmap to follow, a legislative or regulatory framework may need to be put in place or be adapted to accommodate change. In times of change, government can help to provide vision and leadership and to address gaps in the legislative or regulatory framework in order to create a supportive, balanced approach to innovation.

A good example where governments have provided leadership direction is in the development of the regulatory sandbox concept. A regulatory sandbox is:

“a safe space in which businesses can test innovative products, services, business models and delivery mechanisms without immediately incurring all the normal regulatory consequences of pilot activities.”

While the primary purpose of a sandbox is to support product innovation for the betterment of the consumer, it also has the benefit of promoting competition, attracting top talent and generating revenue for the economy. A sandbox is meant to lower the costs and time for market entry and reduce the risk by reducing regulatory uncertainty.

In the UK, the Financial Conduct Authority (FCA) launched Project Innovate in 2014 after the HM Treasury asked the FCA to investigate ways to develop and foster competition to encourage innovation in the interest of consumers. A year later the FCA announced the creation of a regulatory sandbox. Although the FCA ultimately ‘holds the reigns’, they work closely with the Prudential Regulatory Authority (PRA) in certain circumstances.

Several other jurisdictions have followed the UK’s lead and announced plans to implement a regulatory sandbox including Hong Kong and the Ontario Securities Commission in Canada. Australia, Malaysia and Singapore are consulting with industry to determine an appropriate sandbox structure in their jurisdictions.

It is worth noting that not all sandboxes are the same. Australia is structuring their sandbox to be suitable for certain products (e.g. listed securities, simple managed investment schemes and deposit products) whereas Singapore and the UK allow for small and large firms to participate as long as they fit certain prescribed criteria. Singapore makes it clear in their consultation that they will not relax any requirements in relation to anti-money laundering and anti-terrorist financing activities (AML/ATF) or threaten the confidentiality of customer information. The Office of the Comptroller of the Currency (OCC) in the U.S. will

be setting up an outreach program to begin engagement with fintech companies, conduct research and collaborate with other regulators while continuing to explore an appropriate structure for an innovation sandbox.<sup>10</sup>

Furthermore, the regulatory sandbox concept simply helps to accelerate and provide a more structured framework to supportive measures and practices that many regulators already have in place to facilitate innovation in financial services. For example, the Australia Securities and Investment Commission (ASIC) has supportive action in place such as a modular licensing framework and no-action enforcement letters to accommodate new market entrants. Similarly, the Bureau of Consumer Financial Protection in the U.S. issued a no-action policy in Feb 2016. The new policy will help facilitate consumer access to financial products and services that promise substantial benefit to consumers. The new policy establishes a process for companies to apply for a statement from Bureau staff that would reduce regulatory uncertainty for a new product or service that offers the potential for significant consumer-friendly innovation.

Policy is widely recognized as a key lever in supporting the fintech sector and is a major differentiator between regions. The UK is considered to have one of the strongest fintech policy environments with numerous programs to promote competition and innovation. An example is the UK's "fintech visa" that allows prospective entrepreneurs to enter the UK to secure funding and launch a start-up before obtaining a visa, to encourage non-EU entrepreneurs, such as from Canada, to relocate to the UK.

The Australian government acknowledges that stimulating fintech innovation is important in order to make the country's financial services market more efficient, customer oriented and internationally competitive. The recently released National Innovation and Science Agenda introduces measures to incentivize early stage investment to support growth in fintech. The agenda focuses on four key pillars; one of these pillars is the commitment by the government to lead by example by making data available to the public to make it easier for startups and innovative small businesses to do business with the government. In fulfilling the mandate, the Australian government intends to place innovation and science at the centre of the Government by establishing a new sub-committee in the Cabinet and an independent advisory board to help drive the agenda forward. This close interaction between the government and small businesses could lead to some interesting developments in terms of data sharing particularly for consumer applications that would benefit from more efficient data verification. The government also launched measures to encourage early-stage investment including a 20% non-refundable offset on investment capped at \$200,000 per investor per year and a 10-year capital gain tax exemption for investment held over 12 months.

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<sup>10</sup> Office of the Comptroller of the Currency, October 2016.

Another jurisdiction that has a very hands-on government approach to promoting fintech is Singapore. Singapore has the advantage of a very nimble well financed central government that has a long-standing history of supporting the development of its financial service sector. The Monetary Authority of Singapore (MAS), the country's central bank, uses a consultative approach to address change and has a reputation for implementing new policies and legislative amendments quickly. An example of this is the MAS's recently released consultation paper that proposes changes to the payment regulatory framework. The proposal would bring two pieces of legislation: The Payment Systems (Oversight) Act (PS(O)A) and the Money-Changing and Remittance Businesses Act (MCRBA), under a single framework. The framework will provide for the licensing, regulation and supervision of all payments services, including stored value facility holders, remittance companies, and virtual currency intermediaries.<sup>11</sup> The proposal addresses perceived fragmentation of payment services by regulating activities rather than regulating at an entity level. Regulating at an activity level is one way to ensure a level playing field between market participants with varied interests.

