

August 11, 2011

Mr. James Rajotte, M.P.
Chair, Standing Committee on Finance
House of Commons
Ottawa, Ontario
K1A 0A6

Dear Mr. Rajotte:

The Canadian Bankers Association (CBA) is pleased to provide the Standing Committee on Finance with its pre-budget submission as part of the Committee's 2011 pre-budget consultations.

We are pleased to have this opportunity to participate in the Committee's pre-budget consultations again this year and to provide our comments and recommendations on ways to maintain and foster economic growth and competitiveness in these challenging times. We look forward to the possibility of discussing our recommendations with the Committee when it holds pre-budget meetings this fall.

In the meanwhile, please do not hesitate to contact me if the CBA can be of assistance.

Sincerely,



c.c. Guyanne Desforges
Clerk, Standing Committee on Finance, House of Commons

Enclosure

Submission to the House of Commons Standing Committee on Finance

2011 Pre-Budget Consultations

Prepared by the Canadian Bankers Association

August 2011

Executive Summary

The Canadian Bankers Association (CBA) welcomes this opportunity to participate in the 2011 pre-budget consultations of the House of Commons Standing Committee on Finance. The CBA works on behalf of 52 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada. Our submission offers our views and recommendations in a number of areas: enhancing tax competitiveness to promote economic growth and employment; addressing the financial needs of Canadian households; managing the regulatory burden on the financial sector; and protecting and enhancing the federal government's role in the supervision of the banking system.

Initiatives by the federal and provincial governments during the last decade have made the domestic tax system more competitive and growth-oriented and we encourage governments to continue to strive for a competitive tax framework. There are a number of other opportunities that could be explored to make Canada's tax system more competitive, including several options that would have a minimal impact on government revenues. On the domestic front, the CBA welcomed the November 2010 consultation paper on the taxation of corporate groups and is working with federal and provincial governments and other members of the business community to develop an improved approach to loss transfers within corporate groups. Internationally, changes to Canada's system of international taxation would enhance the competitiveness of Canadian companies which operate in increasingly integrated international markets and are seeking growth opportunities in new markets.

While Canada has a strong retirement income system, some Canadians are concerned about their own retirement security. Banks and other financial institutions have the necessary expertise and infrastructure to help Canadians save for their retirement in a manner that combines opportunities and incentives to save, yet ultimately lets individuals control how they do so. The CBA supports the proposal for Pooled Registered Pension Plans (PRPPs) announced last year and is engaged in consultations on the development of the framework. We believe that PRPPs, by providing Canadians with a simple and cost-efficient opportunity to save for retirement and the flexibility to tailor their retirement saving strategy to fit their financial goals, are an effective way to help Canadians achieve their retirement goals.

It is now well known that sound management and a robust regulatory framework made it possible for Canada's banking system to weather the financial crisis and continue to contribute to Canada's economic recovery and stability. However, in response to the crisis, global regulators are instituting a significant number of new requirements in a short period of time that pose substantial implementation challenges for banks around the world. While we appreciate the international desire to act on the lessons learned from the financial crisis, we believe that the regulatory response needs to be measured, and are mindful that these regulations may have unintended negative consequences.

In addition, the CBA strongly believes in the importance of a national banking system in Canada underpinned by a federal regulatory system. We also encourage the federal government to protect and enhance federal jurisdiction over banking and securities as part of its commitment to strengthen the efficiency and effectiveness of our regulatory system.

Introduction

The banking industry has a unique perspective on, and an important stake in, the Canadian economy. The banking industry:

- contributes \$55 billion to the gross domestic product of Canada;
- spends \$14 billion on goods and services from outside suppliers stimulating local economies from Vancouver to Iqaluit to St. John's;
- distributes \$10.3 billion in dividend income out of profits to millions of Canadians and their pension plans, including many retirees;
- directly employs 267,000 people (if indirect employment is included – technology, accounting, actuarial, legal – this number is much higher); and,
- serves more than one million small and medium-sized businesses, providing them with a range of support and advisory services and more than \$87.5 billion in financing.

In short, strong and growing Canadian banks are integral to a strong and growing Canadian economy.

While the Canadian economy has been recovering, there is still a tremendous amount of uncertainty emanating from beyond our borders, including European sovereign debt concerns, overheating in emerging market economies and global imbalances. In order to navigate this uncertainty, a strong and healthy banking system is an essential cornerstone to help families buy homes and save for retirement, help small businesses grow and thrive, and to promote Canada's brand internationally.

Encouraging Business Investment and Job Growth

Economic growth is important to the prosperity of Canada and Canadians. A thriving economy provides more quality jobs for Canadians and generates additional government revenues that can be used to fund government services and programs. A competitive tax framework is one of the main catalysts of economic growth, which is why the CBA has long been an advocate of an efficient tax system that strives towards neutrality across sectors and businesses. Initiatives by the federal and provincial governments during the last decade have set Canada on a course to achieve very competitive tax rates in comparison to other jurisdictions in the G7 and G20. We commend the federal government for maintaining its commitment to reduce the general corporate income tax rate to 15 per cent and urge it to persist in its efforts to encourage the provinces to continue to reduce their own corporate income tax rates to achieve a combined rate of 25 per cent across the country. While the implementation of the HST in Ontario and British Columbia and the pending agreement between the federal and Quebec governments on sales tax in Quebec will lead to an increase in taxes for the banks, we recognize that the collective impact of the tax changes, aggregated across all sectors, will be a substantial reduction in the marginal effective tax rate on new capital investment. Those investments will enhance productivity and create jobs and economic growth.

