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

Turbulent Markets Demand Major Changes

Highlights of a Speech by

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Difficult Financial and Economic Environment

- The economic consequences of the financial crisis are being felt across the country – in aerospace in Quebec, and manufacturing in Ontario, and of course in the resource sector here in the west
- Last month, Alberta suffered 30% of Canada's job losses, 24,000 jobs. We are witnessing the end of the period of continuous growth that the province had been enjoying since 1993, one of the longest stretches of real growth in North America
- Low oil and gas prices together with illiquidity in capital markets have led to cancellation or postponement of both extraction and upgrading projects in the oil sands
- Over $40-billion worth of capital projects have recently been cancelled or postponed
- Forecasted provincial revenues have plummeted by $4.5 billion to $35.6 billion, with a deficit pegged at $1.4 billion for the current fiscal year.
- How will the provincial government deal with this turn of events in its April 7th budget?
- With significant infrastructure and social spending built up through the long period of prosperity, the provincial government has indicated that fiscal stimulus is not in the cards. It has even suggested belt tightening measures

- This harkens to past fiscal patterns when spending was ramped up in the good times and, to maintain fiscal prudence, the province was then confronted with the Hobson's Choice of spending cutbacks, erosion of tax competiveness or debt accumulation from borrowing to fund expenditures
- This would mark Alberta's first use of bond financing since eliminating the provincial debt in 2005

Collapse in equity markets

- Not just Alberta but the whole country has been engulfed in an economic slowdown triggered by the recent meltdown in the financial sector
- This collapse has been wider, deeper, more complex and more unsettling than any downturn in generations
- This market collapse has been wider, deeper, more complex and more unsettling than any downturn in generations
- Loss of investor confidence
- In an economy in which over millions of baby boomers are within 10-20 years of retiring, restoring confidence depends to a large extent on easing doubts in their ability to afford a decent retirement
- This restoration of confidence will ultimately turn on recovery of equity markets
- All of this fuels a retirement crisis for people who already face a steep challenge in meeting their retirement goals. That is why IIAC has been advocating changes in RRSPs and RRIFs

- The market downturn has hit the securities industry hard – like a splash of cold water in the face
- Total industry revenue was down 15% in 2008; profits were down 40%.
- I should point out that despite these significant percentage declines, the industry still turned in its third-best year, due to a strong first half
- However, revenue could be down another 15% this year and profits down another 50%, if fourth quarter performance holds through 2009
- The retail sector is turning in its weakest performance in history. Operating profit is down 60% year-over-year, as retail firms have had trouble controlling costs as revenue has plummeted
- Look at institutional firms – they're down, with operating profit down 50% year-over-year
- The relatively steep profit contraction reflects the collapse of the investment banking business
- If financial conditions fail to improve, all of this will lead to industry consolidation across the large small firm sector

Spending retrenchment

- There may have been a time when many Canadians didn't have to worry that much about the markets and the financial services industry. That time passed long ago. The financial impact and loss of confidence is feeding through to the real economy
- Collapse in investment portfolio of 30 - 40%
- Government has predicted a severe contraction for the first half of this year. We're seeing the highest unemployment rates and the lowest consumer confidence levels in years

Remedial Action

- Canadian recovery will turn on the success of the U.S. stimulus package and efforts to repair the U.S. banking system – but Canadian government has an important responsibility
- The stimulus package (2% GDP) announced in the January Federal Budget will provide support to the weakening economy.
- The B.C. budget last month reflected a similar approach, offering significant government stimulus. Ontario will do the same in its budget in two days
- As I mentioned, here in Alberta the provincial government has initiated debate on a borrowing program to finance infrastructure. As well, the province has launched a three-part incentive program to bolster activity in the oil and gas sector. That includes a royalty credit for drilling on new

wells, a cap on royalty rates for new wells, and a $30 million investment in reclaiming and abandoning old oil and gas wells

- Bank of Canada has played its role injecting substantial ($36B) liquidity to promote the transmission of credit through capital markets to real economy
- Tax relief is an important component of investment stimulus
- Planned corporate tax rate reductions are a positive step
- Need for lower capital gains tax rates to stimulate interest in risk investment – particular equity shares
- Now, more than ever, it is important that Canadians have an incentive to invest

Restrictive Credit Markets

- Stimulus is important – but one of the keys to dealing with this crisis is to unlock the credit markets
- This crisis is an object lesson in the importance of capital markets. They are the lifeblood of the economy, and they just aren't functioning. The global economy has a case of hardening of the financial arteries
- Credit markets have been locked for a year-and-a-half because of a loss of confidence, especially in the institutional side of the market
- The ABCP marketplace raised real concerns and has completely shut down. These credit concerns have spread across the markets, with foreign banks pulling back, auto credit companies collapsing, and other credit channels being cut off

- Large institutions that buy and trade debt in our capital markets have retrenched
- Banks have been left to play a larger role than they otherwise would.
- Access to credit is closed to nearly everyone except top-rated companies' notably financial institutions and utilities
- Traditional capital market borrowers, both financial and non-financial companies, find access to capital restricted and cost of capital higher
- Bank of Canada bolstered substantial liquidity through a flexible repo program
- Federal budget has provided liquidity through various measures: Insured Mortgage Purchase Plan ($125M) and ABCP credit facility ($12B)
- These initiatives designed to kick start market activity and mitigate impact on the local economy
- The wealth of the industrialized world has been based on our ability to provide capital for promising ventures

Long-term Remedial Action

- One of centerpieces of the federal budget: A transition plan to implement a single securities regulator
- Regardless of how one feels about it, the single regulator concept is gaining momentum. It could bring significant benefits to Canadian markets– but only if the structure is cost-efficient, and responsive to market development

- The process has some pitfalls. It will be driven by negotiation and compromise. As a result, the outcome could be a wieldy complex structure that is as inefficient, costly and time-consuming as the one we have now
- The last thing we want to do is trade one cumbersome structure for another
- The industry has to be engaged in the process going forward
- We have to decide what kind of structure we want to see – what kind of structure will lead to the results we need. We have to shape a vision of a regulatory structure that will be conducive to wealth creation
- Process and result are linked. We have to look at the actual regulatory content we need in terms of rules and regulations – and what kind of structure will help shape it
- We have to look at new approaches, such as principles-based regulation. And we have to consider what kind of structure will be conducive to achieving that outcome
- The industry needs a seat at the table. The IIAC will be involved. The process of creating an effective single regulator is important to our future – we have to make our presence known