

The MacKay Report and Beyond

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CANADIAN BANKERS ASSOCIATION

Building a Better Understanding

Good afternoon. Thank you Mary-Anne Chambers for the introduction and it is a pleasure to be back at the podium of the Canadian Club.

The topic of my remarks today is, of course, the challenges facing the financial services industry. I say financial services industry, not just banks, because as we go forward the distinctions among players in our industry, already blurred, are going to largely disappear.

One of the most discussed of the entire set of issues in our industry, at least in the popular media, is the two proposed bank mergers. I will deal with them at the outset, because I will not be dealing with them in my remarks.

You will know why from recent speakers at this very podium.

Harold MacKay, the chairman of the federal task force on financial services, has addressed you and said of the mergers that his report provides a flashing yellow light.

Matthew Barrett has addressed you and suggested that the MacKay report provides a green light for mergers.

Peter Godsoe has addressed you and said of the mergers that whatever the MacKay report says, the mergers deserve a red light.

Well, I happen to work for both Messrs. Barrett and Godsoe, along with all the other bank chairmen, I've told them and I'm telling you - I'm colour blind.

The merger questions aside, then, what I will discuss are some of the critical other issues raised by reforms to the regulatory structure. They are very important. The final decisions on the MacKay Task Force recommendations will be, if you like, the architectural plans for the future financial services industry. These are public policies that will empower consumers, that will allow the financial services industry to maximize its support for the long term growth, productivity and efficiency of the Canadian economy. These are policy choices that will ensure the mobility and safety of capital allocation. These are legislative and regulatory decisions that will increase future consumer and business confidence in the Canadian financial system. They will enhance our nation's competitiveness.

Or they will do the reverse. Because while continuing with the current regulatory environment won't be in the best interest of Canada or Canadians, getting reform right is not automatic.

These are important issues for Canada as a whole; they are of overreaching importance for Toronto. Banks alone are the GTA's fifth largest employer, with over 70,000 men and women directly on bank payrolls. More than twice that many jobs, again in the Toronto area alone, come from financial services as a whole including the banks.

And twice as many again - 320,000 jobs, with \$21 billion per year in GDP, are attributable to all of financial services and its suppliers, again just in the Greater Toronto area.

So financial services is important to Canada for two reasons. The first is its function as the financial circulatory system for the entire economy. The second, is its contribution as an economic sector on its own, a generator of jobs and tax revenues, attracting new investment and new entrants. And to the extent that Canada is the head office of financial services firms operating internationally, Canada and, again, especially Toronto, benefit even more. For the big banks, on average 40% of their profits are earned offshore, but 85% of the taxes they pay are paid in Canada, and 90% of their total employment is here. That "head office impact" means jobs and tax revenues Canadians would not otherwise have.

The MacKay Task Force recommendations, taken as a whole, squarely address both those and many other policy challenges for the future of our industry.

What I find encouraging, is the absence of blanket condemnation or criticism. If there is yet no consensus, I think there is at least an early basis for one.

The banks along with many other observers can at least say that in the broad reach of its work, its structural and functional vision, the MacKay Task Force got it right.

They see a future with hundreds of new financial services suppliers, many more competitors from within and without Canada, operating without barriers. Some will be niche providers, concentrating on a single area and doing it superbly well. Others will be very large, with their success dependent on providing expert advice and instantaneous transactions in a large number of service areas to a full range of customers.

Some will be regional, operating only in, say, Calgary and Toronto. Some will be fully national. Some will be fully electronic. All of them will be essentially operating as banks, even if they are not called that. They will be selling most or all of the same services, competing with banks head to head in a form and with a success that would have been unthinkable even a decade ago. The banks will be competing back, and they too will be changing, at a pace and in as many directions as human ingenuity and strategic plans can provide.

That is a vision that the task force believes unites the interests of all the stakeholders - governments, financial service providers, customers of all types and most importantly, of the public at large. It is why the Task Force report said, and I quote, "When financial institutions work well, our economy functions better and our personal lives are made easier. When they don't, financial institutions and economies deteriorate. Opportunities disappear."

But achieving what MacKay and most others seek will be neither easy nor automatic. There are immense implementation challenges for all sections of the industry, as well as for the federal and provincial governments. There are complex issues of process and levels of co-operation that have been elusive in the past. I want to talk specifically about three challenges industry and governments will face, challenges that have yet to receive much attention in the media. The first is new service standards for an industry that increasingly is focused on financial planning, not financial transactions. The second is new national approaches to regulation. The third is financial services tax reform.

