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ASSOCIATION DES BANQUIERS CANADIENS
CANADIAN BANKERS ASSOCIATION

EXPERTISE CANADA BANKS ON
LA RÉFÉRENCE BANCAIRE AU CANADA

Executive Summary

The Canadian Bankers Association (CBA) welcomes this opportunity to participate in the Standing Committee on Finance's 2009 pre-budget consultations. The CBA works on behalf of 50 domestic chartered banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 263,000 employees. Banks play a critical role as financial intermediaries in the Canadian economy, accounting for $39.3 billion, or 3.2%[1], of Canada's GDP in 2008. By providing access to capital for businesses of all sizes as well as Canadian households, the banking industry serves as a crucial catalyst for economic growth. Canada's strong and secure banking system has been a considerable source of strength during the financial and economic turmoil of the last year and will be at the heart of Canada's economic recovery.

The economic downturn and the decline in pension and investment asset values have prompted policymakers to examine the effectiveness of pensions and other retirement savings vehicles in preparing and providing for financial independence in old age. While Canadians have taken steps to save for retirement, more can be done to help them save, and help educate them on retirement planning. As a source of retirement and financial planning advice for millions of Canadians, the banking industry would welcome the opportunity to work with the government on this important issue.

The one significant area in which the Canadian regulatory structure is weaker than it could be is in the area of securities regulation. The move to a single securities regulator will improve the efficiency, including regulatory efficiency, and competitiveness of our capital markets. The federal government has taken important and necessary steps in this area, including most recently the launch of the Canadian Securities Regulator Transition Office, and Canada's banking industry is fully supportive of the government's efforts to continue to move forward, including the creation of the federal Securities Act.

In the area of fiscal policy related to businesses, the government has undertaken a series of tax measures which have provided important fiscal stimulus during the current economic challenges and will, when fully implemented, contribute to the long-term productivity of the country. We recognize that the difficult economy has placed conflicting demands on government resources, but we believe that the government should stay the course with respect to its growth-oriented tax competitiveness plan since this is one of the keys to sustainably re-energizing the economy.

While much has already been done, there are opportunities to implement additional measures to enhance economic growth on a revenue-neutral basis. Implementation of the recommendations of the Advisory Panel on Canada's System of International Taxation[2] would simplify and update Canada's international tax rules, making Canadian companies more competitive at home and on the world stage. Canada's international tax regime, in combination with the government's competitive tax plan, can be a major competitive advantage in attracting capital investment as well as head offices of global enterprises. These efforts will contribute to Canada's economic recovery from the global recession and help position Canada as an international leader in economic growth.

Introduction

The world economy has experienced what the International Monetary Fund has called "a recession unprecedented in the post–World War II era".[3] As a result, 2009 has clearly been a challenging year globally, and a challenging year for Canada with our domestic economy having contracted by 3.5% from May 2008 to May 2009. The Bank of Canada recently suggested that Canada is beginning to recover and that growth will resume, and the IMF has made similar predictions for the global economy. Nonetheless, there are sectors of the economy and parts of the country that have been hard hit by the recession and Canada's banks are working to help customers through this difficult time.

[1] Includes central bank, banks and other depository credit intermediation.
[2] Advisory Panel on Canada's System of International Taxation, "Enhancing Canada's International Tax Advantage", December 2008.
[3] IMF, World Economic Outlook Update Contractionary Forces Receding But Weak Recovery Ahead, July 8, 2009.

Canada's Banks: the Canadian Advantage

Considering what happened to the global financial system and the unprecedented turmoil it has been going through this year, it is important to remember that this turmoil did not originate in Canada. Furthermore, even though it is having an impact on banks in Canada, they have largely avoided the difficulties that banks around the world are now facing.

Today, Canada's banks remain strong and stable as a result of being well capitalized, well managed and well regulated. This is an advantage for Canadians when looking to the future and Canada's economic recovery. In fact, banks in Canada are among the best-capitalized in the world, exceeding the Bank for International Settlements' norms by significant margins. This is important because a strong capital base, coupled with prudent risk management, has helped to ensure that banks are able to continue to lend through this challenging period.

