



# Strengthening Canada's competitiveness

The Canadian Bankers  
Association's submission to the  
Competition Policy Review Panel

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CANADIAN BANKERS ASSOCIATION

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## Executive Summary

The Canadian Bankers Association welcomes the opportunity to provide input into the Competition Policy Review Panel's deliberations on Canada's competitiveness. We bring the perspective of an industry characterized both by intense competition in Canada and the active involvement of our banks internationally. Our recommendations are based on an array of factors that we feel have the greatest impact on competitiveness:

**Principles:** In considering what changes are needed to Canada's public policy framework, we propose five principles aimed at strengthening competitiveness. First, Canada's public policy framework should be as competitive as other jurisdictions and where possible, should serve as a source of competitive advantage for Canadian firms. Second, the public policy framework should provide Canadian firms with as much flexibility as possible to strengthen their ability to pursue their individual business strategies at home and globally. Third, governments should rely on market-based and principle-based approaches rather than prescriptive rules. Fourth, both domestic firms and foreign investors need certainty regarding the rules that govern the marketplace in Canada, and consistency in their application. Fifth, regulation of those sectors or markets of the Canadian economy that operate on a national or international basis should be national in scope.

**A competitive tax system:** While important improvements have been made to Canada's tax system, more work is needed since the rest of the world will not stand still. On corporate income tax rates, more must be done at the provincial level if the federal government is to meet its target of a combined federal-provincial corporate income tax rate of 25% by 2012. On personal income tax rates, we recommend that relief should come to all tax brackets, with the short-term focus on the lowest tax bracket. In addition, a competitive tax environment of the future should be one that has no capital tax components. Also, harmonizing provincial sales taxes with the GST is a more efficient and less burdensome system, and we encourage governments to work with stakeholders on ways of implementing such a tax in the most balanced and workable way possible. In particular, since harmonization would disproportionately impact the sales tax paid by providers of GST-exempt services such as financial services, we would encourage governments to work with affected industries to develop the most efficient harmonized sales tax regime possible.

**A competitive regulatory system:** Given how extensively regulation impacts the operation of banks (as well as other key sectors in the economy), we recommend improvements to the content of the regulation (e.g., greater reliance on principles rather than prescriptive regulation, as well as establishing workable checks/balances within government before regulations are developed) and the structure of regulation (e.g., eliminating internal trade barriers in Canada and streamlining regulatory fragmentation and duplication in Canada, starting with the creation of a common securities regulator).

**Competition and investment regimes:** Canada needs competition and investment regimes that reflect the desirability of open domestic markets and open borders that welcome incoming investment. In addition to proposing criteria for the Panel to consider, we recommend that the Competition Bureau not be provided the mandate to undertake "market studies" with the power to compel firms to provide data or order remedies. We also recommend that the "net benefit" test remain the key tool in Canada's investment review system.

**Structural policies:** Our submission notes that domestic structural policies affecting such matters as consolidation among large banks and ownership of banks have implications for international competitiveness of Canadian financial institutions, and that a full range of structural options available to financial institutions in other jurisdictions are not available in Canada. Since Canada's policy framework on structural options can neither be deferred indefinitely nor determined in isolation from the rest of the world, we suggest that the Panel make recommendations in these areas, from the perspective of international competitiveness.

**A more active trade agenda:** The CBA welcomes the federal government's recent efforts to achieve new foreign investment opportunities for Canadian companies, but we also believe that more needs to be done. We urge the Panel to make clear that Canada needs to be more active in seeking bilateral and regional agreements (including trade-in-securities agreements) that would (among other things) put Canadian financial institutions on a level playing field with our international competitors.

*The Canadian Bankers Association works on behalf of 54 domestic chartered banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 249,000 employees to advocate for efficient and effective public policies governing banks and to promote an understanding of the banking industry and its importance to Canadians and the Canadian economy.*

[www.cba.ca](http://www.cba.ca)

## Introduction

The Canadian Bankers Association appreciates the opportunity to provide the banking industry's perspectives and recommendations to the Competition Policy Review Panel in response to its October 30, 2007 Consultation Paper, *Sharpening Canada's Competitive Edge*. In our view, it is both timely and of critical importance that there be a thorough assessment of Canada's competition and investment policy, and we welcome the government's initiative to launch this review. As an industry characterized both by a high degree of competition in the domestic marketplace – from Canadian as well as internationally-based banks – and by the active involvement of our large banks on the global stage, the banking industry appreciates the importance of having a business environment that is as flexible, forward-looking, and competitive as possible. Indeed, Canada's public policy framework needs to be focused on creating a Canadian advantage for our businesses on the world stage, and an economy here at home that is as strong and dynamic as possible.

The banking industry agrees with the Panel that the fundamental question is: what changes are needed in Canada's public policy framework to both (a) establish the domestic conditions that encourage Canadian firms to be active and aggressive investors at home and abroad, and (b) maximize Canada's attractiveness as a destination for new investment and talent? Accordingly, this submission takes this question as its starting point, and provides our commentary on the key factors that affect the competitiveness of the banking industry, other sectors in the economy, and the country as a whole, i.e., tax, the regulatory system (as well as structural policies that are specific to the banking industry), Canada's competition and investment regimes, and trade policy. To set the stage for a discussion of these competitiveness factors, our submission also provides an overview of competition in the banking and financial services marketplace, both here and abroad, as well as a set of principles that the Panel may find useful as it considers Canada's competition framework.

## Competition in the banking and financial services marketplace

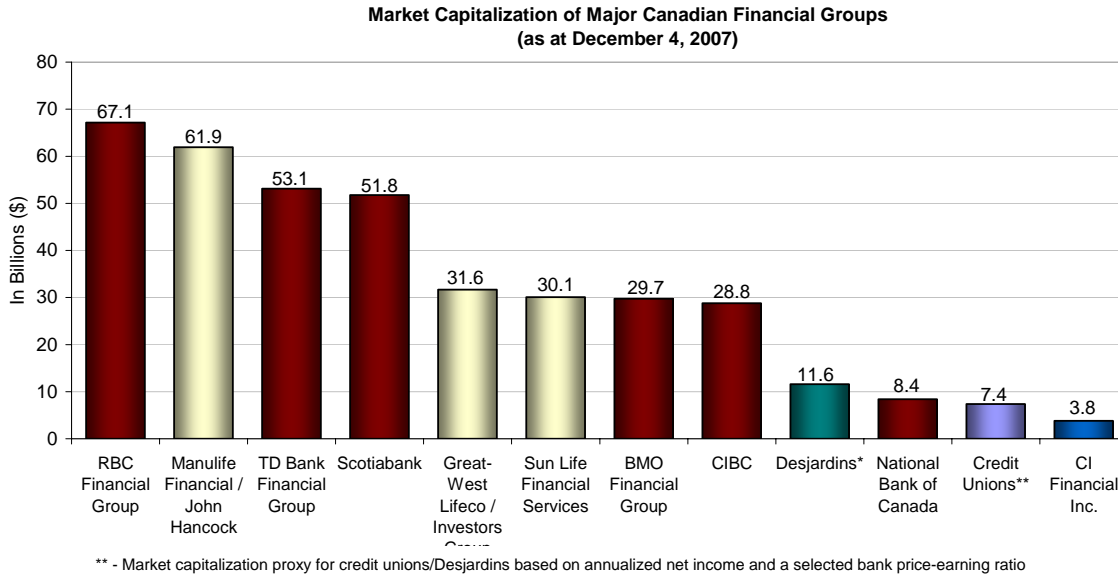
The banking sector is a Canadian-headquartered industry that provides a very wide array of services to Canadians nation-wide. We are also an important and growing export industry, representing Canadian expertise globally. Both domestically and in marketplaces around the world, this industry is characterized by a high degree of competition, which drives innovation for the benefit of individual and business customers.

