

Canadian financial services

Quietly prospering





Ann Davis

Largely away from the gaze of international commentators, financial services in Canada remain in robust health, and in certain cases are positively booming. A number of factors are responsible, including a generally conservative culture of excessive risk-avoidance, strong regulation, and a welcoming business environment. **Ann Davis** explains.

Across the developed world, the financial crisis has seen banks collapsing, being bailed out by governments or being taken into public ownership. More than a trillion US dollars of value has been wiped out from bank balance sheets. However, many Canadian banks have proved much more resilient than those of any other major economy. Last November, Time magazine called Canada 'the new gold standard in banking'¹. The 2009 Global Competitiveness Report from the World Economic Forum ranked Canada No 1 for soundness of banks². By any measure, Canada's banking sector is one of the strongest – if not the strongest – in the world. How so?

Ten years ago, the Financial Times top-50 ranking of the world's biggest banks was dominated by US and UK banks. No Canadian banks made the list. Today, all of the 'Big 5' Canadian banks are now in the top 50⁵.

Canada's banking sector embraces:

21

domestic banks.

55

foreign-owned subsidiaries and branches.

47

Trust companies.

Five major banks dominate Canada's banking sector (see box), which in total embraces 21 domestic banks, 55 foreign-owned subsidiaries and branches and 47 Trust companies. The financial services sector as a whole has shown remarkably steady growth of about 3.5 percent per year over the last ten years, to reach a total turnover of C\$80 billion³. Over the same period, the 'Big 5' has collectively doubled their market capitalization⁴. Ten years ago, the Financial Times top-50 ranking of the world's biggest banks was dominated by US and UK banks. No Canadian banks made the list. Today, all of the 'Big 5' are now in the top 50⁵. Royal Bank of Canada and Toronto-Dominion are among only seven global financial institutions to hold a triple-A credit rating from Moody's.

Regulation is part of the reason for the solid success of Canadian banking. Cultural attitudes are also crucial. In both of these respects, Canada has maintained a distinctive tradition, the roots of which extend deep into the early half of the last century. That regulatory framework, coupled with a conservative attitude to risk-taking, has helped to ensure a consistently prudent approach and a greater degree of openness and transparency than in many other systems.

Another key feature is that mergers and acquisitions in the banking sector are constrained among the 'Big 5', which has limited the size of individual banks and avoided concentration of risk. Government policy encourages the establishment of new banks to promote competition. Large banks – those with

more than C\$5 billion equity – must remain 'widely held'. Bank mergers have been proposed as a route to greater international competitiveness, but have been vetoed at the political level. Limits on foreign ownership have been imposed and mergers between banks and insurance companies are not allowed. A further significant factor is that during the 1980s, the big banks bought most of the large independent investment dealers, thereby integrating them into the more prudential banking structure.

These strengths have been consistently recognized by the International Monetary Fund. In its regular Financial System Stability Assessment in 2008, the IMF concluded⁶:

- The Canadian financial sector is among the world's most highly developed
- The five large banking groups that form the core of the system are conservatively managed and highly profitable
- Stress tests suggest that the large Canadian banks are able to withstand a broad range of shocks

Of course Canada's banks have not been unaffected by the global crisis. Nevertheless, none have collapsed, none have needed government bailout and there has been no need for injections of government capital. There may have been an air of confidence in the comments by the governor of the Bank of Canada, Mark Carney, when he claimed in April 2009 that

**Canada's 'Big 5' Banks⁹
Market Capitalization (Q3 2008)**

Royal Bank of
Canada:

C\$45 billion

Toronto-Dominion:

C\$37 billion

Bank of Nova Scotia:

C\$30 billion

Bank of Montreal:

C\$17 billion

Canadian Imperial
Bank of Commerce:

C\$18 billion



'Our system is better'⁷. But who is to deny that it certainly seems to be?

Complacency would obviously be a mistake. Although the Canadian financial system has weathered the storm better than other global financial institutions, the future remains unclear. Increased regulation will surely impact on all Canadian financial institutions, and Canadian banks will still need to work hard at remaining globally competitive. But it has shown itself to be an inherently stable system.

Beyond this, Canada has shown that it's a great place to do business for the wider financial services community. Toronto, in particular, has proved itself to be a natural magnet for financial services. Over 200,000 people are employed in the financial services sector in Toronto, including around

10,000 chartered accountants⁸. The city boasts the second largest CFA (chartered financial analyst) society in the world after New York. Toronto is also more affordable than many other major financial centers. All these factors have driven one of Canada's most notable but little-appreciated, success stories: the growth of hedge fund administration in Toronto.

Canada's domestic hedge fund market is comparatively small – perhaps C\$20-30 billion of assets under management. But the great untold story in the Canadian hedge fund sector is the movement of global hedge fund administrators to Toronto and other parts of Canada. There is likely well over a quarter of a trillion dollars of global hedge fund assets being administered in Canada. Toronto has always had a large domestic fund administration industry. But since the mid-1990s, hedge fund administrators such as Citco, Butterfield Fulcrum Group and SS&C Fund Services have been setting up offices in Toronto, Halifax and other parts of Canada, and existing traditional fund administrators such as State Street, Citibank and RBC Dexia have been expanding their services to hedge fund clients.

Seven of the top 10 global hedge fund administrators now have offices in Toronto likely employing several thousand hedge fund administrators.

Toronto offers solutions to many of the issues facing administrators, through the key competitive attributes of quality and cost. Toronto has an excellent telecommunications infrastructure, the most fiber optic cable of any city in North America, the largest public transport system in North America after New York, and the fourth busiest airport in North America. It is only the 54th most expensive city globally, and Canada as a whole was ranked the most economical of the G7 nations by Competitive Alternatives, 2008 edition.

Strong stable banks, a steadily-growing financial services sector and a growing presence in niches such as fund administration – it is time for the rest of the developed world to take a closer look at the Canadian system.

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2. *The Global Competitiveness Report 2008-2009*, World Economic Forum.

3. *Banking and Financial Services: Prudence equals strength*, Halcyon Business Publications, March 2009.

4. 'Canadian Banks: A better system', Financial Post, April 2009.

5. Financial Times, March 23, 2009. www.ft.com.

6. *Canada: Financial System Stability Assessment – Update*, IMF, January 2008.

7. Remarks to the University of Alberta School of Business Edmonton, Alberta, March 30, 2009.

8. *Hedge Fund Administration in Toronto*, KPMG in Canada, December 2008.

9. Office of the Superintendent of Financial Institutions, 2009.