An important part of this good news about the strength of Canada's financial system is that Canadian taxpayers have not had to bail out financial institutions, not had to inject capital into our institutions, and not had to set up public entities to buy toxic assets, as happened in most other G-8 countries. Even so, because global financial markets were not functioning properly, the Canadian government undertook initiatives to increase liquidity, such as the Insured Mortgage Purchase Program.

Canada's regulatory system is robust, and is suitable to the Canadian industry and marketplace. Unlike the wide array of different regulators who oversee banks in the US for example, bank financial groups in Canada are federally regulated by the Office of the Superintendent of Financial Institutions (OSFI) for prudential matters and the Financial Consumer Agency of Canada (FCAC) for consumer matters.

There are clear benefits to consolidated regulation, and we believe these benefits would be further enhanced if Canada were to move to a single securities regulator. While Canadians are able to have confidence in the regulation of the banking sector, there are areas of regulation where more work can be done. We congratulate the government for its initiative to move quickly towards a single securities regulator. It is now clear that financial risks move easily and quickly between financial markets and capital markets, both within countries and across international borders. The events of the past year have highlighted the need for regulators, including securities regulators, to have a structure in place to deal quickly and effectively with systemic risk. The one significant area in which the Canadian regulatory structure is weaker than it could be is in the area of securities regulation. A move to a single securities regulator would improve the efficiency, including regulatory efficiency, and competitiveness of our capital markets.

Access to Credit

Despite tough economic times and global financial market turmoil, Canadian banks have continued to make priced-to-risk credit available to credit worthy businesses in Canada and their strong capital position has enabled them to respond to business needs. Lending to businesses has grown at a pace commensurate with business demand. In the fall of 2008, just as the global financial markets were at their most fragile, Canadian bank lending to businesses accelerated as other sources of financing contracted. Despite the fact that banks were increasing their share of the business financing market, they were not able to fill the credit gap completely. The federal government recognized this in Budget 2009 with the introduction of the Business Credit Availability Program (BCAP), which provides at least $5 billion for additional lending to firms with a viable businesses model through Export Development Canada (EDC) and the Business Development Bank of Canada (BDC), in cooperation with private sector lenders. Banks welcome this program as an extra effort to find credit solutions for creditworthy business clients during this challenging economic time and are working with both EDC and BDC on this program. As financial markets gradually return to normal, the need for extraordinary government financing programs should abate and banks' share of the overall financing marketplace may return to more traditional levels.

Canadians continue to have confidence in their banking sector – they know that Canada's banks are at the heart of Canada's economic recovery and that our banks will be there to ensure Canada's economic well-being in the long term.

Fiscal Policy

The central question that Committee members have asked respondents to consider is how fiscal policy could be used to ensure a prosperous and sustainable future for Canadians. Economic prosperity and sustainability, both at an individual and a corporate level, are both functions of investment. People need to invest in their future, and so do businesses. For individuals that means saving for the future; for businesses it means making productivity-enhancing investments. There are fiscal policy measures that the government can take on both of those counts.

Retirement Savings

The banking industry welcomes the public discussion on the adequacy of retirement savings and the effectiveness of the retirement savings vehicles available to Canadians. We recognize the general concerns about the overall adequacy of retirement savings on the part of Canadian households, as well as specific concerns about the lack of occupation-based pension coverage (and its reliability) for many workers. These are important public policy matters and their importance only grows as the population ages.

There is no simple answer to these concerns. As the financial advisor and wealth manager to millions of Canadian households, we believe the banking industry already plays an important part in enabling households to meet their savings objectives by accumulating financial and non-financial assets and we believe the industry can play a role in enhancing savings opportunities and in reducing the risks of inadequate financial resources in retirement. Also important is the role of financial literacy. A recent international retirement report by HSBC Insurance found that 43% of people globally, and 44% of Canadians, had never accessed any form of financial education.[4] We applaud the government's efforts to improve Canadians' financial literacy as a key plank in addressing this issue. The appointment of the Task Force on Financial Literacy to develop a national strategy on financial education will bring a welcome and much-needed focus to this effort. The banking industry has traditionally played an important role in enhancing financial literacy of Canadians.