Let me start with the empowered consumer, deservedly and justifiably at the centre of the MacKay prescriptions. That welter of future competition, all of it excellent for innovation and better costing, is going to be marvelous for consumers. The task force sees consumers as being empowered - using their power of choice to demand and get the financial services they want, when and where they want it - and they have made significant suggestions on encouraging that vision.

But empowering consumers is far from being just a regulatory issue or problem. Financial institutions are going to find themselves in the business of empowering consumers - not just with an ever wider range of services and custom tailored options; not just with a nearly infinite choice of delivery methods and access modes - but with information and advice. Consumers can be protected by regulation, but they will only be genuinely empowered by what they know and understand. That applies to understanding the Canadian economy and how it's changing. It applies to improving management of their finances and to their knowledge of choices available to them.

And consumers want it. The CBA has some empirical proof. Earlier this year, we launched an information program called Building a Better Understanding. It is aimed at individual Canadians, and it was based on intensive consumer research. Canadians told us they wanted more information from their banks, and they were quite specific about what kind.

And they have responded in extraordinary numbers. More than 1.1 million copies of our 14 publications like Managing Money, Saving for your Children's Education and Getting Started in Small Business have been ordered since April. Frankly, we have been overwhelmed by the response.

Providing this kind of information is a responsibility banks have. While most of our larger members had done so to some extent in the past, our research showed clearly that those efforts were seen as inadequate. Banks had to do better, and will have to keep doing it better. But that bar is rising not just for us, but for all financial services providers.

Consumer information is directly connected, an essential part of, new professional standards, training and in some cases licensing for financial institution staff.

The execution of transactions in the new world of financial services will increasingly be a commodity - gigantic in volume, very low in cost with only razor thin if any differences in competitive impact. Financial advice is replacing transaction capability as the centrepiece of what we do, and how competitive we are.

And what training and licensing standards will we need? Individual customer needs vary enormously. Consumers are likely to be particularly vocal on what they need, and what they don't need, and what they are willing to pay.

At one end of the scale is the complex estate and investment planning and management needs of the high net worth client.

In the middle are the much larger volume needs of middle income earners saving for their children's education and planning for their own retirement. And it all rests on a base of even greater volume, providing customers with simple financial literacy - basic access and use of savings, chequing and credit.

Large institutions like the banks have the necessity, and the desire to serve all three, and to serve all well.

Customers in each category deserve and must have competent, fully trained and in some cases licensed advisory services - but tailored to the level of sophistication prudentially required by the customer. How do we do that? How do we develop the standards and training, many elements of which ought to be common to mutual funds and bank investment departments and securities dealers and others?

This isn't a question of one set of standards for everyone, or even of high standards for this group and low standards for that. It's tailoring training and standards and resulting costs to a huge variety of customer needs.

The CBA is already consulting with a number of stakeholders groups and participating in a process led by provincial regulators. It's a very large challenge to all sectors of financial services and to provincial and federal authorities. We all have to take it on, and we're going to be judged by how well we do on it.

The second large implementation challenge I want to address is that of streamlining, making financial services regulation more efficient, as well as more effective.

The Prime Minister has recently spoken forcefully about the national challenge of increasing productivity. Improved and simplified regulation are among the keys to unlocking that vault of future increased prosperity.

Large national financial services providers are now subject to the oversight of - and regulation by - more than eighty different departments and agencies of the federal and provincial governments. There are thousands of pages of legislation and regulations, all requiring reports, and inspections, and compliance.

A recent study on regulatory costs reported that between 1975 and 1997, more than one hundred thousand new federal and provincial regulations were created. That's over four thousand a year, better than a quarter of them from Ottawa alone. Even more chilling is the cost of compliance, which has risen to over \$11,000. per household per year. The rhetoric of regulatory reform is still light years from the reality.

The blunt truth for financial services is a stark one: this new vision will not work, will not develop and flourish, unless we can commit ourselves to moving to national regulation from the current impossibly complex mess.

What does national regulation mean? Does it mean Ottawa does everything and the provinces vacate the field? Or vice-versa? Not at all. In fact, national regulation can only be achieved by governments choosing to participate and pursue it - a choice we have to urge on them.