**Competition within Canada:** Within Canada there are 72 banks – domestic banks, foreign bank subsidiaries, and foreign bank branches – actively competing for customers' business and this is not a static marketplace. Canada has a very open banking system, and there have been a number of new players bringing new competition entering the marketplace over the last few years:

- There are banks owned by commercial enterprises, such as a hardware retailer and a grocery store;
- There is a bank owned by an insurance brokerage, which in turn has acquired a bank that was only recently established by a credit union;
- There are two new Alberta-based banks, one owned by auto dealers and one owned by a motor club;
- And, more than ten major foreign banks have entered the Canadian marketplace in recent years, in addition to the foreign banks that have had an established presence for years in this country.

But as intense as the competition is among banks, that is not the full picture of competition in the Canadian marketplace. Banks also compete for the business of Canadian consumers, households, and businesses with literally thousands of other regulated and unregulated financial services providers, including some 35 trust

companies, over 70 life insurance companies, 190 finance companies, over 1000 credit unions and caisses populaires, an array of federal and provincial financial agencies, and some 3700 firms with assets over \$5 million in the financing marketplace for small and medium-sized businesses. This wide variety of financial service providers manifests itself in institutional market shares. While banks have over 80% of deposits, they have only two-thirds of consumer loans, 57% of residential mortgages, under 40% of mutual funds and just over a quarter of non-residential mortgages. The chart below shows some of the larger players actively competing in the Canadian marketplace.

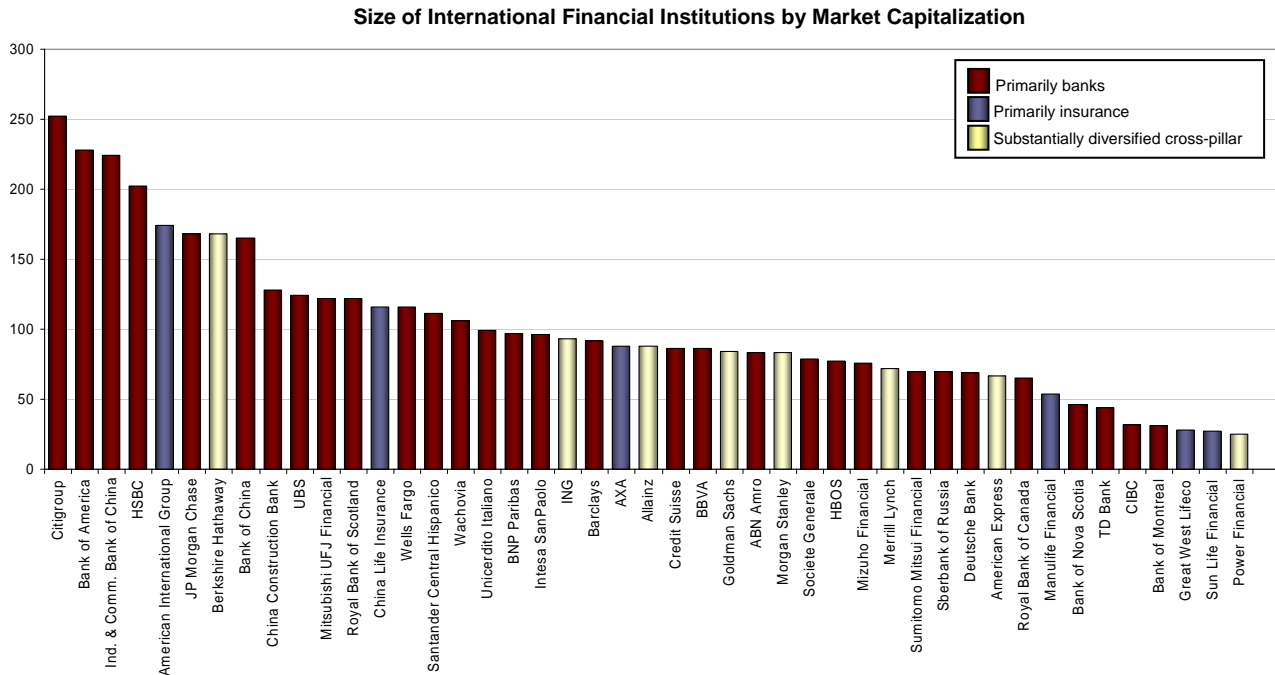


This high degree of competition brings a range of benefits to consumers, in terms of access, price and innovation. In terms of access, for instance, approximately 99% of Canadians have an account with a bank or other deposit-taking institutions. This compares very favourably with the United States where only about 87% of adults have a bank account. In addition, Canadians have the highest combined number of bank branches and ABMs per capita in the world and, when taken into account with telephone banking, internet banking, and cash-back at point-of-sale terminals, this represents a highly accessible banking system. The high degree of access also means that Canadian small/medium sized businesses (SMEs) face fewer obstacles to growth originating from the financial sector than do SMEs in other countries, as shown by international surveys conducted by the firm Grant Thornton. In terms of price, whether bank services are paid for directly via fees or indirectly via the spread between deposit and lending rates, Canadians benefit from some of the lowest priced bank services in the world.<sup>1</sup>

**Competition internationally:** Canada's banks and other major financial services providers are also an export success story both in retail markets around the world and in providing support to Canadian businesses as they expand abroad, with an array of operations in the US, the Americas, and Asia. Indeed, as the Panel's Consultation Paper noted, the finance and insurance sectors contributed 44.1% of Canada's direct investment abroad in 2006. Since 2001, Canada's six largest banks invested about \$38 billion through acquisitions, 95% of which was outside Canada (by comparison, Canada's three largest life insurance companies invested over \$42 billion through acquisitions, of which 56% was outside Canada). The important point to note here is that the industry's ability to be strong players on the world stage helps the contributions that the industry is able to make at home: while Canada's banks make a significant percentage (41%) of their profits from foreign activities, the bulk of the jobs (81%) and taxes paid (80%) are here in Canada.

<sup>1</sup> Bank accounts: 2002 Public Interest Advocacy Centre survey, 2001 US Federal Reserve Board Survey of Consumer Finances; ABM/branch data: World Bank 2005; SMEs: Grant Thornton International Business Owners Survey 2006; Price comparisons: Capgemini World Banking Report 2005, World Economic Forum, The Global Competitiveness Reports, 1997-2007

While Canada's banks are successful players on the global stage, the international marketplace is intensely competitive and becoming more so. The financial institutions against which Canadian banks compete (both for market share as well as possible acquisitions in foreign markets) are large and getting larger as the wave of consolidation within countries and increasingly cross-border continues around the world, and are able to bring ever more significant resources to bear on product development, systems development, and acquisitions. The chart below ranks international financial institutions in order of size, and shows the relative size of the competitors faced in other markets (Canada's banks are shown at the right hand end of the scale).



Source: Source: Financial Times Global 500, March 2007 \* (size of business based on total value of outstanding stock of firm. Scale = billion \$US)

It is also important to note that international competition comes not only from other companies, but also from other governments around world. Indeed, a number of leading jurisdictions are taking active steps to enhance the competitiveness of their financial centres, to avoid losing business to other jurisdictions and to enhance their attractiveness to new investment:

- The UK's Financial Services Authority has moved from detailed/prescriptive rules to principles-based regulation to provide greater flexibility while ensuring strong oversight;
- The US Treasury has launched a regulatory streamlining initiative, explicitly aimed at enhancing competitiveness;
- New York City has undertaken a major study on how it can improve its competitiveness and reverse loss of market share to London;
- Australia has reorganized and simplified its regulatory structure, moving from state-level regulation to one national prudential regulator and one consumer regulator.

In this environment, Canada's public policy framework must be as competitive as possible. Set out below is a set of principles that we feel may help guide the Panel, as well as public policy makers in Canada, in considering how best to strengthen the competitiveness of our policy framework.

## Principles to guide a more competitive policy framework

We are proposing the principles below as guides to a more competitive financial services policy framework, but in our view they would also have broader application to considerations of competitiveness of the economy as a whole.