An area that is of increasing interest to governments and consumers around the world is the use of digital currencies as an alternative payment option. Some of the positive impacts include the potential for cheaper, faster and more transparent payments especially in the context of cross border payments. However, digital currencies can offer a degree of anonymity that can be attractive for illegal users. Proper safeguards are essential yet extending anti-money laundering legislation can be challenging from a policy standpoint. One challenge is how to classify a digital currency (as a: currency, commodity, security). One solution is to categorize digital currencies in a way that folds them to existing statutory regimes; another way is to introduce new regulations focusing specifically on digital currency. Some jurisdictions are regulating digital exchanges on a case-by-case basis while exploring a wider regulatory approach for digital currencies. For example, Coinbase, a company that offers digital wallets and other services to bitcoin users, received regulatory approval from a number of U.S. states in 2015. It is likely that this approach will become more common across most jurisdictions as the regulatory sandbox framework matures.

It is evident that countries around the world recognize that fintech is gaining significant momentum and causing disruption to the traditional value chain. However, there is no uniform approach across jurisdictions in addressing these changing dynamics. What is clear is that regions where there has been significant government involvement and leadership direction such as the UK, Singapore and Australia are further ahead in developing a new financial ecosystem supportive of innovation. Smaller countries are also seizing the opportunity to create new niche markets that may overtime have an impact on traditional banking centres.

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<sup>11</sup> Proposed Activity-based Payments Framework and Establishment of a National Payments Council - First Consultation, August 2016.

## *Collaboration – A Necessary Ingredient for Change*

Collaboration between incumbents and new players is useful to fully understand the effects, both positive and negative, of technological developments. Equally important is coordination between the government, academia and industry in assessing the wider implications of innovation. Distributed ledger technology or blockchain is an area where there is a considerable amount of collaboration due to its potential to significantly disrupt the financial services sector. Blockchain could represent the next evolutionary jump in business process optimization technology. It has the capability to optimize business processes by sharing data between businesses (counterparties) that have differing competing economic objectives in an efficient, transparent manner. One particular area of interest is that of 'smart contracts' – contracts that are converted into computer programs and, as such, have the ability to be self-executing and self-maintaining.

However, there are questions around the scalability and security of blockchain and the social implications of different uses and financial costs and benefits of adoption.

Consequently, there is a role for the government and academia to play in understanding these risks. In the UK, the research councils are playing an important role, led by the Engineering and Physical Sciences Research Council (EPSRC) and Economic and Social Research Council (ESRC), in supporting research in universities and in the newly-created Alan Turing Institute. The Alan Turing Institute is a joint venture by the universities of Cambridge, Edinburgh, Oxford, University College London, Warwick and EPSRC with a mission to become a world leader in data science research and innovation.

Singapore has established an International Technology Advisory Panel (ITAP) to advise on international developments in fintech and how Singapore can harness new technologies.<sup>12</sup> The ITAP comprises chief innovation and science officers in major financial institutions, fintech business leaders, venture capitalists, and thought leaders in technology and innovation. The ITAP also engaged more than 500 industry professionals, academics and university students over four panel discussions. The discussions explored the impact of technologies like blockchain, wearables, and telematics on the financial services industry, as well as new business models for banking and fixed income and foreign exchange markets.

The Federal Reserve Board in the U.S. has established a working group that is engaged in a 360-degree analysis of financial innovation across a range of areas under their purview including supervision, consumer protection, financial stability and information technology.<sup>13</sup> One important focus area is the impact of new technology on the payments system to ensure financial stability is not at risk. The

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<sup>12</sup> 2 August 2016, MAS sets up International Technology Advisory Panel. [www.mas.gov.sg](http://www.mas.gov.sg)

<sup>13</sup> Speech by Governor Lael Brainard, at the Institute of International Finance Annual Meeting Panel on Blockchain, Washington, D.C., 7 October 2017.



working group will draw on engagement with industry stakeholders and on expertise from across the federal reserve system.

The most well-known industry consortium for blockchain is R3. R3 is a collaborative effort between leading financial institutions to support research and product development efforts to advance the application of distributed ledger technologies for financial services.<sup>14</sup> Smaller groups have also formed to advance a particular application and credit unions, asset managers and the insurance industry are exploring alliances.

