Written Submission for the Pre-Budget Consultations in Advance of the 2021 Federal Budget

Vanguard Investments Canada Inc.

August 2020

LIST OF RECOMMENDATIONS

Recommendation 1: That the Government of Canada invest in financial literacy efforts and work to ensure that a greater level of transparency is provided in all financial sector transactions.

Recommendation 2: That the Government of Canada support the Cooperative Capital Markets Regulatory System and introduce and pass the Capital Markets Stability Act.

INTRODUCTION

The Vanguard Group, Inc. is one of the world's largest investment management companies. It was founded in Pennsylvania in 1975 on a simple but revolutionary idea – that an investment company should manage the funds it offers in the sole interest of its clients.

Vanguard's core purpose is to take a stand for all investors, to treat them fairly, and to give them the best chance for investment success.

Vanguard established Canadian operations in Toronto in 2011. In Canada, Vanguard is the third largest exchange-traded fund (ETF) provider.

The COVID-19 pandemic is impacting economies and markets globally. This submission provides Vanguard's perspective on the global economic recovery, largely taken from the 'Vanguard Canadian Quarterly Overview & Outlook: July, 2020'. The paper also makes two specific recommendations that we feel are warranted to ensure a successful recovery.

GLOBAL ECONOMIC RECOVERY

Overview

Vanguard has been studying the global impact of the COVID-19 pandemic, including an analysis of the pandemic's economic impacts and the measures governments have introduced to support the economic recovery. While this section does not include specific recommendations from Vanguard, we thought it important to share as the Committee contemplates the economic impact of the pandemic.

The global COVID-19 pandemic and associated lockdowns have caused the sharpest and deepest short-term economic contraction in modern history. Even as countries in Asia and Europe brought the number of coronavirus cases under control in early July, the case count continued to grow globally, fuelled by increased outbreaks in emerging economies and parts of the U.S. The twin crises of health and economics are far from over.

Vanguard estimates an unprecedented peak-to-trough drop in global GDP, compared with pre-virus levels, of about 9%. Comparable collapses in economic activity are difficult to find outside wartime. In particular:

- The 2008/2009 global financial crisis saw global GDP fall by 6.0% peak to trough[1];
- The Great Depression of the 1930s saw global GDP fall by 12.1% peak to trough[2];
- The global recession that followed the oil price shock of 1973 saw global GDP fall by 1.8% peak to trough[3].

Vanguard expects a moderate recovery in the global economy in the second half of 2020, as supply gradually comes back online after interruptions owing to COVID-19 containment efforts.

[1] The Impact of the Great Recession on Emerging Markets, Llaudes, Salman, and Chivakul, 2010

[2] Rates of World Economic Growth, Maddison, 1991

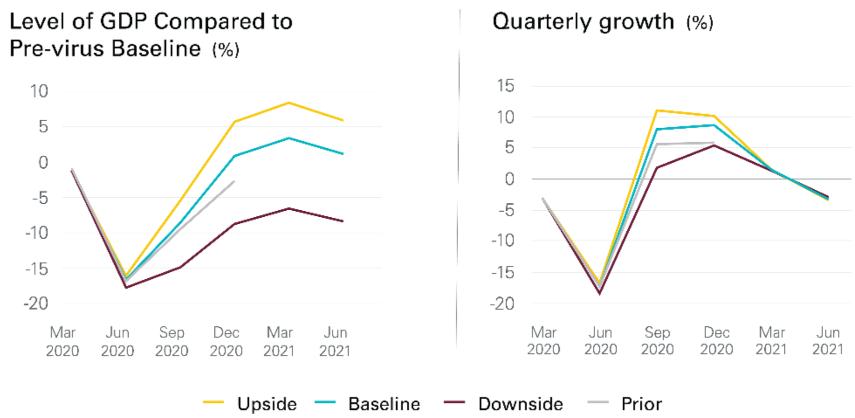
[3] Maddison, 1991

But we expect economies to lag behind pre-virus trends as shocks to incomes and contagion fears limit demand.

Canada

Growth & Output

As a result of the pandemic-induced sharp decline in global demand for oil, virus-induced lockdowns, and a sharp increase in unemployment, Vanguard expects Canadian GDP to fall significantly compared to our expectation of 1.8% growth from the beginning of the year. We now anticipate GDP to fall between 5% and 6% in 2020, based on our probabilistic scenario analysis. We anticipate three scenarios: Baseline, Upside, and Downside (see tables below).



	Pre-COVID	Upside	Baseline	Downside
Probability	0%	40%	50%	10%
Real GDP	1%-1.5%	-1% to -3%	-5% to -6%	-9% to -11%
Monetary Policy	1.5% One cut	0.25% $100 bn in QE	0.25% ~$400 bn in QE	0.25% ~$500 bn in QE
Unemployment rate	~5.5%	6% to 8%	8% to 10%	>12%
Inflation	1.5% to 2.5%	~1%	~.5%	<0%

Expansion of fiscal support, notably the Canada Emergency Response Benefit, has been a major driver in limiting the severity of the slowdown and a key reason for our upwards revision (along with higher commodity prices). Fiscal support seems adequate to avoid a large default cycle among highly-levered Canadian households, though this remains a key risk.