**An internationally competitive public policy framework:** Canada's public policy framework should be at least as competitive as other major jurisdictions in terms of the options, powers, and latitude provided to Canadian firms, and in terms of the compliance costs imposed. Where possible – consistent with prudential and consumer protection interests – the policy framework should serve as a source of competitive advantage for Canadian firms as they compete internationally. If, in comparing Canada to other key jurisdictions, this country's public policy framework has elements that are out of step with the rest of the world, impose restraints not found elsewhere, or serve to disadvantage firms or the Canadian economy, there would need to be a clear, compelling public policy rationale articulated by the government to maintain these elements.

**Maximum flexibility:** The public policy framework should provide Canadian firms with as much flexibility as possible to strengthen their ability to pursue their individual business strategies at home and globally. In practice this means that the framework should not be overly prescriptive but rather define desired outcomes and permit participants to achieve those outcomes as they see fit. Unless there are clear, compelling public policy reasons to do so, regulation should neither prescribe nor restrict the options available to firms in terms of structure, products and services, business operations, etc.

**Market-based solutions:** To the extent possible in pursuing public policy goals, governments should rely on market-based approaches rather than prescriptive rules. Unless there is clear evidence to the contrary, government should (a) start from the position that the financial services marketplace is highly competitive and is working to the benefit of consumers and SMEs in terms of access, choice, price, innovation, and security; (b) avoid formal regulation unless it is clear that the benefit of additional regulation outweighs the cost and all other alternatives have been fully considered; and (c) where regulation is considered necessary, avoid wherever possible detailed, prescriptive rules and instead adopt workable, flexible, principle-based approaches. In short, government should not resort to regulation until all other alternatives have been fully considered.

**Certainty and consistency:** Both domestic firms and foreign investors need certainty regarding the rules and standards that govern the marketplace in Canada. This would be enhanced if decisions were to be based on objective considerations rather than political factors and if there is a consistent application of those rules and standards. A lack of certainty and consistency can inhibit the ability of domestic firms to consider all options for pursuing their individual business strategies (for example in the regime governing the structural options available to bank financial groups) and can act as a disincentive to foreign players considering investing in this country (for example, in Canada's investment regime).

**A national approach to regulation:** Regulation of those sectors or markets of the Canadian economy that operate on a national or international basis should be national in character and scope. A national approach to regulation, in turn, would strengthen Canada's ability to deal effectively with policy-makers and regulators in other jurisdictions and with international standard-setting bodies.

## A more competitive tax system

A competitive tax regime is one of the building blocks of a vibrant, productive economy. The fundamental reason that entrepreneurs invest time and energy is to generate a return. The greater the potential return, the more economic activity that will be generated. In contrast, uncompetitive tax rates dampen economic activity by reducing the potential returns to entrepreneurs and investors. This slows economic growth and job creation, and reduces the

economic vibrancy that comes with entrepreneurial drive. It also reduces new capital formation, which is a key determinant of productivity growth.

**Focusing on the margin:** In building for the future, the focus of Canada's efforts should be on how the tax system affects economic decisions about what to do next. Decisions are always made *at the margin*. An investor's decision to make a new investment is made on the basis of his/her after-tax return on that investment. A person makes a decision about whether to upgrade their skills based on the net after-tax increase in their wage they expect to enjoy from doing so. A potential entrepreneur decides whether to start a new venture based on the net additional return they expect to get from their additional effort. In short, it is the marginal rate that affects where Canada will be in the future, so that is where the government needs to place its focus.

**Where Canada stands:** Canada has made important progress in developing a growth-oriented tax environment. According to the CD Howe Institute<sup>2</sup>, Canada's marginal effective tax rate (METR) on new investment in 2007 was 30.9 per cent. This is significantly lower than the 36.6 per cent METR Canada had in 2006, resulting from tax reductions announced in Budget 2007. However, this is significantly higher than the OECD average<sup>3</sup> of 20.8 per cent. While progress has been made, clearly more work can and should be done.

The overall METR on new investment masks a significant variation between the manufacturing and the service sectors. Canada's METR in manufacturing is a fairly competitive 23.1 per cent, as compared with the average OECD rate of 21.5 per cent. However, Canada's METR on capital investment in services is particularly poor. The effective tax rate on the service sector is 36.4 per cent, or the 6th highest tax rate in the world, and is nearly 16 per cent above the OECD average of 20.8 per cent. In fact, the only other advanced economy with a higher METR on capital is the United States, with a higher rate of 40.1 per cent.

The federal government has recognized the importance of a growth-oriented, competitive tax environment. As a result of the corporate income taxation measures announced in the 2007 fall Economic Statement,<sup>4</sup> by 2012 Canada's METR on new business investment will stand at 25.3 per cent, slightly lower than the current lowest G7 rate of 27.1 per cent. Clearly Canada has made progress, particularly in the area of corporate income taxes, and the Canadian Bankers Association applauds the government for these important steps.

While the above analysis indicates that there are areas where progress is being made, it points to the factors that the government needs to consider in designing a forward-looking and competitive tax policy:

- **The rest of the world is not standing still.** While the measures proposed by the government will, by 2012, make Canada competitive with current G7 average, it stands to reason that other developed countries will move forward with their own tax reforms. In fact, some countries have taken steps to reduce their tax burden, and many more will do so between now and 2012, when Canada's planned tax cuts are to be fully phased in. Enhancing international competitiveness should be the key criteria guiding decisions about the changes to be made to taxes and other charges levied by government. Specifically, when making decisions about the tax regime in Canada, government should weigh the impact on domestic firms in light of their opportunity to compete with international peers.
- **Targeted tax measures distort economic activity.** While done with the best of intentions, it is clear that the result of decades of targeted tax initiatives has been to create an environment where different firms in different industries pay different rates and firms of different sizes pay different rates. For example, research from the CD Howe Institute indicates substantial tax relief in Canada has been primarily targeted at the manufacturing sector. While tax competitiveness in manufacturing is important and we certainly encourage it, the result has

<sup>2</sup> Duanje Chen, Jack Mintz, Finn Poschmann, Andrey Tarasov, "2007 Tax Competitiveness Report: A Call for Comprehensive Tax Reform" C.D. Howe Institute Commentary, No. 254, September 2007, Study in Brief.

<sup>3</sup> Simple average of OECD countries.

<sup>4</sup> Economic Statement – Strong Leadership. A Better Canada, October 30, 2007, pg. 80.

been that the tax rate on the service industry is now far higher than the rate on manufacturing. The irony of this is that most job growth in Canada is in the service sector. Indeed, 70 per cent of Canadian GDP and 78 per cent of employment is attributed to the service sector. Furthermore, since 2000, service sector employment has been growing by 2.12 per cent annually, higher than every other sector with the exception of the construction industry.<sup>5</sup>

High tax rates have almost certainly reduced employment growth and diminished the long-term economic potential of the most dynamic part of the Canadian economy. Not only is this important in-and-of-itself, it also poses serious challenges for Canada to attract global talent, a critical factor when considering the challenges created by an aging labour force. Tax measures should be broadly-based, allowing both small and larger businesses to compete and grow on the basis of a strong business case, without regard for distorting tax measures. A neutral, efficient, equitable and predictable tax system is one of the best means by which to ensure that businesses can compete on a level playing field.

- **The administrative burden of tax compliance is becoming a serious concern.** There is an increasing awareness that “the tax burden” is not simply how much a firm pays in tax but also includes the cost of compliance with the tax code. A recent study on international taxation by the World Bank and PricewaterhouseCoopers<sup>6</sup> notes that “(T)ax compliance costs are a significant cost to companies. Simplifying the tax system can offer the potential of a win:win scenario for both government and business.”<sup>7</sup> The complexity of tax administration in Canada has grown in recent years and will grow even further if certain proposed legislative initiatives become law (see “Tax Administration” below). A competitive tax system is one that is simple, clear, and fair.