Recently, UBS, Deutsche Bank, Santander and BNY Mellon as well as broker ICAP have teamed up to develop a new form of digital cash: a 'utility settlement coin.' Their goal is to make the coin the industry standard to clear and settle financial transactions over blockchain. The utility settlement coin, based on a solution developed by Clearmatics Technologies, aims to let financial institutions pay for securities, such as bonds and equities, without waiting for traditional money transfers to be completed. Instead they would use digital coins that are directly convertible into cash at central banks, cutting the time and cost of post-trade settlement and clearing. Yet, they are not alone in their pursuit. There are several other rival digital cash systems being developed including Setl and Citigroup's "Citicoins" solution.<sup>15</sup>

Many of the emerging trends and technologies are still in the early stages of their development life-cycle. However, the pace of change is rapid and it is important that market participants continue to engage with each other to foster socially beneficial innovation while making an effort to fully understand, manage and control risk.

### *Governance and Standards – In a Nascent Stage*

Establishing standards for many of these new technologies will not be an easy task since many of these new technologies transcend borders and there are varying laws between jurisdictions for data protection and privacy of information.

The topic of blockchain is complicated because blockchain standards can be divided into three interrelated vectors, comprised of technical, business and legal considerations. Standards carry with them a number of benefits, including some network effects, easier interoperability, shared implementation knowledge, lower costs and less overall risk however they are not easy to implement.

Standard setting is very much in a nascent stage since in many cases market participants are still working on user cases on how to apply new technologies. For example, there will not be widespread adoption of blockchain in financial services unless there is a network effect – meaning that the financial community comes together and accepts the application and integrates it into their business

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<sup>14</sup> The Bank of Canada has worked in partnership with the Canadian Banks and R3 CEV Blockchain to test possible use of blockchain technology in interbank payments.

<sup>15</sup> Setl is a London based group founded by hedge funds and trading executives.

workflow. Business standards will need to be agreed and put in place to safeguard their interests before the network effect will take root. Some work is being done on standards within the R3 consortium.

It is possible that the industry creates a forum to develop standards similar to the FIX Trading Community or leverages an existing organization like the International Standards Organization (ISO). The FIX Trading Community is a non-profit industry driven standards body that developed the FIX protocol, a messaging language for global trading. The community has formed a working group for digital currency and blockchain but it is too early to know how this might develop.

Some jurisdictions are exploring the development of standards. The UK announced in a HM Treasury Report that they plan to work on a "pioneering" framework of voluntary standards for consumer protection.<sup>16</sup> The government will work with the British Standards Institution<sup>17</sup> and the digital currency private-sector to create a series of "best practice" standards for consumer protection. The MAS proposes to establish a National Payments Council to coordinate key initiatives such as promoting interoperability and adopting common standards.<sup>18</sup>

Although standard-setting will play a key role as new technologies evolve, currently there is very little progress internationally to provide clear direction on how this will take shape.

Innovation in financial services has caught the attention of governments, regulators and market players around the globe however there appears to be no set formula in meeting these new challenges. Jurisdictions such as Singapore have been agile and are quickly implementing policies to capitalize on opportunities to grow their economy while other jurisdictions such as the UK and Australia have had success in pushing forward their agenda due to strong government leadership and support.

Several jurisdictions have implemented a regulatory sandbox to hasten innovation and support the entrance of new market participants to the financial ecosystem but each jurisdiction has a slightly different approach to accommodate nuances in their market structure.

What is clear is that there is widespread recognition that addressing this change is a collective effort. There are new industry consortium initiatives announced frequently and numerous examples around the world of government, academia and industry collaborations working together to understand the implications and risks of these new technologies on the financial ecosystem. Canada should

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<sup>16</sup> Digital Currencies: response to call of action, March 2015.

<sup>17</sup> The British Standards Institute is the UK's National Standards Body.

<sup>18</sup> Proposed Activity-based Payments Framework and Establishment of a National Payments Council - First Consultation, August 2016.

evaluate international best practices and what is best for the Canadian economy and take deliberate action to speed the pace of connection among stakeholders to drive Canada's fintech sector and innovation agenda forward.

### ***Internationalization of the Renminbi (RMB)***

In November 2014, an agreement was reached between Canada and China which designated Canada as the first trading hub in the Americas for the Chinese currency, the RMB. Since then the RMB's role within the international financial system has continued to strengthen. In August 2016, the RMB represented 1.86% of global payment volumes ranking fifth in the world and is now the first emerging market currency to be included in the IMF's Special Drawing Rights (SDR) basket with an 11% weighting.

