



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

Investment Industry Association of Canada

Pre-Budget Submission:

Making the Case for Fiscal Reform

February 18, 2010

From managing the crisis to growing the economy

In the past year, the government has managed the financial crisis and subsequent recession through a balanced mix of spending stimulus and monetary easing. After tumbling as much as 40% to 50% in 2008, global equity markets have made a partial recovery, and show signs of stabilizing, but still remain well below the peak levels of 2007. Credit markets, while significantly improved, continue to show pockets of illiquidity, restricting the flow of credit to corporate borrowers. The economic recovery has not shown the same pace of recovery, reflecting cautious consumer spending and narrowing margins in the manufacturing and export sectors from an appreciated dollar. Investor portfolios affected by the market collapse will require significant time to recoup losses, leading to heightened concerns about a potential retirement savings shortfall in Canada.

The IIAC has been generally supportive of the federal government's 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. However, policy makers must balance the need to stimulate economic growth with the need to contain expenditures.

Strategic planning to contain expenditures

The IIAC commends the government for its recognition that a spending review is an integral part of the budget process. There is increasing concern about the escalating size of the national deficit, estimated to reach \$56.2 billion by the end of the government's fiscal year.¹ Continued deficits, including an estimated annual structural deficit of \$19 billion, will result in a projected \$170 billion increase in the national debt by 2014-15.²

The IIAC recommends that the government include as part of its 2010 budget a clear plan for reducing the federal deficit over the medium term, with the emphasis on fiscal restraint and reduced spending rather than tax increases.

Plans to reduce expenditures should be strategic and focused on achieving efficiencies, while preserving programs and services that contribute to economic growth. According to the Bank of Canada, the Canadian economy was operating 3.25% below its production capacity in the fourth quarter of 2009, indicating federal stimulus programs are still required in the short term, and can only be phased out gradually as the economy responds to private sector demand. We recommend that government reduce the annual deficit steadily over a five-year period to balance through judicious spending cutbacks.

Lowering capital gains tax on common equity shares

Canada's current framework for capital gains tax is an impediment to accessing risk capital for productive investment. Policy should introduce modest capital gains tax relief to provide support to the capital-raising process.

¹ "Federal budgetary deficit hits \$36 billion eight months into fiscal year," *The Globe and Mail*, January 24, 2010.

² "Federal budget will launch spending review, Day says," *The Globe and Mail*, January 20, 2010.

The IIAC recommends lowering the effective tax rate on capital gains on shares of small publicly listed companies.

Lower capital gains rates stimulate risk investment in equities, enabling listed companies, especially small public companies ineligible for the \$750,000 capital gains tax exemption, investment tax credits and lower corporate rates, to tap public and private markets for capital, enhancing productivity and competitiveness. A selective reduction in capital gains tax on the shares of smaller public companies would result in further business and job creation, increase economic activity and overall wealth creation and prosperity for Canadians.

Measures to improve retirement savings

Retirement savings reform is one of the most important and complex issues facing Canadians today. We agree with the findings of the federal-provincial research working group on Retirement Income Adequacy (the “Mintz Report”) that, on balance, the system is performing well, and providing working Canadians with adequate replacement income upon retirement. However, there is evidence that not all Canadians are saving enough to meet income replacement needs during retirement and more analysis should be conducted to understand this phenomenon before initiating any major policy changes.

The IIAC recommends that the federal government continue to support the three-pillared approach to retirement savings reform (OAS/GIS, CPP and private pensions and savings) that balance public and private responsibility.

If the federal government is considering options to enhance the three-pillared system of retirement savings, we suggest that the most efficient and fair means to stimulate savings among middle-class Canadians (earning between \$30,000 and \$100,000 per annum) is to provide more tax-assisted savings room to accumulate savings more quickly. Research completed for the Mintz Report found that the introduction of tax-assisted savings plans has been shown to increase net private savings by approximately 30%, and that the removal of tax on income derived from saving can result in a faster accumulation of savings for retirement.³

The IIAC urges the government to explore practical and efficient ways to assist middle income Canadians to bolster their retirement savings through privately administered tax-assisted savings plans, such as RRSPs and TFSAs.