*“(T)ax compliance costs are a significant cost to companies. Simplifying the tax system can offer the potential of a win:win scenario for both government and business.”*

- **In the world of taxation, less is often more.** According to the CD Howe Institute<sup>8</sup>, there is a growing body of evidence indicating that Canada’s high marginal effective tax rates have been dampening economic activity to the point where the overall level of revenue obtained by the government is lower than it would have been at a lower tax rate. Other countries provide an example of directions Canada should consider. Ireland, for example, provides a good model of lower tax rates yielding higher tax revenue. Ireland’s corporate income taxes comprised a 3.4 per cent share of GDP in 2005, similar to the level of corporate tax collected in Canada (3.5 per cent of GDP), even though Canada has a statutory corporate income tax rate that is almost three times higher than Ireland. OECD research shows these results are not limited to Ireland.<sup>9</sup> Indeed, many OECD countries that have deeply cut tax rates show rising tax revenues measured as the ratio of tax to Gross Domestic Product. The report states that *“recent increases in income tax revenues – both personal and corporate – have come despite the fact that statutory rates of corporate and personal income taxes remain stable or are falling in many OECD countries. There were no increases in personal or corporate tax rates in the three countries with the largest tax ratio increase: Iceland, the United Kingdom and the United States”*.<sup>10</sup> Everyone, including the government, benefits from moving away from an excessive tax regime.

**Building a Canadian tax advantage:** The factors above set out clear markers for the competitive tax regime Canada needs in the future: it must be internationally competitive, neutral between firms, clear, simple, and growth-oriented. For Canada to capture its full economic potential, it must incorporate these principles into its

<sup>5</sup> Industry Canada “Services Sector Overview - October 2006”, <http://www.ic.gc.ca/epic/site/si-is.nsf/print-en/ai02201e.html>, Accessed on December 7, 2007.

<sup>6</sup> The World Bank-Pricewaterhouse Coopers, “Paying Taxes 2008: The Global Picture”, pg. 36.

<sup>7</sup> Paying Taxes 2008, p. 44.

<sup>8</sup> Duanje Chen, Jack Mintz, Finn Poschmann, Andrey Tarasov, “2007 Tax Competitiveness Report: A Call for Comprehensive Tax Reform” C.D. Howe Institute Commentary, No. 254, September 2007, pg. 13.

<sup>9</sup> OECD Revenue Statistics, October 2006

<sup>10</sup> Ibid

taxation policy decisions. Moreover, it must examine its tax structure as a whole – progress on some fronts cannot be diminished by backsliding in other areas. Therefore, we recommend that the Panel urge governments across this country to adopt the following measures to create a competitive tax regime:

- **Corporate income taxes:** The Canadian Bankers Association strongly supports the recent federal reduction of the corporate income tax rate to 15 per cent by 2012<sup>11</sup>. In addition, recent or planned corporate income tax reductions in Alberta, Saskatchewan and Manitoba point in the right direction. They are moving Canada towards a more growth-oriented tax regime. However, much more must be done at the provincial level if the federal government is to meet its target of a combined federal-provincial corporate income tax rate of 25 per cent by 2012. The CBA recommends that the Panel urge the federal government to work with the provinces to encourage provincial CIT reform. The federal capital tax incentive initiative may provide a model that the federal government can build upon to encourage further corporate income tax reform at the provincial level.
- **Personal income taxes:** To attract and retain the best and the brightest, Canadian industry needs to be able to offer potential employees a competitive personal income tax environment. A tax system that encourages entrepreneurship and initiative through economic rewards will increase Canada's global competitiveness. This is particularly important as Canada's population ages. High personal income tax rates will deter Canada from attracting the best and brightest the world has to offer, precisely the people we need to attract as our labour force contracts.

The interaction of the tax system and social benefits also creates disincentives at lower incomes. The CD Howe Institute examined the effective marginal tax rate on earned income and found that lower income individuals face the highest effective tax burden among Canadians, in some cases approaching 80 per cent of income.<sup>12</sup> While relief should come to all tax brackets, the short-term focus should be on the lowest tax bracket. It is these workers who can face the highest marginal effective tax rate on their income. This is fully consistent with the principle of tax neutrality. Canada cannot afford not to utilize all the talents of its citizens when faced with an aging population and acute labour shortages already affecting wide swathes of the Canadian economy.

Going forward, however, attention must also be turned to competitiveness in higher income brackets. Recent research by the Organization for Economic Cooperation and Development (OECD) showed Canada as having the second highest top marginal personal income tax rate for employees (46.4 per cent) among G7 countries. In comparison, the US and UK had top marginal personal income tax rates of 41.3 and 40.0 per cent, respectively.<sup>13</sup> And in the case of the US, the income threshold at which the top marginal rate is applied is much higher than in Canada. Indeed, according to the OECD Taxation Database, in the US the top marginal rate kicks in at 10.6 times the average wage, while in Canada it applies at 2.8 times the average wage. Highly skilled individuals are mobile. If Canada wants to attract and retain the best the brightest that our knowledge-based industries (including financial services) depend upon, Canada's personal tax environment for highly skilled, highly paid labour must be comparable to that of other competing jurisdictions such as the US and the UK.

- **Capital taxes:** There is a general understanding throughout developed countries that taxing capital is simply bad economic policy. It is the antithesis of a growth-oriented tax regime, penalizing investment and reducing productivity. The federal government has made significant progress recently with the elimination of the 1.12 per cent Corporate Surtax effective January 1, 2008. However, the government still retains the Part VI Capital Tax on financial institutions, which is equal to 1.25 per cent on capital over \$1 billion. This tax is discriminatory because it only applies to one sector of the economy. Second, financial institutions are mandated by law to

<sup>11</sup> Economic Statement – Strong Leadership. A Better Canada, October 30, 2007, pg. 77.

<sup>12</sup> Duanje Chen, Tina Lee, Jack Mintz, Finn Poschmann, "2006 Tax Competitiveness Report: Proposals for Pro-Growth Tax Reform" C.D. Howe Institute Commentary, No. 239, September 2006, pg. 5.

<sup>13</sup> OECD Tax Database, "Table 1.4: Top Marginal Personal Income Tax Rates for Employee", [www.oecd.org/ctp/taxdatabase](http://www.oecd.org/ctp/taxdatabase), Accessed on December 12, 2007.

maintain high levels of capital to ensure liquidity in the event of a financial crisis. In effect, financial institutions are being penalized for complying with federal regulations. Finally, the Part VI Capital Tax only applies when corporate income taxes fall below a certain level – in other words, financial institutions are subject to the tax when profit margins are low or experiencing losses.

At the provincial level, the record is mixed. By 2012 most, if not all provinces will have eliminated the general capital tax. However, for financial institutions, the record is less benign. At present, only Alberta, Ontario and Quebec have either eliminated or will eliminate their portion of the capital tax that applies to financial institutions by 2012. We are encouraging provincial governments to take advantage of the financial incentive introduced by the federal government in Budget 2007 to eliminate their capital taxes.

Canada's competitive tax environment of the future should be one that has no capital tax components.