Canadian financial institutions are generally positive about China and the growth opportunities it presents the Canadian economy. All of the major Canadian banking institutions provide foreign exchange services in RMB and many of them offer or are working on introducing RMB as a payment option for trade financing transactions. Many institutions are exploring opportunities to introduce commercial banking services in RMB however the availability of investment products such as corporate deposits, term deposits, dim-sum bonds, panda bonds are still in an early stage in Canada.

Bond issuance in RMB has mainly been supported by efforts from the Province of British Columbia and Export Development Canada (EDC). In 2013, the BC government was the first foreign government to issue a bond into China's offshore market (known as a "dim-sum" bond). That bond and a subsequent bond in 2014 together raised approximately \$1 billion Canadian. The province of BC issued its first bond in China's on-shore market in January 2016 (known as a "panda" bond). The three-year-term bond, priced at 2.95%, raised 3 billion Renminbi (RMB), or about \$665 million Canadian. Export Development Canada has also issued several short-term dim-sum bonds over the last couple of years.

Canadian banks are active participants in the international bond market and bond issuance in RMB provides another way for financial institutions to diversify their funding. In September 2016, National Bank of Canada became the first North American bank to enter China's onshore bond market when it was approved to sell up to \$5 billion RMB of bonds. In fact, panda bond issuance totalled \$11.8 billion RMB with 29 deals since the beginning of the year. This surpassed the \$7.2 billion RMB dim-sum bond market which is sold outside of China. The Federal Government issuing a dim-sum or panda bond would be an important step and signal in supporting Canada's RMB hub and broader economic relations with China.

## ***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. 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. Canadian life insurers are already active in Islamic financial services internationally in markets such as Malaysia and Indonesia.

A recent study by Thomson Reuters, titled *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. 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.

### **TFSA Recommendations:**

- To support Canada's emerging fintech sector, the Federal Government should evaluate the supportive policy and regulatory initiatives undertaken by other international jurisdictions, including the concept of a "regulatory sandbox" for Canada, and continue to increase collaboration with industry and stakeholders.
- Following the lead of Government of BC and EDC, the Federal Government should issue a dim-sum or panda bond as an important step and signal in supporting Canada's RMB hub and broader economic relations with China.
- The G-20 has noted the potential of the Islamic bond market for infrastructure financing. Similar to other jurisdictions such as the UK, Luxembourg, and Hong Kong, the Federal Government should issue a sovereign Islamic bond.

## **Responses to Consultation Questions**

### **What actions could be taken to strengthen the financial sector framework and promote economic growth, including with respect to the identified themes? How should those actions be prioritized?**

There are several measures that Canada can take that will strengthen the financial services sector, create growth and employment, while also strengthening the financial sector framework. These areas include: tax reform, implementation of the Cooperative Capital Markets Regulatory System (CCMRS), and continuing to develop Canada as a global hub for Public-Private Partnerships (P3s).

#### ***Tax Reform to Promote Growth***

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, which 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.<sup>19</sup>

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 in Canada. 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.

Canada's financial services sector is proud of its significant contribution to the country'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 further promote investment and job creation.

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

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<sup>19</sup> 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.

## ***Cooperative Capital Markets Regulatory System (CCMRS)***

The initiative to create a Cooperative Capital Markets Regulatory System remains a priority of the TFSA as Canada is the only industrialized country without a common regulator.

A cooperative system will foster more efficient and globally competitive capital markets in Canada, facilitate new investment in the financial services sector, provide increased protection for investors, and strengthen Canada's capacity to manage systemic risk.

In July, the Ministers responsible for capital markets regulation in British Columbia, Ontario, Saskatchewan, New Brunswick, Prince Edward Island and Yukon, and the Minister of Finance of Canada selected the Capital Markets Regulatory Authority's initial board of directors and set new timelines for implementing the Authority.

Once created, the Authority will be the single regulator administering the proposed uniform provincial-territorial Capital Markets Act and complementary federal Capital Markets Stability Act. When passed, these acts would form the legislative cornerstones of the new Cooperative Capital Markets Regulatory System.

## ***Public-Private Partnerships (P3s): Canada as a Global Hub for P3 Development***

Canada has a significant need for construction and renewal of public infrastructure, especially at the provincial and municipal level. These infrastructure deficits include unfunded or underfunded public transit and transportation projects, aging legacy infrastructure (i.e. water, wastewater), and trade-enabling infrastructure (i.e. airports, ports). To address this deficit, especially at a time when resources are constrained, it has become important for governments to look at innovative ways of delivering infrastructure.