Taxation of Corporate Groups

The CBA welcomed the November 2010 federal consultation paper on the taxation of corporate groups. In Canada, corporations are required to report and pay tax on their income on an unconsolidated or legal entity basis. As a result, losses incurred by some affiliates within a corporate group cannot be offset against profits earned by other affiliates in a timely manner. In the absence of loss transfer provisions within the *Income Tax Act*, the Canada Revenue Agency (CRA) has developed administrative practices to permit losses to be utilized through indirect means, but they are *ad hoc*, costly and unpredictable for both corporations and governments. A formal system for the taxation of corporate groups would address these shortcomings.

The CBA believes that a loss transfer system similar to that in place in the United Kingdom is the preferred starting point as it would be relatively simple to implement and administer. It would significantly reduce the costs

and uncertainties associated with the current Canadian system while achieving the main objective sought by taxpayers – the ability to use tax losses and credits currently if there is capacity in the corporate group. The CBA is working with the federal and provincial governments and other members of the business community to develop an improved approach to the taxation of corporate groups.

International Competitiveness

While progress has been made to make the domestic tax system more competitive, more can be done to enhance the competitiveness of Canadian companies that operate globally or that compete against international firms in the Canadian market. In 2008, the Advisory Panel on Canada's System of International Taxation studied the impact of Canada's international tax rules on foreign investment by Canadian firms and investment in Canada by foreign firms. The Advisory Panel made a number of recommendations that, if implemented, would enhance the competitiveness of Canadian businesses. Those recommendations remain very pertinent today as Canadian companies continue to compete in increasingly integrated international markets and are seeking growth opportunities in new markets. We believe that the government should continue to implement recommendations made by the Advisory Panel.

Recommendation 1: The government should continue to implement the recommendations of the report of the Advisory Panel on Canada's System of International Taxation.

Addressing the Financial Needs of Canadian Households

Retirement Savings

While Canada has a strong retirement income system, some Canadians are concerned about their own retirement security. Banks and other financial institutions have the necessary expertise and infrastructure to help Canadians save for their retirement. The CBA believes that a private sector pension option can build on that expertise and infrastructure while helping the government achieve its public policy goals. This is why the CBA supports the proposal for Pooled Registered Pension Plans (PRPPs) announced last year, and is working very closely with the federal and provincial governments as they design and implement the plan over the coming year. We believe that PRPPs, by providing Canadians with a simple and cost-efficient opportunity to save for retirement and the flexibility to tailor their retirement saving strategy to fit their financial goals, are an effective way to help Canadians achieve their retirement goals.

We are supportive of the overall objective to provide an accessible, straightforward, low-cost and easy-to-use pension plan that takes advantage of the benefits from the pooling of resources and professionally-managed funds for the benefits of Canadians. The public policy objective of the PRPP is to expand the retirement coverage of individuals who currently do not participate in a pension plan, particularly the self-employed and employees of small businesses. Consequently, PRPPs should address the participation and enrolment of individuals to ensure that a maximum number of Canadians participate in PRPPs. This will also ensure that the scale of the plans is sufficient to enable the cost savings envisioned by the government. In addition, rules should be harmonized between provinces in order to ensure that Canadians benefit from the highest possible cost savings. Other features, such as locking-in of funds to ensure that they are used for retirement savings purposes and provisions for a predictable income stream in retirement, also require careful consideration to ensure that the government's objectives will be achieved and that Canadians benefit from the lowest possible fees. Lastly, strong consideration should be given to simplifying the supervision of PRPPs by assigning regulatory and supervisory responsibilities to the jurisdiction under which the administrator falls. In the case of federally regulated financial institutions such as the banks, this would be OSFI.

Financial Literacy

The federal Task Force on Financial Literacy reported to the government earlier this year. The CBA supports its approach for a national strategy to increase financial literacy among Canadians. The Task Force rightly recognized that a strong national economy is built on the foundation of a financially literate population, where people can make informed decisions and take control of their financial future, both with respect to the way in which they use credit and the way in which they save for the future. The CBA encourages the federal government to consider the recommendations included in the report as it contemplates its next steps to improve financial literacy across the country. In particular, we encourage the government to develop a single website managed by the Canadian government where Canadians can access information and materials related to a broad range of financial matters. The financial needs of Canadians are diverse and change throughout the course of a lifetime. Creating a single site that people know they can return to for reliable financial information would have great value.