- **Taxes on international trade:** The banking industry has been a strong advocate for the elimination of withholding taxes. The reciprocal elimination of Canada-US withholding tax is a wise and welcome move on the part of the federal government. This action will benefit the Canadian economy by improving the competitiveness of our tax regime and will facilitate increased investments and encourage the free flow of capital. At present, the ratification process in the US has yet to be completed. Given the reciprocal nature of the treaty, we look forward to the timely US ratification of it. As the benefits of eliminating the withholding tax are apparent, we are pleased the government is moving forward in eliminating the taxes on non-arm's length transactions in the three-year period announced. We would also recommend that Canada build on this by negotiating similar reciprocal arrangements with other countries to eliminate withholding taxes on non-arm's length transactions to encourage foreign investment in Canada.
- **Excise taxes:** Harmonization of provincial sales taxes with the GST is sound economic policy. As a substantial proportion of provincial sales taxes revenue is accounted for by tax on business inputs, this represents a tax on investment. According to the Department of Finance, sales tax harmonization would reduce the marginal effective tax rate on new business investment to 16.4 per cent, thereby encouraging increased investment, which will lead to higher productivity longer term. The CBA encourages those provinces that have not yet harmonized to do so, and we encourage all governments to work with stakeholders on ways of implementing a harmonized sales tax in the most balanced and workable way possible. In particular, since harmonization would disproportionately impact the sales tax paid by providers of GST-exempt services such as financial services, we would encourage governments to work with affected industries to develop the most efficient harmonized sales tax regime possible.
- **Tax Administration:** The burden of complying with Canada's ever more complex tax system is becoming an increasing part of the overall tax burden on corporations in Canada. A recent World Bank-PriceWaterhouseCoopers study found that Canada ranked 8th in the OECD in terms of the ease of tax compliance, and behind key competing jurisdictions such as the UK. Canada should aim to have the simplest and most efficient tax regime in the world. Part of the answer to making the tax system administratively simpler is to promote greater harmonization of tax policies across federal and provincial governments. Indeed, recent harmonization of the federal and Ontario corporate income tax regimes illustrates the type of objectives we must continue to undertake. In particular, the World Bank-PWC study highlights the fact that compliance with consumption taxes such as GST and provincial sales taxes is particularly burdensome in Canada. The study indicated that compliance with consumption taxes represents approximately a third of the total tax compliance burden for Canadian businesses.<sup>14</sup> Differing federal and provincial sales tax regimes account for part of the problem. Harmonizing provincial sales taxes with the federal GST in those provinces that have yet to do so would significantly reduce this burden.

<sup>14</sup> The World Bank-PriceWaterhouse Coopers, "Paying Taxes 2008: The Global Picture", Appendix 1.3, pg. 53.

PST-GST harmonization alone is not enough. The federal government must also carefully examine the compliance burden that GST regulations place on businesses. The proposed GST legislation on imported supplies perfectly illustrates the absolute necessity of having an administratively simple tax regime. The proposed legislation is unnecessarily complex and opaque. If implemented as proposed, the legislation may result in taxing imported financial services such as foreign securities trading desks that are supported by back office operations and trading room operations located in Canada. While this may not have been the intent, the proposals are so complex that they could inadvertently capture these types of transactions. This could result in Canadian banks being forced to relocate these services outside Canada with the result that Canadian jobs will be lost and tax revenues will be adversely impacted. We are pleased that one of the objectives of the government's recently announced Advisory Panel on Canada's system of international taxation will be to minimize compliance costs for business and facilitate administration and enforcement by the Canada Revenue Agency. The government has recognized that simplicity must be a feature in Canada's tax system of the future.

Canada is a relatively small player on a global stage, and both capital and labour are mobile. To compete, Canada must create tax advantages that encourage business growth, productivity and innovation which will translate into success and prosperity in our own economy. Canada currently has the fiscal room to make such changes, which will help position our country for more stable and sustained growth in the future.

## A more competitive regulatory system

Canada's financial services industry is one of the most heavily regulated industries in the country. Indeed, virtually all aspects of the structure, activities and business operations of bank financial groups are subject to oversight by a variety of federal and provincial regulatory bodies. Consequently, the competitiveness of our financial services sector is profoundly affected by the legislative and regulatory framework. In this section, we address two key aspects of the regulatory system – the need for a more flexible, less prescriptive approach to the content of regulation and the inefficiency of the overlapping and duplicative structure of regulation in Canada. While these comments are directed specifically at financial services regulation, they also have relevance to regulation in other parts of the economy, as we note below.

**Content – a new approach to developing regulations:** Although previous governments periodically announced various regulatory streamlining initiatives, little in the way of practical results were achieved, and over the years the cost, complexity, intrusiveness, and prescriptiveness of regulation have continued to grow. What is needed is a new approach to regulation that both ensures high standards of consumer protection, while also providing institutions with more flexibility. Set out below are approaches that we recommend the Panel consider as ways of making Canada's regulatory system more competitive.

- **Principles-based regulation:** The CBA was pleased to see the government highlight in its March 2007 "Aspire" document its interest in pursuing a principles-based approach to regulation, an approach to regulation which other jurisdictions, most notably the Financial Services Authority ("FSA") in the UK, are increasingly adopting. Although difficult to put in place – since it needs a shift in attitudes and regulation-design capacity – principle-based regulation holds out the prospect of a more flexible regulatory system that can help competitiveness by enhancing the ability of firms to be responsive to changing market opportunities and by reducing the drag of regulatory complexity on firms' efficiency.

In its April 2007 document, "Principles-based Regulation – Focusing on the outcomes that matter", the FSA concluded that principles-based regulation offered benefits to consumers, financial firms and regulators alike. Citing past experience, the FSA remarked that prescriptive standards have been unable to prevent misconduct and had become, in the UK, an increasing burden on the resources of the FSA as well as the firms it regulates.

This was particularly so as financial markets are in a constant state of flux, with continuous innovation and product development. A regulatory system based largely on prescriptive rules, the FSA concluded, is unable to address constantly changing market circumstances and practices, resulting in delays and preventing innovation.

As the FSA makes clear, however, for principle-based regulation to truly result in an improved regulatory system, there needs also to be significant change in the approach of regulators. In effect, financial institutions need to have a high degree of trust in regulators' capacity to be flexible in compliance judgements and to assess outcomes rather than adherence to prescriptive rules. A key element of principles-based regulation is a risk-based, proportionate approach, one that creates a climate that allows institutions to be more forthcoming in discussing potential problems with the regulator, and to work cooperatively toward finding reasonable and proportional solutions. In the financial services area, Canada's federal government has taken a first step toward a principle-based approach in its draft regulation on Principal Protected Notes, but the remainder of its regulations, particularly in the consumer area, are unduly prescriptive and intrusive. Accordingly, in its report to the government, the Panel should consider encouraging the government to build on its intentions to explore principles-based regulation and to set targets for moving the regulatory system more fully into a principles-based system.

- **Checks and balances within government:** More broadly, the government needs to articulate – and just as importantly, *enforce* within departments – a clear statement of principles and guidance about how it will approach regulation. Again, previous governments have attempted similar exercises, but without much measurable difference in the nature, scope, intrusiveness, or volume of regulation with which institutions must comply. What is needed is a new approach to regulation, one that:
  - Takes into account the impact of regulation on international competitiveness. The US is currently doing so through the Treasury Department's preparation of a plan, for release in 2008, for an improved financial regulatory structure to help US financial markets compete globally. The Panel's recommendations could put Canada on a parallel path toward an enhanced competitive environment.
  - Recognizes that a well-informed consumer is the most effective way to ensure consumer protection.
  - Sees formal regulation as a last resort, to be relied upon only after other alternatives – including first and foremost, reliance on the operation of a competitive marketplace – have been tried.
  - Incorporates into the machinery of government regulation-development a formal challenge function – similar to the US Office of Management and Budget (which can reject proposed regulations that do not meet rigorous cost-benefit analysis requirements) – where departmental proposals for regulation can be assessed on clear, objective criteria before they go forward for approval. One such test should be “will the regulation enhance or inhibit competition?” Unless there is a clear, compelling, and documented public policy rationale to the contrary, the government should remove obstacles that impede the ability of individual institutions to compete and the ability of consumers to make informed choices in the marketplace. A key example in Canada of politically-driven decisions that inhibit both competition and customer choice is the continuing restriction on in-branch involvement in most types of insurance by banks. Canada remains an outlier among modern financial systems in its prohibition of not only in-branch sales of insurance, but of any in-branch promotion of insurance products or referrals to qualified insurance professionals, to the detriment of the Canadian consumer.

**Structure – strengthening the economic union within Canada:** There is a need for more concerted action by all governments to achieve the free flow of goods, services, and investments within Canada – a real, working free

trade zone in our own country.<sup>15</sup> There is widespread recognition that the 1995 Agreement on Internal Trade has not been effective. While there have been bilateral efforts that merit support (e.g., the Alberta/BC Trade, Investment and Labour Mobility Agreement and the recent announcement of discussions between Ontario and Quebec), overall the provinces have not been able to make real collective progress to remove barriers to internal trade. Accordingly, we urge the Panel to address the negative impact of the internal trade barriers among provinces, and to recommend more direct action by the federal government in this area. The banking industry was pleased to see that in its October 2007 Speech from the Throne the federal government is prepared to use its Trade and Commerce power. One approach the Panel could consider is recommending that the federal government use its constitutional powers to legislate a set of domestic free trade principles, which can serve as guidance to the provinces and set some benchmarks against which to measure progress.