Tax Free Savings Accounts (TFSAs) have proven to be a very popular savings option for many Canadians, with nearly \$3 billion held in TFSAs at IIAC member firms as of the first nine months of 2009.⁴ Recent studies have concluded that TFSAs may also be more advantageous for individuals who are nearing retirement than RRSPs.⁵ Retroactive application of TFSA deposits could provide older Canadians who are close to retirement with approximately \$160,000 in additional tax-free retirement investment and compensate for previous pension portfolio losses. Additionally, TFSA contributions would be cost-effective for the government as any retroactive contributions would be made from investors' after-tax income.

³ Mintz, Jack M. “Summary Report on Retirement Income Adequacy Research,” December 18, 2009 (pp. 23-24).

⁴ *Investor Economics* retail brokerage report, 2009.

⁵ Laurin and Poschmann. “Saver’s Choice: Comparing the Marginal Effective Tax Burdens on RRSPs and TFSAs,” C.D. Howe Institute, January 27, 2010.

The IIAC recommends that older Canadians be permitted to make retroactive contributions to TFSA accounts.

Canadians over the age of 71 are mandated to withdraw annual amounts from their RRIF accounts, even if they have no need for the money. Last year, the federal government reduced the required minimum withdrawal to prevent Canadians from unnecessarily cashing out their investments at the bottom of the market cycle. Older Canadians should have the discretion to choose the timing of withdrawal from their RRIFs and not be subjected to defined minimums.

The IIAC recommends the removal of minimum annual withdrawal limits from RRIFs for Canadians over the age of 71.

Strengthening Canadian securitized markets

The IIAC was supportive of the government's introduction of the Canadian Secured Credit Facility (CSCF) in early 2009. The CSCF was intended to provide liquidity and encourage originators of vehicle and equipment loans to package these lending instruments into marketable securities to facilitate cost-effective funding to purchasers of autos and equipment. In May 2009, the Business Development Bank of Canada (BDC) announced that \$10 billion had been allocated to 15 Large Enterprise Tranche lenders to purchase asset-backed leases and loans on vehicles and equipment, and that another \$1 billion had been allocated to lenders under the Small Enterprise Tranche.

However, lenders in the auto/equipment lending and leasing sector have only drawn down a small amount under the CSCF facility (\$300 million). There are a number of reasons behind the lenders' reluctance to use the facility:

- Significant upfront and ongoing set-up and administrative costs associated with the CSCF requirements for public issuance, which restricts access to everyone except the largest participants (captive finance companies of the large automotive and equipment manufacturers).
- Inability of existing ABS issuers to raise more than \$300 million through the CSCF unless they establish a new issuing trust that meets CSCF requirements.
- Challenges associated with off-market structural requirements from the BDC that effectively require performance guarantees from Federally Regulated Financial Institutions to cover non-credit related risks associated with the management and administration of the issuing Trust.

We have consulted with senior practitioners to discuss these concerns and to identify remedial steps to strengthen the securitized marketplace. Significant progress has been made in moving closer to a fully functioning market; however certain displaced asset classes and smaller issuers are still unable to access the market.

The IIAC recommends that the government consider establishing direct lending programs, such as those available through existing BDC programs, or a tailored securitization solution to assist smaller issuers.

Market conditions have improved sufficiently for most lenders and asset classes in the auto and equipment sector to obtain sufficient market funding at competitive terms for lending and leasing activities. However, many smaller asset originators (asset pools less than \$75 million) that would have accessed the ABCP market prior to the crisis continue to encounter funding difficulties today. The securitization solution for these issuers is much different than the securitization solution for larger issuers, especially given the barriers to entry for these companies to access the CSCF program in its current form.

Single securities regulator

The IIAC supports the government's initiative to build a Canadian securities regulator. A single regulator will result in more cost efficient regulation, strengthen oversight of systemic risk, and provide more responsive rulemaking in dynamically changing capital markets.

The IIAC recommends that the government continue to promote the efforts of the Canadian Securities Transition Office and introduce a common securities act in 2010.