The CBA welcomes the efforts of the federal-provincial working group on retirement savings and looks forward to the opportunity to work with governments to explore these issues and to develop policy prescriptions based on that work. In particular, we would welcome the opportunity to explore options for evaluating the current suite of tax-advantaged savings products – principally RRSPs, RRIFs, and TFSAs – to assess how these products could be modified to help Canadians save more for retirement and to consider other options to reduce the risk of inadequate income. In the interests of equity for all Canadians and efficiency in the operation of retirement savings plans, we would urge the government to seek national rather than regional or provincial solutions.

Domestic Tax Policy

There are two elements to fiscal policy – government spending and taxation. Both elements of fiscal policy can affect the competitiveness of the Canadian economy, and both can be positive forces for economic growth and Canadian competitiveness if well-designed. On the government spending side of the fiscal ledger, clearly the recession has placed new demands on the government for the provision of fiscal stimulus.

On the taxation side, over the past few years the government has made important strides in increasing the competitiveness of Canada's tax system, strides that take on even greater importance as a key driver of economic recovery. Most notable among these efforts are lowering rates, eliminating capital taxes and amending key treaties such as the Canada-US tax treaty to eliminate withholding tax on interest income. The government has reduced the general federal corporate income tax rate from 22.12% in 2005 to 19% in 2009 and set out a schedule of further reductions that will see the rate decline to 15% in 2012. Coupled with corresponding provincial moves to decrease rates, Canada is now on track to achieve a 25% combined federal and provincial corporate income tax rate, which was a national target that had been set by the federal government. The benefits from a competitive tax regime are already being realized. Most recently, iconic

[4] HSBC Insurance, The Future of Retirement: It's time to prepare, June 2009, p. 33.

Canadian chain Tim Horton's announced that it would repatriate its head office back to Canada from the U.S. in part because of the competitive tax environment in Canada.

Canada has also made excellent progress in reducing the taxation of capital. Capital taxes at the federal level were removed in the 2006 Budget and incentives were put in place in the 2007 Budget to encourage the provinces to eliminate their capital taxes. Capital taxes continue to decline at the provincial level and have been eliminated or are scheduled to be eliminated for all sectors in Alberta, British Columbia, Ontario and Quebec. The federal government can take some credit for this improvement, both through the leadership it has shown in this area and because of the incentive program it established to reward provinces that eliminate capital taxation.

The tax policy decisions taken by the federal government have been designed to further the objective of reducing Canada's marginal effective tax rate (METR) on business investment. METR is a broad measure which examines the tax system from the perspective of a company that wants to expand or an entrepreneur who wants to start a new business. The Canadian METR on capital has declined from 39.3% in 2005 to 29.1% in 2008 and is projected to decline to 25.8% in 2012[5]. Lowering METRs increases the incentive for businesses to invest in Canada which, in turn, raises Canadian productivity and ultimately creates more sustainable, high-paying jobs for Canadians.

Canada can be proud of its strong fiscal position which, combined with an increasingly competitive tax regime and a healthy banking sector, will provide the base for economic recovery and will give it an ongoing advantage in comparison to other OECD countries which may not have the fiscal room to remain competitive in attracting skilled workers and capital investment.

Recommendation: Continue on the course already set by the federal government in Budget 2008 to make Canada more tax competitive through the implementation of the planned reductions to Canada's federal corporate income tax rate, which will see the rate decline to 15 per cent by 2012.

International Taxation

In its 2009 Budget the government indicated its intention to study and respond to the Report of the Advisory Panel on Canada's System of International Taxation (the Advisory Panel), issued in December 2008. The Advisory Panel studied the impact of Canada's international tax rules on Canadian businesses investing in foreign markets and foreign businesses investing in Canada. Its Report made a series of recommendations, in aggregate fiscally neutral, designed to improve the competitiveness, efficiency and fairness of Canada's system of international taxation, minimize compliance costs and facilitate administration and enforcement[6].