**Structure – the need for a common securities regulator as a key step towards national regulation:** The structure of Canada's financial services regulatory system results in both fragmentation across jurisdictions as well as overlap between federal and provincial/territorial jurisdictions. Indeed, bank financial groups need to deal with some 50 government financial services regulators and self-regulatory organizations, in addition to the more than 100 regulators, supervisors and oversight bodies that apply to businesses generally across the country. This regulatory apparatus results in Canada having a relatively more expensive regulatory system than other leading jurisdictions, such as the UK and Australia.<sup>16</sup> These countries have simplified their regulatory systems (in the UK through the consolidation of an array of different regulatory bodies into the Financial Services Authority, and in Australia through the establishment of a national-level regulatory system in place of the previous state-level system), and it is time that Canada did the same.

In our view, the first step towards the broader goal of national financial services regulation is securities reform. In this regard, we fully agree with the federal government's emphasis (as set out, for example, in *Advantage Canada*) on the importance of a well-functioning capital market to investment, job creation and economic growth in Canada. The current fragmented system encompassing 13 provincial and territorial jurisdictions – a legacy of an early period in Canada's capital market which no longer reflects the needs of today's investors and businesses seeking to raise capital – works against these important goals<sup>17</sup>:

- **Negative impacts on SMEs:** The fragmentation of the current system imposes unnecessary costs and disincentives on small and medium-sized enterprises seeking to raise capital. CBA research shows the additional cost associated with an offering increases by approximately seven per cent for every additional jurisdiction. These regulatory costs limit the number of jurisdictions in which firms seek to raise capital.<sup>18</sup>
- **Increased cost of capital:** The current system increases the cost of equity capital and hinders the development of efficient capital markets in Canada. Bank of Canada research indicates that it costs companies more to raise capital through equity issues in Canada compared with the US, a phenomenon known as the "Canada discount."<sup>19</sup> This discount exists whether a firm raises capital in one jurisdiction or many. In addition, the "Canada discount" raises concern that Canadian companies will increasingly raise capital in the U.S., to the detriment of the development of a deeper and more efficient Canadian capital market. While there are different factors contributing to the "Canada discount", the inefficiency of the current system is a key element.
- **Slow policy-development:** The need to negotiate among multiple regulatory bodies means that decision-making and policy formation is unduly slow in Canada, at a time when the need to be responsive to changes and developments in the capital market is critical. The Canadian Securities Administrators' policy development

<sup>15</sup> The negative impact of internal trade barriers on competition and innovation was most recently made in the December 12, 2007 "International Monetary Fund 2008 Article IV Consultation with Canada – Preliminary Conclusion of the IMF Mission"

<sup>16</sup> UK Financial Services Authority Annual Report 2003-04 (Appendix 5); Canadian expenditure estimate includes IDA, MFDA, Financial Services Commission of Ontario, and the overhead costs of OSFI

<sup>17</sup> In its December 12, 2007 preliminary report on Canada, the International Monetary Fund notes that "...a single regulator is the most effective way to lower costs, ensure timely policy responses, and foster consistent enforcement."

<sup>18</sup> "The impact of multiple regulators on the cost of raising capital for small and medium-sized businesses", February 2007

<sup>19</sup> Michael R. King and Dan Segal, "Valuation of Canadian- vs. U.S.-Listed Equity: Is There a Discount?", Working Paper 2003-06, March 2003.

process is cumbersome, as witnessed by the length of time (well over 10 years) it took to develop the mutual reliance system. A more recent example relates to rules governing Alternative Trading Systems (ATs) in equity trading. These rules were developed later and took nearly double the time to introduce in Canada compared with the U.S. Whereas ATs in the U.S. have already undergone a first round of consolidation, ATs have only recently begun to emerge in Canada.

- **Negative impacts on enforcement:** Effective enforcement and investor protection are hampered as available resources are fragmented and a confusing overlap of responsibilities exists among securities regulators. According to the recent report on enforcement by Nick LePan, former Superintendent of Financial Institutions, *"The existence of multiple securities regulators in Canada can make achieving consensus on [enforcement] issues difficult and time consuming. For example, it took considerable time to sort out the approach to sharing of information between regulators and the police in Canada and between Canadian authorities and their international partners. It is not fully resolved. Canada did not have a uniform position vis-à-vis its international partners."* He also noted that *"...different provincial regulators have different interpretations of court decisions which has hampered setting up joint securities intelligence units with the RCMP in some provinces, though these are a success in other provinces."*
  
- **No unified voice for Canada:** Canada is deprived of a unified voice in international securities venues, a concern when Canada and the US have announced their interest in negotiating a free trade in securities agreement. As we note below, such an agreement would benefit Canada by reducing transactions costs, improving market efficiency, and improving investor protection if it leads to more uniform disclosure. While we applaud the federal government for pursuing this agreement, we also note that Canada's ability to negotiate a deal would be enhanced if there were a single regulator with which the US could deal. As noted by the Bank of Canada, *"A greater degree of comfort in the regulatory framework will be necessary for free trade in securities, most notably in the area of enforcement. Canada's enforcement has been criticized and could pose a risk to the process when other countries assess the comparability of standards. Canada might also be at a disadvantage in implementing a nationwide agreement on free trade in securities, since it has multiple securities regulators and thus greater jurisdictional complexity for implementing mutual recognition with a foreign entity."*<sup>20</sup>
  
- **The time for action is now:** The need for securities reform has been thoroughly discussed in recent years, and a well-developed common regulator model that ensures equal input by each participating jurisdiction and regional centres of expertise has

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<sup>20</sup> Bank of Canada, Financial System Review, December 2007, p. 33, 34

been put on the table (i.e. the Purdy Crawford Panel model). We urge the Panel to recommend to governments across the country to move beyond the passport system – which, while an improvement over the status quo does not fully address the problems outlined above – and commit to a common regulator. If, however, it appears that this will not take place in the near future, the Panel should recommend that the federal government use its powers under the constitution to take unilateral action to create a single regulatory body. Again, we note with great interest the indication by the federal government that it is prepared to use the Trade and Commerce power.

Moreover, the efforts to streamline the regulatory system should not stop there: a single securities regulator should be the first step in the direction of a truly national approach to market conduct regulation in the financial sector, which (unlike the largely national approach to prudential regulation) is still fragmented between federal and provincial levels of government. More broadly, it is our view that the federal government should actively work to protect and enhance the federal role, involvement, and jurisdiction in financial services with a view to improving the efficiency of the policy and regulatory role, and as an important step in strengthening the economic union.

## Canada's competition and investment regimes

**Competition policy:** The enforcement of competition policy and the *Competition Act* can be thought of as the actions of a referee who ensures that the rules of the game in markets are complied with. This would achieve two primary goals:

- Ensuring that Canadians enjoy the benefits of competition in the marketplace, namely easy access to a range of suppliers of goods and services, at competitive prices (i.e. “access, choice, and price”),
- Fostering an environment in which firms can prosper and compete effectively.

It is important to recognize, however, that competition policy is not what delivers the benefits of competition in the marketplace. Those benefits arise from the interaction of suppliers and consumers in the market. With these basic points in mind, we would encourage the Panel to consider the following as the Panel undertakes its review of Canada's competition regime:

- **International competitiveness:** While the reality of modern economics is that firms often need to be large in order to be internationally competitive, Canada is a relatively small economy which creates certain challenges in this quest for international competitiveness. This puts a premium on the need for competition policies that are designed to take into account not just “local markets” (as Canada's competition authorities tend to focus on) but also the need for international competitiveness.
- **Interventionism not appropriate:** In a modern, well-developed, open economy such as Canada which is characterized by ease of entry, the basic premises underlying competition policy should be that the marketplace is functioning properly to deliver benefits to Canadians, and only under very narrowly defined circumstances (e.g. violations of the Criminal Code provisions of the Act as well as mergers and acquisitions) should competition regulators be authorized to intervene, and then to do so in a transparent and non-discriminatory manner. There is no need for an interventionist approach to competition policy, e.g. where authorities are empowered to pro-actively seek out potential gaps in the marketplace or to make orders to “enhance” the competition aspects or performance of markets.

