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Katch Koch
Clerk
Standing Committee on Finance and
Economic Affairs
Room 1405, Whitney Block
Queen's Park
Toronto, ON M7A 1A2

Dear Sirs and Mesdames:

RE: Pre-Budget Submission

We are writing to provide comments on behalf of the members of The Investment Funds Institute of Canada ("IFIC" or "we") with respect to the 2015 provincial pre-budget consultations of the Standing Committee on Finance and Economic Affairs. IFIC is the voice of Canada's investment funds industry, bringing together 150 organizations – including fund managers and distributors – to foster a strong, stable investment industry through which investors can realize their financial goals. We are proud to have served Canada's mutual fund industry and its investors for more than 50 years.

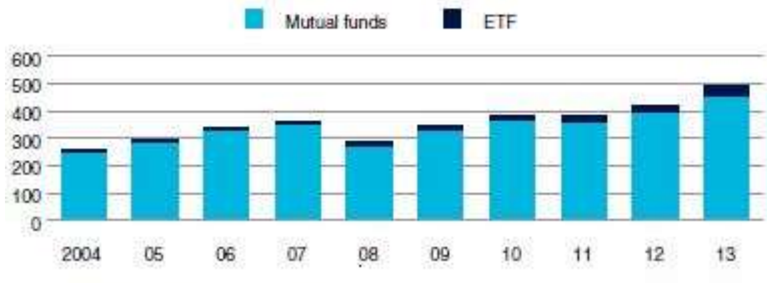
In preparing our comments, we have focused on four areas:

- The significant economic footprint of the mutual funds industry in Ontario;
- How the industry supports Ontarians as they save for retirement, and ensuring that pension reform efforts build upon the strengths of the existing retirement savings system;
- Improving Canada's securities regulatory framework without causing market disruption and uncertainty;
- Highlighting a particular tax issue in Ontario that could raise costs for retail investors if not addressed in the year ahead;

Economic Footprint

Ontario's funds industry plays a valuable role in the province's economy—one that continues to grow in importance. Data from Investor Economics show that during the last decade, the value of mutual funds and exchange-traded funds (ETF) assets held in Ontario has grown by 90 per cent. In 2004, assets under management were valued at an estimated $257 billion, and by 2013 that had increased to $489 billion. (See Chart 1.)

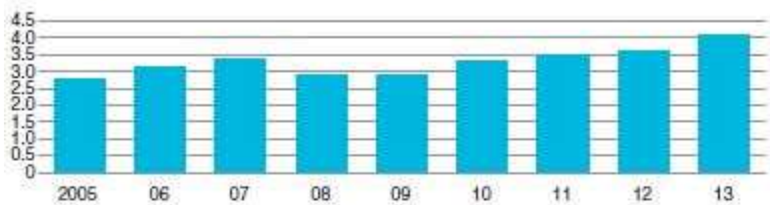
Chart 1
Mutual Funds and ETF Assets Held in Ontario
($ billions)



Sources: Investor Economics; The Conference Board of Canada.

The $489 billion in funds assets held by Ontario residents represented 49 per cent of the nearly trillion dollars in assets held nationally in 2013. Furthermore, the Conference Board of Canada estimates that the funds industry directly contributed $4.1 billion to Ontario's economy in 2013—that's up from an estimated $2.8 billion in 2005. (See Chart 2.)

Chart 2
Ontario's Funds Industry: Real GDP
(2007 $ billions)



Sources: The Conference Board of Canada; Statistics Canada; Investor Economics.

Based on the employment multipliers for this industry, it is estimated that Ontario's funds industry directly employed 44,413 full-time workers in 2013, out of the 67,941 workers employed nationally in the industry. Ontario's share of industry employment (and GDP) is larger than its share of assets under management due to the large proportion of headquarters—where portfolio management occurs— located in the province. In addition to this large share of direct employment, Ontario's funds industry sustains more than 119,000 jobs across the province.

The upshot of these strong GDP and employment figures is greater tax revenue for the Ontario government. In 2013, total tax revenues collected from the industry's economic activity in Ontario was $2.8 billion. This includes indirect taxes and corporate and personal income taxes.[1]

In short: Ontario's funds industry is a vitally important and growing contributor to employment and prosperity in communities all across the province. We are and will continue to be invested in Ontario and in Ontario's success.

