THE INVESTMENT FUNDS INSTITUTE OF CANADA | L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA

IFIC.CA

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Delivered By Email submissions@ontario.ca

The Honourable Charles Sousa
Minister of Finance
c/o Budget Secretariat
Frost Building North, 3rd Floor
95 Grosvenor Street
Toronto, ON M7A 1Z1

Dear Minister:

RE: 2015 Pre-Budget Consultations

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 Ministry of Finance. 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 how your government can ensure 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; and
- 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 and to contribute to Ontario's stature as a global financial centre. 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.

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.

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 - roughly 65% of the total 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.

Retirement Savings

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. We have also 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.

We urge your government to reconsider its plans to introduce the Ontario Retirement Pension Plan (ORPP). As it is currently formulated, we are concerned that the ORPP would undermine and displace rather than complement and enhance Ontarians' private retirement savings options. We have participated in some of the consultation sessions hosted by the Honourable Mitzie Hunter. We heard, as she did, significant feedback from employers – both large and small - advising that the ORPP will not only displace some current pension plan offerings, but potentially result in lower savings and reduced employer contributions for some employees as some employers choose to eliminate current DC or Group RRSP plans that enjoy significantly higher employee/employer contribution rates. 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. 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 existing workplace 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.

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[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/

[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/

Cooperative Capital Markets Regulatory System (CCMRS)

IFIC commends the Ontario government for its leadership in moving the goal of a single national regulator forward. We have welcomed several key elements outlined in the September 2014 Memorandum of Agreement and draft provincial and federal enabling legislation, 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, we have identified several aspects of the proposed CCMRS[3] that require further attention and development before the legislation is finalized. 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. In drafting the CCMRS enabling legislation, officials have made substantive policy decisions in choosing one participating province's regulatory requirement over another without the normal consultative process and the benefit of a market impact analysis such a process would provide.

Of greatest concern 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. Most troubling is that the CMSA also identifies mutual funds as a potential source of systemic risk, despite the strong evidence against it.

Beyond raising these specific concerns, IFIC continues to advocate for several improvements to strengthen the new securities regulatory regime, including:

- Retention of the specialized regulation of mutual funds in a nationally-harmonized manner;
- Building expertise in mutual funds and their distribution at the CMRA board, senior management and staff levels in recognition that funds investment represents 30% of household financial assets; and
- Adopting a simple and fair fee payment formula for all market participants that brings the current higher fees regime for fund firms to an end.

Taxation – HST

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 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.

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[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

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 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, a legislative amendment reinstating the original formula is required. 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. Without such an amendment, Ontario-based mutual funds trusts and their investors will be 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 could choose to move their operations out of Ontario (with attendant job losses) in order to avoid the negative consequences created by the surtax.

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We would be pleased to provide further information or answer any questions you may have. Please feel free to contact me directly or 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

By: Joanne De Laurentiis
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