With these principles in mind, the CBA recommends that Panel not support an extension or expansion of the Competition Bureau's powers regarding market studies. There have been a number of calls at the political level over the last several years to provide the Bureau with powers to initiate and conduct market studies, with a view to

making determinations about the state of competition (and possible “remedies”) in those markets. Currently, the Bureau may conduct market studies using public information and voluntary requests to obtain information from stakeholders. The debate is whether it should have further investigatory powers whereby it can compel firms to provide data. In our view, such powers are inconsistent with the principles outlined above – i.e., letting markets function freely and intervening only where there is a clear justification to do so – could lead too easily into politically-motivated reviews, and could ultimately be counter-productive.

**Canada's investment regime:** The banking industry agrees with the Consultation Paper's observation that “foreign direct investment brings benefits to Canada through new sources of capital, ideas and know-how”. We also agree that a country's productivity – which in Canada lags behind that of the US – is directly related to investment, including foreign direct investment. Given these benefits, it is our view that the federal government policy position should be to welcome foreign direct investment into Canada and to ensure that the entry process is as open, transparent and free of unnecessary regulatory costs and delays as possible.

At the same time – and as has also been noted in the Panel's Consultation Paper – there may be some instances where certain investments may not be in the best interests of Canadians and the government should have the ability to deal with those cases. In considering how to balance these two interests, we believe that certain important cautions need to be borne in mind:

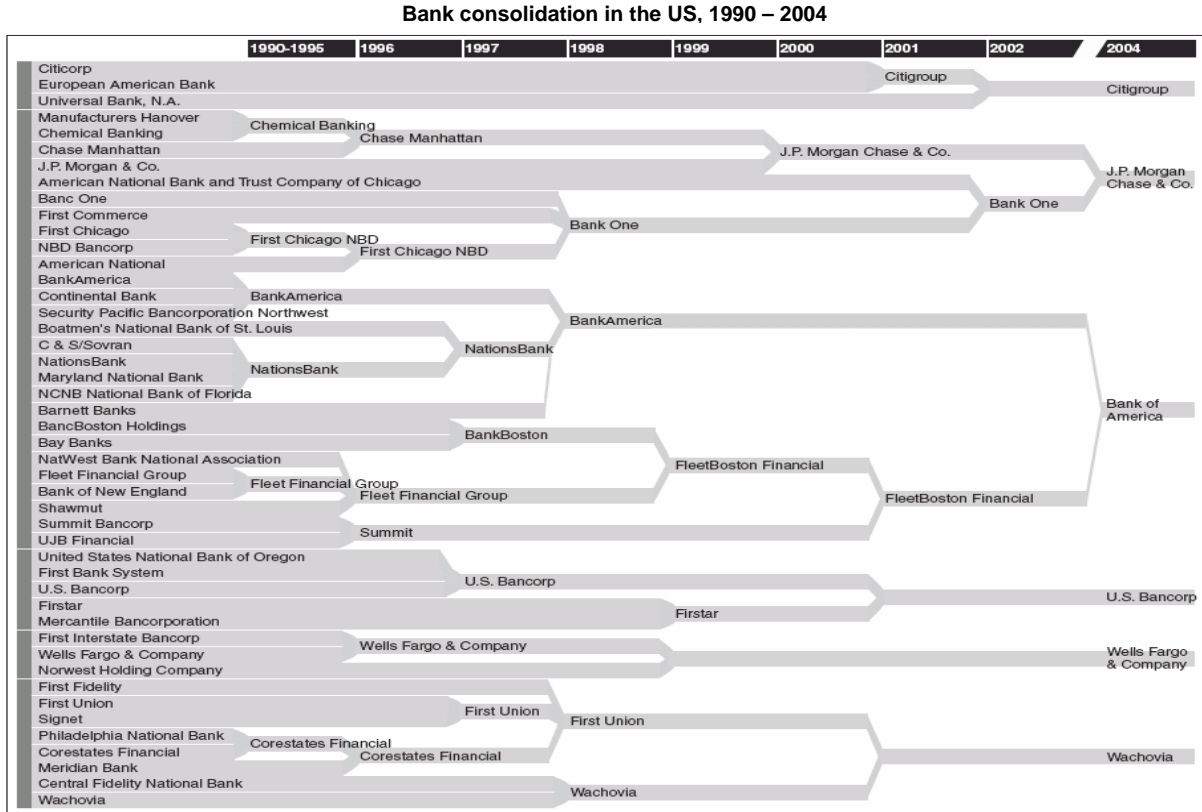
- Dealing with potential concerns about whether specific foreign investments are in Canada's interests should not be, and should not be perceived to be, a licence to erect barriers to entry.
- Any deviation from the general principle of openness should be used sparingly, and needs to be justified by documenting the risks associated with such investment and clearly stating how it would not be in the best interests of Canadians.
- Since each investment will be different, each case needs to be examined on its own merits, rather than on the basis of across-the-board rules, prohibitions, or criteria such as country of origin. As the International Chamber of Commerce has noted, tests should be “directed toward individual transactions and the actions an investor may take, rather than the nationality of the investor.”
- The review process should be based on transparent, objective criteria and aimed at predictability of outcomes for applicants.

With the above in mind, it is our view that the “net benefit” test should remain the key tool at the government's disposal in assessing foreign investment into Canada, as the Panel pursues its review of Canada's investment regime. Regarding those aspects of the investment regime that the government has indicated it will address on a separate track from the Panel's review process, we believe that the government's policy on state-owned enterprises announced on December 7, 2007 – i.e., taking the approach of setting out factors to consider (e.g. the governance of the SOE, the commercial orientation of the acquired entity etc.) as clarifications under the “net benefit” test – is appropriate. Similarly, it is also our view that the government should adopt the same approach – that is, primacy of the “net benefit” test rather than an overlay of separate tests or processes – to national security implications of foreign investment, which we understand the government will address in 2008.

## **An international perspective on structural policies**

Canada's banks are highly integrated into the competitive world economy. As was noted above, however, competition is becoming increasingly intense as the financial sector around the world has been going through massive restructuring and consolidation. In the US alone, more than 4,200 bank mergers occurred between 1994

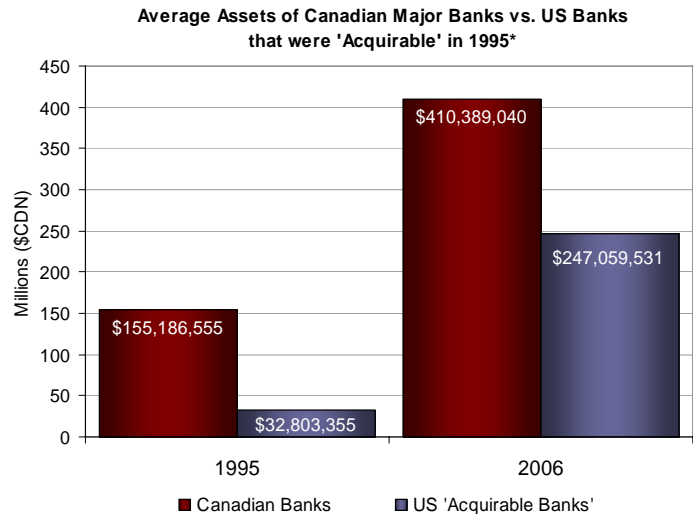
and 2006 and this trend of in-country consolidation shows no sign of abating. As the chart below shows, the biggest players in the US today are themselves the result of multiple waves of consolidation.