[1] All figures in this section taken from *Money Management Matters: Assessing the Economic Footprint of Ontario's Funds Industry*. The Conference Board of Canada. November 2014. Available at: https://www.ific.ca/wp-content/uploads/2014/11/Assessing-the-Economic-Footprint-of-Ontarios-Funds-Industry-Conference-Board-of-Canada-November-20-2014.pdf/9221/

Retirement Savings

As indicated in its 2014 budget, the government of Ontario is developing a provincial public pension scheme – called the Ontario Retirement Pension Plan (ORPP) – that will aim to supplement the existing and universal Canada Pension Plan (CPP). Key features of the proposed ORPP include:

- Shared employer and employee contributions, each up to 1.9% (3.8% combined) of an employee's earnings and up to a maximum earnings threshold of $90,000 per year;
- Retirement benefits targeted to replace 15% of an individual's pre-retirement earnings, with benefits indexed to inflation;
- An exemption for employers offering "comparable" workplace pension plans; namely, defined-benefit (DB) and target-benefit (TB) pension plans; and
- Phased implementation, scheduled to begin with large employees in 2017 and smaller employees in 2018.

As Ontario develops the ORPP, IFIC urges careful consideration of a) whether it will actually address the serious yet targeted issue of inadequate retirement savings by a subset of middle- and upper-middle-income Ontarians, and b) how it will interact with the existing pillars of Canada's retirement savings system.

As it is currently formulated, we are concerned that the ORPP would undermine and displace Ontarians' private retirement savings options, particularly if employers offering Group RRSPs and PRPPs are not afforded a "comparable" workplace plan exemption. Group RRSPs in particular are the retirement savings vehicle of choice for thousands of workplaces across Ontario. These plans offer employees choice and flexibility to meet their savings needs, while also providing widespread access to financial advice. If Group RRSPs are not provided a comparability exemption, we expect that the introduction of the ORPP will cause many employers to rapidly discontinue their Group RRSP programs – negatively impacting individual savings habits

Furthermore, the creation of an entirely new public pension scheme will be costly and duplicative. While the government of Ontario has (inappropriately) framed the ORPP as an alternative to "expensive" private savings options like mutual funds, the high start-up costs of new public pension schemes (like the UK's NEST) must be added to the all-in cost of running such a program (for the Canada Pension Plan, this annual cost is 1.15%). On this basis, not only are mutual funds competitively priced, but they usually include a vital feature that is absent from public pension schemes: the provision of financial advice. Academic research has repeatedly demonstrated that financial advice engenders strong savings habits and improves long-term financial outcomes[2] in those who use advisors thereby helping millions of Ontarians secure their financial futures in retirement.

The mutual funds industry has a strong interest in promoting retirement security for all Ontarians, and has consistently advocated for improving both the number and effectiveness of savings options available across the country. IFIC has supported the introduction of Pooled Registered Pension Plans (PRPPs), despite the fact that our members are largely ineligible to participate in the development of these products. Moreover, we have advocated for a modest enhancement of the CPP and have recently encouraged the federal government to consider pension rule changes that would help to ensure seniors do not outlive their retirement savings.

In other words: we wish to work constructively with the government to improve Ontario's retirement savings framework. To that end, we urge the government to recognize workplace

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[2] See: *New Evidence on the Value of Financial Advice* by Dr. Jon Cockerline, available at: https://www.ific.ca/wp-content/uploads/2013/08/New-Evidence-on-the-Value-of-Financial-Advice-November-2012.pdf/1653/

retirement savings programs as a vital component in this framework, and to ensure that the ORPP builds upon rather than diminishes the strengths of our current system.

Cooperative Capital Markets Regulatory System (CCMRS)

The Governments of British Columbia, Ontario, New Brunswick, Prince Edward Island, Saskatchewan and Canada are collaborating to create a cooperative capital markets regulatory system (CCMRS), in which a single regulator, the Capital Markets Regulatory Authority (CMRA), will enforce the legislation in the participating jurisdictions.

In September 2014, the participating jurisdictions released their Memorandum of Agreement and draft provincial and federal enabling legislation. IFIC has welcomed several key elements included in the CCMRS agreement, including the creation of a uniform act with central legislative and policy accountability, an independently nominated expert board, and a degree of ministerial oversight.

