INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

# IIAC Recommendations to the House of Commons Standing Committee on Finance


**Executive Summary**

Canada is in a period of contracting growth and recovery. The collapse of global financial markets and prospects for a slow and arduous recovery has set the stage for three public policy objectives:

1. **Promote growth through economic stimulus**
2. **Improve the functioning of domestic capital markets**
3. **Assist Canadians in rebuilding their retirement savings**

A continued priority for policy makers should be on renewing growth in the Canadian economy. This will improve investor, consumer and business confidence, contribute to the functioning of capital markets, and improve Canadians' prospects for a sound retirement.

The Investment Industry Association of Canada (IIAC) recommends to the House of Commons Standing Committee on Finance the following:

1. **Lower the effective tax rate on capital gains for common equity shares by reducing the inclusion rate.** A reduction in capital gains tax would result in additional risk capital, lead to further business and job creation, enhance productivity and economic activity and overall wealth creation and prosperity for Canadians.

2. **Reinforce current credit facilities for insured NHA mortgages and term Asset Backed Securities (ABS) backed by loans and leases on vehicles and equipment.** To meet the varying needs of borrowers, we recommend that these financing facilities offer a longer financing term of one to two years, and that the size of the facilities be kept flexible so that funding can accommodate demand.

3. **Introduce a defined tax-assisted lifetime pension allowance (supplemented by retroactive TFSA contributions), combined with the removal of minimum annual withdrawal limits from RRIFs.** The introduction of a defined lifetime pension allowance would give investors flexibility to recoup market losses in their portfolios, and could be supplemented by allowing retroactive contributions to Tax-Free Savings Accounts (TFSAs). Additionally, to ensure that older Canadians receive the benefit of maximum flexibility to manage their portfolios efficiently, we recommend the removal of minimum annual withdrawal limits from RRIFs for Canadians over the age of 71.

## Background

Canada's economy is contracting, as evidenced by 10 consecutive months of negative GDP growth. The current environment has brought about a massive deleveraging in the marketplace, a flight to increased savings in low risk assets and a continued pessimism about the economic outlook. After tumbling as much as 40% to 50% in 2008, global equity markets have made some recovery, and show signs of stabilizing, but still remain well below the peak levels of 2007. Credit markets, while also significantly improved, continue to show pockets of illiquidity, restricting the flow of credit to corporate borrowers. Continued strains on Canada's manufacturing sector, resurging but volatile resource prices and an export sector hampered by the recent appreciation of the Canadian dollar are all delaying Canada's economic recovery. Business and consumer spending remains modest, and investor portfolios affected by the market collapse will require significant time to recoup losses, leading to heightened concerns about a potential pension shortfall in Canada.

The IIAC commends the federal government for undertaking a judicious mix of public spending and growth initiatives to improve the functioning of Canada's economy and capital markets. Canada's fiscal position remains sound and compares favourably to other jurisdictions, most notably the United States. A continued priority for policy makers should be on renewing growth in the Canadian economy. A vibrant economy will improve investor, consumer and business confidence, the functioning of credit markets, and prospects for a sound retirement.

**The IIAC recommends the following:**

**1. Lower the effective tax rate on capital gains for common equity shares by reducing the inclusion rate.**

Canada's current framework for capital gains tax is a major impediment to the supply of risk capital for productive investment. The current high rate of tax on capital gains discourages the flow of scarce investment capital by deterring investment in high risk projects and is an impediment to the transfer of capital to more productive investment. A reduction in capital gains tax on common equity shares would result in further business and job creation, enhanced productivity and economic activity and overall wealth creation and prosperity for Canadians.

***The IIAC recommends lowering the effective tax rate on capital gains on common equity shares by reducing or eliminating the current 50% inclusion rate.***

Reducing or eliminating capital gains taxes on common equity shares may likely not have a meaningful impact on government coffers and may actually increase overall tax revenues stemming from further business and job creation, increased capital spending, corporate income and profits, and investor wealth.