Do we have to have a fully national regulatory structure before we can begin implementing any of the MacKay recommendations? Again, not at all.

But it does mean beginning to build unified regulatory offices and functions acting on behalf of both federal and provincial authorities. It does mean identical requirements, reporting

forms and schedules, wherever possible and soon. It does mean replacing multiple inspections and inspectors with fewer, by combining responsibilities. It means using electronic reporting and inspection to the maximum extent possible - already in place inside the institutions.

It means that it is greatly in the interest of all financial services providers, and all of their customers, that Ministers of Finance and provincial Treasurers commence a joint and urgent effort to develop commonly operated and directed regulatory offices. The aim should be nothing less than a commitment to combine and harmonize and unite policies, legislation, staff and requirements.

Because without such far-reaching reform, in our capital and insurance and deposit-taking and credit and investment markets, we will continue to be burdened by unnecessary, costly and hugely inefficient regulatory duplication. No country is large enough to afford it. Canada certainly cannot.

Our industry, all sectors of it have major responsibilities here. We know how complex and duplicative the current structure is. We can work with governments to find and implement improvements. And we have a large role in making this a consumer issue as much as an industry and government issue. We have to build public and political support for the compromises politicians will be asked to forge - not compromising safety or soundness, but compromising the inevitable tendency of one jurisdiction to say to another "Well, I guess we'll just do this one our way."

A third challenge is tax policy reform. Over the last century or more, quite dramatically different tax structures and tax treatment have been established for the different players in financial services. The differences may have made sense when they were created. They no longer do. They are in fact increasingly expensive and inefficient distortions.

It is more than simply the collapse of the four pillars, or components that used to characterize our industry. Too much of our broad tax structure in Canada dates from an era when the physical economy, rather than the services economy was the central driver. As a result, that structure less and less recognizes the increasing contribution services industries, financial services importantly among them, make to national economic growth.

And there are real costs, not to the institutions as much as to their customers, suppliers, employees and shareholders. You, your neighbour and your colleagues bear the real impact of disproportionate tax burdens.

There is a particular perversity to capital taxes - perverse in any economic sector, but absolutely ludicrous for financial institutions. As the MacKay report documents, federal and provincial capital taxes took nearly \$900 million dollars out of the capital base of financial institutions in 1996 alone. They increased the spreads on loans of every size, from credit cards to corporate loans and even commercial paper. They increased the cost of raising new capital. They make safety and soundness more expensive, and encourage institutions to have less of it. They essentially invite capital to leave Canada.

The Task Force report made a number of useful suggestions on getting out of that mess. They cover capital taxes - best eliminated entirely, but at the very least eliminating different rates, harmonizing the federal provincial tax base and investment allowances, eliminating

its operation at the margin and making it operate like a true, creditable minimum tax.

They dealt with transaction taxes, particularly on insurance - where both the level and the layering, in some instances tax on tax on tax - exacts a significant toll on that industry. And much more.

Both federal and provincial tax authorities should study all of these recommendations in detail and with care. In the meantime our industries must find ways of encouraging them to act.

Those examples - training and licensing serving a better informed, empowered consumer, national and unified regulation wherever possible, standards, and broad tax reform - are just the first three on a considerable list of challenges. They are primarily but not exclusively implementation issues. I raise them now, first because they have yet to receive much attention, but far more importantly because they are critical to achieving the MacKay vision.

Some of these challenges are for government alone. Some will need our support, political and procedural. Some will engage both sectors. And a final portion will require enhanced co-operation between and among all types of financial services providers.

And that latter challenge is something I am pursuing to discuss with our members and with

my opposite numbers in other associations representing the entire financial services sector. We need to find a way to work in a more cooperative fashion.

Because the ultimate effect of the MacKay recommendations - the full vision and effect of their recommendations - is to take us into an era where the issues and interests that preoccupy all financial services providers will be increasingly common.

Those issues are the core of the Task Force mandate, and the core of its report. Empowering consumers. Enhancing competition and competitiveness. Expanding our ability to meet Canadians' expectations on numerous aspects of corporate conduct. And improving the regulatory framework.

Each is important separately. Together, they provide a vital, cohesive and coherent vision of a future industry and its future contributions to all its stakeholders, including the most important: the country, its economy and its citizens.

Thank you.