However, IFIC has expressed serious reservations with several aspects of the proposed CCMRS.[3] The draft provincial and federal acts do not contemplate how the new regulatory framework will interface with non-participating jurisdictions, thereby risking a further fragmentation of Canada's securities regulatory landscape. Moreover, in drafting the CCMRS enabling legislation, officials have made substantive policy decisions (i.e. choosing one participating province's regulatory requirement over another) without the normal consultative process.

Of greatest concern, however, is the approach to systemic risk contained within the draft federal Capital Markets Stability Act (CMSA). As drafted, the CMSA would provide the CMRA with sweeping powers to designate capital markets participants as systemically risky, with potentially unlimited consequences for designated firms (up to and including forced suspension of business). Moreover, the CMSA offers firms minimal due process protections within this regime. Perhaps most troubling is that the CMSA also identifies mutual funds as a potential source of systemic risk, despite the strong evidence to suggest otherwise.

Beyond raising these specific concerns, IFIC continues to advocate for several critical improvements to the Canada's securities regulatory regime, including:

- Retention of the specialized regulation of mutual funds in a nationally-harmonized manner;
- Internal staff expertise in mutual funds and their distribution;
- Senior management and board representatives with knowledge of the mutual funds industry;
- A simple fee payment system fairly allocated among market participants that does not result in higher fees for fund firms and investors; and
- If there are provinces that choose not to participate in the ultimate structure, an effective interface between participating and non-participating provinces.

Taxation – HST

IFIC shares the government's concern that some individuals are saving insufficiently for retirement. In 2010, the harmonization of the GST created an additional obstacle for Ontarians to overcome when saving for retirement. The HST more than doubled the amount of tax that Ontario mutual fund investors pay on the Management Expense Ratio charged by Canadian mutual funds. As almost 60% of Canadian mutual fund investors hold their units in government sponsored registered savings plans, one of the effects of harmonization was a significant tax increase on Ontarians saving for retirement through mutual funds. We ask that the Ontario

[3] IFIC's submission on the proposed Capital Markets Stability Act (CMSA) and Provincial Capital Markets Act (PCMA) is available at: http://ccmr-ocrmc.ca/wp-content/uploads/com_20141208_draft-legislation_the-investment-funds-institute-of-canada.pdf

government support IFIC's advocacy efforts with the federal government to reduce this tax on retirement savings.

Taxation – Ontario Surtax

In 2014, the Ontario Taxation Act was amended to increase the surtax on high income individuals from Ontario residents in the top tax bracket. The formula for calculating the surtax was also changed.

The change to the calculation of the surtax was intended to cause the Dividend Tax Credit (DTC) to have the same value to all taxpayers, regardless of their income. However, the amended legislation was drafted such that it changed a formula for offsetting capital gains tax within a mutual fund trust (located in Ontario) with a refund that is calculated by reference to capital gains of investors who redeem units of the fund.

As a result, it is no longer tax effective for mutual fund trusts to retain dividends and take advantage of both the DTC and the capital gains tax refund (derived through the use of the "capital gains refund mechanism") in order to minimize the amount of taxable distributions paid to their unitholders. If a trust were to continue to do so (similar to prior years), it would end up paying the Ontario surtax.

This was not the government's intent and IFIC deeply appreciates the quick action of the Ministry of Finance that led to the issuance of a 'comfort letter' on December 11, 2014 that permits mutual fund trusts in Ontario to continue utilizing both the DTC and the capital gains tax refund for the 2014 tax year.

To permanently resolve the problem, amended legislation will need to be passed in 2015 that reinstates the original formula. This will ensure that mutual fund trusts will not pay Ontario surtax where expenses are used to offset Canadian dividends, and some realized capital gains are retained in order to obtain offsetting refunds of capital gains tax.

Failure to do so would put Ontario based mutual funds trusts and their investors at a significant disadvantage when compared to similar funds located in other provinces. If the funds remain located in Ontario, investors would pay more tax on income derived from the fund. However, funds may choose to move their operations out of Ontario (with attendant job losses) in order to avoid the issues associated with the surtax. We ask that the committee include support for this legislative change in its report.

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We would be pleased to provide further information or answer any questions you may have. Please feel free to contact Graham Smith, Senior Policy Advisor by email at gsmith@ific.ca or, by phone 416-309-2328.

Yours sincerely,
THE INVESTMENT FUNDS INSTITUTE OF CANADA

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