**2. Reinforce current credit facilities for insured NHA mortgages and term Asset Backed Securities (ABS) backed by loans and leases on vehicles and equipment.**

The 2009 federal budget introduced several initiatives under the Extraordinary Financing Framework (EFF) to strengthen the capacity of Canadian financial institutions to expand credit and reduce gaps in the credit markets. As of May 2009, sixteen different financial institutions have been able to access almost $58 billion in funding through the Insured Mortgage Purchase Program (IMPP). An additional $10 billion in funding has been allocated to fifteen lenders from a cross-section of the vehicle and equipment financing industry under the Canadian Secured Credit Facility (CSCF).

These initiatives have been effective in improving the functioning of domestic credit markets generally. Debt issuance in the first half of 2009 is up over 60% from the previous six months with several large-scale corporate financings completed. However, certain segments of the market continue to function sub-optimally, most notably the securitization market. Additional attention should therefore be devoted to initiatives undertaken by the federal government to ensure that businesses can access capital quickly and at a reasonable cost and intermediaries can continue to maintain adequate two-way markets for buying and selling securities.

***To help support domestic credit markets, the IIAC recommends that the government reinforce current credit facilities for insured NHA mortgages and term Asset Backed Securities (ABS) backed by loans and leases on vehicles and equipment.***

Specifically, market participants have expressed uncertainty about the government's longer term commitment to maintaining the IMPR and CSCF, discouraging borrowers and intermediaries from utilizing these facilities. To meet the varying needs of borrowers, we recommend these facilities offer a longer financing term of one to two years. The size of the facilities should also be kept flexible so that funding can accommodate demand.

Additionally, eligibility for participating in the facilities should be expanded. Expanding eligibility paves the way for additional market participants and corporate borrowers to benefit from the facilities, widening channels for capital to flow into the real economy.

The investment industry is also taking direct initiatives aimed at supporting credit markets. Specifically, we are exploring measures to revitalize the securities lending and repo market through the more efficient use of balance sheets. We also continue to maintain dialogue with the Bank of Canada in order to provide them with our industry's assessment of the marketplace.

**3. Introduce defined tax-assisted lifetime pension allowances to alleviate the retirement savings shortfall faced by older Canadians.**

Retirement savings reform is one of the most important and complex issues facing Canadians today. As such, we commend the government on its decision to establish a federal-provincial research working group on Retirement Income Adequacy to be chaired by the Honourable Ted Menzies. This is a worthy initiative to which we give our support. However, it is important that the Working Group focus on the retirement savings shortfall faced by older Canadians, as well as make recommendations that promote increased retirement savings over a longer time frame.

***The IIAC recommends the introduction of a defined tax-assisted lifetime pension allowance (supplemented by retroactive TFSA contributions), combined with the removal of minimum annual withdrawal limits from RRIFs.***

The introduction of defined a lifetime pension allowance, potentially using Canadian public sector pension plan valuations and comparable allowance limits set in other countries as a guideline for setting a maximum amount, would give investors flexibility to recoup market losses in their retirement portfolios. The lifetime pension allowance could be supplemented by allowing retroactive contributions to Tax-Free Savings Accounts (TFSAs). Retroactive TFSA deposits for older Canadians could compensate for previous pension portfolio losses and supplement current RRSP contributions. It has been estimated that the retroactive application of TFSAs could provide older Canadians who are close to retirement with approximately $160,000 in additional tax-free retirement investment room.[1] Additionally, TFSA supplementary contributions would be cost-effective for government as any retroactive contributions would be made from the investor's after-tax income.

In conjunction with the introduction of a lifetime maximum pension allowance, and to ensure that older Canadians receive the benefit of maximum flexibility to manage their portfolios efficiently, we recommend the removal of minimum annual withdrawal limits from RRIFs for Canadians over the age of 71.

**Conclusion**

The IIAC appreciates the opportunity to offer our recommendations to the Committee, and we look forward to making our oral presentation to the Committee in the months ahead. We would be happy to more fully expound upon the recommendations, or to answer any of the Committee's questions during the presentation, or at any other time.

Investment Industry Association of Canada

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[1] "*Coming back from the brink*", Financial Post, July 25, 2009.