In this environment, public-private partnerships (P3s) have become a successful method for infrastructure development in Canada, with more than 220 projects worth over \$70 billion to date.<sup>20</sup> Canada's P3 models for alternative financing, procurement and delivery (including the model used in Ontario) are particularly ideal for large and complex infrastructure investments, as these types of projects benefit from P3's value for money proposition, their ability to be on-time/on-budget, and the transfer of related risk from the public to private sector. Indeed, Canada's unique approach to P3s has been recognized internationally as best in

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<sup>20</sup> X-X Yuan & J. Zhang, "Understanding the Effect of Public-Private Partnerships on Innovation in Canadian Infrastructure Projects", Ryerson Institute for Infrastructure Innovation, Prepared for PPP Canada, 2016: <http://www.ryerson.ca/content/dam/riii/ryerson-construction-innovation-2016.pdf>

class, making the country a destination for those interested in P3 infrastructure delivery and investment.

Infrastructure projects require long term financing and capital. Canada benefits in this area from having world-leading pension funds and life insurers that have deep expertise and experience with such investments. For example, the Canada Pension Plan Investment Board (CPPIB), the Ontario Teachers' Pension Plan (OTPP) and the Ontario Municipal Employees Retirement System (OMERS) have all participated with the private sector in global P3 projects. As pension funds have a long investment horizon, they make excellent owners of infrastructure. These funds, and others like them across Canada, are attracting global attention from governments who are trying to encourage them to invest in their domestic infrastructure.

P3 financing has also become a specialty for other Canadian financial institutions. Following the recent global financial crisis, organizations (such as RBC Capital Markets, CIBC Capital Markets, TD Securities, Scotiabank, etc.) developed specialized solutions for P3 infrastructure ventures. Also, as long-term investors serving the long-term financial protection needs of Canadians, Canadian life and health insurers such as Sun Life Financial and Manulife Financial are natural and active participants in P3 projects, both in Canada and internationally. Canada's work in P3 bond financing over the last few years has been impressive and demonstrated that it is an effective and value-enhancing source of financing. The bonds are designed to be low risk, stable long-term investments that offer premium yields when compared to traditional government or quasi-government debt issues. Toronto's legal, investment and advisory firms have participated in P3 bonds involving more than \$7 billion, making Toronto a global hub for this type of infrastructure financing.<sup>21</sup> Toronto's bond market for P3s is unique and not found in many other cities, making it another key feature of the Canadian model.

While the Canadian private sector has been at the forefront of P3 development, government support is critical to their success. Provincially, governments like Ontario and Saskatchewan have been driving P3 projects and procurement forward as they benefit from ventures being on-time and on-budget. Federally, PPP Canada manages the \$2.5 billion<sup>22</sup> P3 Canada Fund – the first national infrastructure program dedicated to supporting P3 projects – and the Building Canada Plan has previously encouraged greater involvement by screening projects with capital costs over \$100 million with a P3 lens to determine whether

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<sup>21</sup> Toronto Financial Services Alliance, "Toronto: A Centre for P3 Excellence", p8.

<sup>22</sup> \$1.25 billion was allocated to the fund in 2009, with an additional \$1.25 billion provided over five years starting in 2014. See: <http://www.infrastructure.gc.ca/plan/nbcp-npcc-eng.html> and <http://www.p3canada.ca/~media/english/press-releases/files/ppp%20canada%20launches%20round%20six%20of%20the%20p3%20canada%20fund.pdf>

better value for money can be obtained.<sup>23</sup> These efforts have spurred on the P3 industry in Canada and demonstrate the significant benefits of government continuing to support P3 development.

Governments around the world have turned to Canada for support in their own P3 infrastructure projects as they find new ways to deliver much needed infrastructure while maximizing government investment. Canada should take advantage of the ecosystem of P3 experts in law, finance, tax, accounting, development, and risk assessment that it has generated.

### **TFSA Recommendations:**

- The following recommendations for tax reform should be considered by the Federal Government in order to strengthen the competitiveness of the financial sector and increase investment and job creation:
  - 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 modeled 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 (SRED) 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.

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<sup>23</sup> The Federal Government eliminated the requirement for P3 screening in 2015: <http://www.theglobeandmail.com/report-on-business/liberals-drop-public-private-requirement-for-infrastructure-funding/article27322884/>



- 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.
- In light of Canada's status as a global hub for P3 development, the Federal Government should expand and leverage the use of P3 models, notably those already employed in provinces such as Ontario. Using P3 models will help to ensure that infrastructure projects are delivered on-time and on-budget, and transfer the risks to Canadian private sector entities best equipped to manage and minimize such risks.