We support the conclusions of the Advisory Panel's Report and believe that the government should implement its recommendations. The international tax system is very important for a trading nation such as Canada. The Advisory Panel noted that "Because the Canadian market is relatively small, Canadian companies often need to engage in cross-border trade sooner than other companies that are based in countries with larger domestic markets."[7]

The Advisory Panel's findings are even more relevant given the change in international tax direction by the U.S. which will make it less attractive for U.S. based companies to expand abroad. The U.S. administration recently proposed changes in its approach to the taxation of foreign operations of domestic firms based on the argument that investment abroad reduces capital investment and job creation at home. This has prompted some large U.S. corporations such as Microsoft to state publicly that they are considering moving jobs and investments to other countries.[8] Canada is well-positioned to take advantage of this opportunity. Canada's relatively stronger fiscal position can provide the conditions to compete successfully with the U.S. to attract not only capital investment but head offices of global enterprises as well. This would be further

[5] Duanjie Chen & Jack Mintz, "Still a Wallflower: The 2008 Report on Canada's International Tax Competitiveness" C.D. Howe Institute *e-brief,* September 18, 2008, pp. 2-3.
[6] Advisory Panel on Canada's System of International Taxation, "Enhancing Canada's International Tax Advantage", December 2008, p. 1,3.
[7] Ibid., p. 12.
[8] "Ballmer Says Tax Would Move Microsoft Jobs Offshore", *Bloomberg*, June 3, 2009.

enhanced by additional improvements to Canada's international tax regime, as recommended by the Advisory Panel.

Recommendation: Continue to implement the recommendations of the Report of the Advisory Panel on Canada's System of International Taxation**.**

Efficient Administration — Consolidated Reporting

Economically challenging times focuses everyone's attention on the need to be streamlined and efficient. In business, that means looking for administrative streamlining that could reduce costs without affecting the quality of products or services. Government can assist business in this effort by implementing measures that ease the administrative burden that Canadian companies face when complying with legislation, include tax legislation. One area where the government could make great strides in reducing the cost of compliance for business is by moving to a system of consolidated reporting in Canada.

Consolidated tax returns for groups of related companies are common practice in developed countries but not permitted in Canada. A recent study on the issue of consolidated reporting by the CD Howe Institute[9] found that France, Germany, the United States, Australia, Italy and Japan, among others, all offer some form of consolidated reporting, and many others offer some sort of offsetting measure of similar effect. The report went on to state that Canada is the only country within the G7 which does not have consolidated reporting or a similar mechanism.[10] The report concludes that *"Providing a comprehensive group taxation regime would bring fairness, simplicity and certainty of tax outcome for Canadian corporations. As it is, Canada's approach to corporate group taxation gives rise to a number of problems, including higher administrative and transaction costs, unfairness among different types of corporations, uncertainty, and weakened international competitiveness."*[11]

Absent consolidated reporting, losses incurred by some affiliates within a corporate group cannot be offset against profits by other affiliates. Both the 1998 Report of the Technical Committee on Business Taxation and the 1985 Department of Finance Discussion Paper, "A Corporate Loss Transfer System in Canada", identified legal, accounting, administrative and compliance cost issues that would be resolved through a group reporting / loss transfer system.

Recommendation: Amend tax legislation to allow for consolidated tax reporting by Canadian companies.

Conclusion

In the wake of the global financial turbulence, Canada has been faced with major economic challenges on the domestic front. However, Canada has a number of advantages that will hasten its economic recovery, including a sound fiscal base and an ongoing strategy to achieve international tax competitiveness. This fiscal policy direction has served Canadians well by providing fiscal stimulus in the short-term while helping to put the economy on a strong foundation for sustainable growth. The CBA believes that the government should stay the course with respect to the direction of its taxation regime and that there are revenue-neutral tax measures which can be undertaken to further enhance Canada's tax competitiveness with beneficial impacts on economic growth, job growth and wealth creation. Canada's secure and stable banking sector is working with customers to help them get through this tough economic time and is an important catalyst for economic growth as our national economic recovery continues.

[9] Alexandre Laurin, "Cleaning Up the Books: A Proposal for Revamping Corporate Group Taxation in Canada" C.D. Howe Institute Commentary No. 284, March 2009.
[10] Ibid., p. 7.
[11] Ibid.,The Study in Brief.