We also support the Task Force's suggestion that federal and provincial governments work together to make financial education a part of school curricula across the country. In recognition of the importance of early education on financial matters for more than a decade the CBA has, in collaboration with the Financial Consumer Agency of Canada, brought financial literacy to Canadians through its high school seminar program, YourMoney. Through the program, bankers have volunteered to teach more than 200,000 senior high school students about budgeting, borrowing, saving, investing, and protecting themselves from financial fraud: the basics of responsible money management.

Recommendation 2: In designing the PRPP, governments should focus on expanding pension plan coverage by making PRPPs appealing to employers, employees, and the institutions that would act as administrators. All participants in a PRPP should have the same opportunities to accumulate savings and make withdrawals in retirement. The regulatory regime should be efficient and not impose undue obligations and costs on employers and administrators. It should be harmonized across the country. Regulatory and supervisory responsibilities should be assigned to the jurisdiction under which the administrator falls. In the case of federally regulated financial institutions, OSFI would be the prudential regulator and supervisor for PRPPs offered by banks.

Global Regulatory Initiatives

One of the most significant challenges for the Canadian banking sector over the next few years will be the implementation of numerous global and domestic regulatory, capital and liquidity reforms. In the wake of the financial crisis, governments around the world, through organisations such as the G20, set a number of regulatory reform priorities aimed at addressing what were viewed as the shortcomings of the existing regulatory system. We recognize that regulatory reform was needed in some countries and that modern regulatory reform typically takes place in a coordinated fashion among countries. We note that the Canadian financial system remained stable and sound throughout the crisis and has been rated as the soundest in the world. Our concern is not with the objectives of regulatory reform but with the pace and sequencing of regulatory reform initiatives. We believe that too many initiatives are being implemented within too short a time frame, which can create its own set of risks and negative consequences.

While regulatory reform is taking place in a coordinated fashion, it is not being implemented evenly across countries. In Canada, there is a tendency to impose stricter requirements and to implement those requirements more quickly than elsewhere. This creates additional challenges and potentially negative consequences for Canadian financial institutions that may put them at a competitive disadvantage in international markets. Adding to the burden of regulatory changes, Canadian banks are facing these challenges at the same time that Canada will transition from the current accounting standards (Canadian GAAP) to international accounting standards starting the first fiscal quarter of 2012.

The regulatory burden on Canadian financial institutions is also increasing as a consequence of initiatives taken by the United States. For example, the *Foreign Account Tax Compliance Act* (FATCA), which is scheduled to come into effect in phases beginning in 2013, places severe penalties on Canadian and other foreign financial institutions unless they enter into agreements with the Internal Revenue Service to identify and report on U.S. persons holding accounts with them. If the United States proceeds with this initiative unchanged, it will require Canadian financial institutions to spend hundreds of millions of dollars to build systems to meet FATCA client identification and reporting requirements. In addition, some of the requirements under FATCA conflict with Canadian banking and privacy laws. We appreciate the work done by the Minister of Finance and the Government of Canada to address this issue and we encourage the government to pursue bilateral or multilateral agreements that would address the U.S. objectives within existing tax information sharing agreements between national tax authorities.

Federal Jurisdiction over Banking and Securities Regulation

The CBA strongly believes in the importance of a national banking system in Canada. We are pleased that the federal government clearly favours a national financial services model, as evidenced by its strong leadership in moving towards a national securities regulator to replace Canada's current fragmented system of provincial and territorial regimes. We commend the federal government's initiative to seek a decision from the Supreme Court of Canada about the constitutionality of the proposed *Canadian Securities Act* and appreciate the opportunity to intervene in its support.

However, we are concerned about numerous provincial attempts in recent years to regulate the operation of Canadian banks in core areas that have been traditionally viewed as falling within the exclusive jurisdiction of the federal government. These encroachments open up the regulation and supervision of federally-chartered banks to Canada's thirteen provinces and territories which causes confusion for consumers by creating inconsistencies and different standards of service across the country. Furthermore, they occur at a time when consolidated federal regulation and supervision of banking, exemplified by Canada's system, are being recognized around the world as the model towards which other nations should strive.

Recommendation 3: We encourage the federal government to act clearly and decisively in order to protect and enhance the federal jurisdiction over banking as part of its commitment to strengthen the efficiency and effectiveness of our regulatory system.

Conclusion

The recent recession and global financial crisis highlighted the benefits to the economy of a sound and stable banking sector. The sector contributed to a stable employment base for the economy and retained the capacity to provide the credit demanded by both households and businesses. We believe public policy should build on that stability and soundness, for the benefit of all Canadians.

We commend the government on its measures already taken to ensure a competitive taxation system, which will enhance economic recovery by promoting business investment and job creation. Additional measures can also be taken, including enhancements to the effectiveness and efficiency of Canada's taxation system; initiatives to improve retirement savings through the introduction of PRPPs; and by improving financial literacy. Such measures will benefit Canadians across the country and measures should be taken to maximize their effectiveness. Finally, the CBA also believes that regulators should carefully monitor the scope and implementation of the total regulatory burden applied to the financial sector and that the federal government should act clearly and decisively to protect its jurisdiction over banking.