Source: GAO, Financial Regulation: Industry Changes Prompt Need to Reconsider U.S. Regulatory Structure. October 2004. P. 49

This process is not limited to the US, and indeed, has taken on new dimensions as more and more cross-border mergers are also taking place (for example, the recent take over of the Netherlands-based bank, ABN-AMRO, by a consortium of international banks led by the Royal Bank of Scotland). As a result, Canada's banks continue to slide in relative size. In 1985, the average assets of Canada's five largest banks equalled about 38% of the average assets of the top 10 global banks. Today, that ratio has fallen to about 19.5%. In 1995, the average assets of a big five Canadian bank was slightly larger than the assets of Chase Manhattan Bank. Today the average assets of a big five bank is less than a third of JP Morgan Chase.

Although it is not the only factor, in the international marketplace size is an important consideration, in terms of the resources that can be brought to bear for product and system development, as well as for acquisitions. Regarding the latter, the continued consolidation elsewhere in the world means not only that our competitors are bigger, but so are the potential targets that Canadian banks may be interested in acquiring. Although Canadian banks continue to actively pursue their international activities, the pool of "acquirable" banks is becoming smaller as potential targets grow in size. The chart shows this shift by examining a group of US banks that were acquirable (meaning they were



about one fifth to one quarter the size of Canadian banks) in 1995. Today, these banks are about two-thirds the size of Canadian banks making them less affordable.

These international developments put a focus on Canada's policy regarding the structure of its large financial institutions. Although there are other elements that come into play, the current structure of the financial sector in Canada is in large measure the product of three policy stances that governments have adopted over the years:

- the on-going deferral of consideration of mergers between large banks (despite the fact that mergers are recognized in government policy as a legitimate option);
- the ban on mergers between large banks and the two large demutualized insurers in this country (Manulife and Sun Life); and
- the widely-held rule limiting ownership in large banks (over \$8 billion in equity) to no more than 20% of voting shares and 30% of non-voting shares (i.e. no control of the bank by a single shareholder).

At a time when the financial sector around the world has been going through a massive restructuring and consolidation, the structure of the financial sector in Canada – at least among the large players – has been frozen. In the face of this constraint, Canada's banks have successfully adopted a range of individual strategies over the years, but the fact remains that the full range of options available to financial institutions in other jurisdictions to pursue their individual business strategies are not available in Canada. And this, despite the fact that (a) it is part of the federal policy framework that mergers among large banks are a legitimate option; (b) the ban on mergers between large banks and certain large insurance companies is clearly out of step with the rest of the world (as the chart on page 4 shows); and (c) that widely-held ownership rule (where Canada appears to be alone among industrialized countries in its outright prohibition of ownership above the prescribed limits) is a matter of government policy, not a regime sought by the industry. As the Governor of the Bank of Canada has recently noted, "...a flexible framework [governing Canada's financial institutions] that provides incentives for innovation and efficiency is needed. Bank [of Canada] research suggests that Canadian financial institutions may find efficiency gains through economies of scale – gains that could flow across the economy through lower cost business and retail lending."

Given that (a) domestic structural policies have implications for international competitiveness of Canadian FIs, and (b) Canada's policy framework on structural options can neither be deferred indefinitely nor determined in isolation from the rest of the world, we urge the Panel to consider these structural options and make recommendations in these areas, from the perspective of international competitiveness.<sup>21</sup>

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<sup>21</sup> Of relevance is the December 2007 "Preliminary Conclusions of the IMF Mission" on Canada, where the International Monetary Fund notes that "...reducing barriers to acquisition of large banks, including by foreign entities, would foster contestability and innovation in the financial system."

## A more active international trade agenda

Opening new global markets: Just as in-bound foreign direct investment is key to Canada's future success, so too is the opening of new markets to Canadian goods, services and investment. Accordingly, the CBA applauds the greater focus that the federal government is giving to out-bound trade and to achieving new market access, foreign investment opportunities and investment protection for Canadian companies abroad. In this regard, we are encouraged by the government's recent initiatives to open new markets in the Andean Community countries, Central America, the Caribbean basin, Europe and Asia. In particular we welcome the inclusion of financial services components to these initiatives since, as is recognized in the Competition Panel's paper, the financial services sector plays a leading role as a key export industry in Canadian direct investment abroad.

But more needs to be done. While in an ideal world, multilateral trade agreements are the preferred approach to enhancing trade, recent experience with the Doha Round of the WTO negotiations has shown that multilateral agreements are difficult to achieve and frustratingly incremental in their outcomes. Other countries, notably the US, are aggressively pursuing bilateral trade deals, deals that include trade in financial services. Accordingly, we urge the Panel to include trade considerations in its recommendations to the government, and make clear that Canada needs to be more active in seeking bilateral and regional agreements that would, among other things, put Canadian financial institutions on a level playing field with our international competitors. This is of importance to the financial sector, since the Canadian marketplace is mature – while growth opportunities exist within Canada, financial institutions are increasingly looking abroad for new opportunities to apply their experience and know-how.

In encouraging the government to pursue this trade agenda, the Panel should also make clear that:

- The government should not pursue “deals for deals’ sake”, i.e., agreements must be based on principles of national treatment and reciprocity based on mutual recognition;
- In pursuing bilateral deals, it is critical that Canada continue to make every effort to enhance our relationship with our largest trading partner, the US.

**Free trade in securities:** As Canada increasingly becomes a high-value services economy, cross-border provision of services is becoming ever more important. The industry applauds the government's recently negotiated enhancement of the Canada – Chile Free Trade Agreement that will allow access to markets for cross-border provision of financial services and for investment in financial institutions. Upon conclusion, the agreement will allow Canadian-based firms to deliver portfolio management services electronically and inexpensively from their offices in Canada to institutional investors located in Chile. Similarly, and as we note above, we welcome the government's announcement in the 2007 Budget document, “Creating a Canadian Capital Advantage in Global Capital Markets”, of bilateral discussions being pursued with the United States with respect to free trade in securities by means of mutual recognition of each other's securities regulation regimes. We are also encouraged by the government's ongoing exploration within the G7 of free trade in securities based on mutual recognition, as announced by the G-7 finance ministers in February of 2007. On a parallel track, as discussed above, the CBA has long supported the establishment of a single securities regulator. In the CBA's view a single securities regulator, with strengthened enforcement powers, would give Canada greater respect internationally and facilitate mutual recognition by the US Securities and Exchange Commission and European regulators of the Canadian securities regime. The timely negotiation of international securities agreements would be greatly facilitated were Canada able to speak with one voice rather than reckoning with thirteen provincial and territorial authorities. Again, the Panel can play an important role in strengthening Canada's ability to compete internationally by encouraging the federal government to actively pursue its promising undertakings in pursuit of free trade in securities.

## Conclusion

The Competition Policy Review Panel's task is of critical importance to the Canadian economy. While Canada has an enviable track record in developing a strong, diversified economy, and maintaining our role as one of the leading trading nations in the world, we are facing increasing competition as other countries seek to attract new investment to their domestic markets and support their domestically-headquartered companies to succeed globally.

Both business and government have a role in addressing this challenge. Given the mandate of the Panel, our comments in this submission have been focused on the steps governments should be taking to enhance competitiveness. In our view, the best way to address this challenge is to ensure that the business environment here in Canada is as flexible, forward-looking, and competitive as possible, and that public policy in this country is directed towards creating a Canadian advantage for our businesses on the world stage. To that end, we have focused on the factors that we feel can have the greatest impact: a competitive tax system, a competitive and flexible regulatory system, competition and investment regimes that reflect the need for open markets and open borders, structural policies that are informed by international perspectives and experiences, and a more active international trade agenda.

The Canadian Bankers Association hopes that the Panel finds these observations and recommendations of use. The banking industry looks forward to continuing the dialogue with the Panel as this important review of Canada's competitiveness framework proceeds.

*The Canadian Bankers Association works on behalf of 54 domestic chartered banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 249,000 employees to advocate for efficient and effective public policies governing banks and to promote an understanding of the banking industry and its importance to Canadians and the Canadian economy.*