Unemployment

Canada reported back-to-back stronger-than-expected job gains in May and June, adding over 1.1 million jobs in the last two months of the quarter, as opposed to survey forecasts of 200,000 job losses. Those numbers highlight the potential for a swift job market recovery, as the country demonstrated relative success in containing COVID-19. Challenges remain, particularly as the number of new virus cases in the United States (U.S.) continues to rise, accentuating the risks of reopening the economy, and indirect impacts of the virus on economic confidence may persist for a protracted period. The June unemployment rate is still in the double digits – at 12.3% - which is slightly higher than expected. Vanguard expects increasing job gains in the coming months, with an uneven recovery and considerable data revisions.

Interest Rates: Monetary Policy and Asset Purchases

We believe that Canadian interest rates will be under pressure and remain low across both the short and the long end of the curve, due to unprecedented monetary easing (impacting the short end of the curve) and the BOC's asset purchases (affecting the medium to long term interest rates).

United States

In the U.S., we expect output to fall in the second quarter of 2020 before staging a slow and gradual recovery. We expect the recession to be short-lived (in fact, the shortest ever), with recovery likely starting in Q3. And there are already signs – including stronger-than-expected May and June jobs reports and the retail and food services report showing that sales rose 17.7% in May and 7.5% in June – that economic activity is picking up. U.S. GDP is not expected to get back to its pre-virus level until the end of 2021, and it likely will be well beyond then before the output gap is closed.

Vanguard's outlook for 2020 includes a U.S. economic contraction in the range of –7% to – 9% and, as per our estimates, U.S. GDP contracted in the second quarter by as much as –30% to –40%. But we foresee positive growth rates starting in Q3 2020 and growth potentially reaching double digits in the second half of the year. We also recognize that significant risks to the economy remain.

The wildcard for the U.S. is the pending Presidential election campaign in November of this year. Polls are currently volatile and the outcome is by no means clear. The Presidential election and the policy direction of the U.S. Federal Reserve are two important inputs into U.S. monetary policy and even if there was a clear election outcome, the impact of that on the economy remains to be seen.

We foresee global growth falling by about –3% in 2020, the largest economic contraction ever recorded outside wartime. With that view, Vanguard is more bullish on the global economy than the International Monetary Fund, after the latter's most recent economic outlook, though we're less optimistic than much of the industry.

Only in China do we expect the recovery to be relatively fast and V-shaped, with an expected second-quarter rebound in GDP in the high single digits compared with a quarter-on-quarter contraction of –9.8% in the first quarter.

TRANSPARENCY

Financial literacy

The pandemic has accelerated the move by many financial sector participants to FINTECH solutions, which directly impacts consumers of financial services – including those using personal finance and investment products. That trend, along with the broader economic impact of the pandemic, has increased the need to improve the financial literacy of Canadians of all ages.

Vanguard has a long history of supporting and leading financial literacy efforts in the U.S. and globally. In the U.S., Vanguard has developed and sponsored the program 'My Classroom Economy', which has the same overall objectives for all grades – to instill basic financial responsibility and teach the value of delayed gratification. We believe that the need to improve financial literacy and understanding of how financial systems work – and the costs associated with them – has never been more important.

Investment fees

Vanguard believes that the mutual fund market operates in the best interests of investors when product providers operate in a transparent manner and compete on the price and quality of their products for distribution, without undue influence or the perception of undue influence by the payment of embedded commissions.

Embedded commissions, and the lack of understanding of them by many investors, can give rise to potential conflicts of interest that misalign the interests of investment fund managers and intermediaries with those of the investors that they serve.

It is essential for all governments in Canada to undertake efforts to enhance fee transparency, whereby all investors would be provided clear, concise language related to the products that they are investing in. Such measures would increase investor awareness and the overall financial literacy of the investing public.

Effective cost reporting and disclosure plays a critical role in providing investors with the necessary awareness and understanding in order for them to confidently make investment decisions that are aligned with their investment goals. It is critical that investors understand the investment fees that they pay, the services that they receive in return, and - crucially - the impact of those fees on net returns.

Recommendation 1: That the Government of Canada invest in financial literacy efforts and work to ensure that a greater level of transparency is provided in all financial sector transactions.

COOPERATIVE CAPITAL MARKETS REGULATORY SYSTEM

The Cooperative Capital Markets Regulatory System is intended to consolidate participating provincial and territorial securities regulators to better assess and minimize systemic risk in capital markets and to improve regulatory enforcement.

The investment funds industry is currently regulated by all 13 of Canada's securities regulators, which work together, through the Canadian Securities Administrators (CSA), creating a passport system – a harmonized set of regulations, policies, and practices that streamline the regulatory process. As a result, the investment funds industry currently enjoys many of the benefits that a cooperative system would bring.

The impact of the COVID-19 pandemic on investment services and the investment funds industry has only increased the need for continued harmonization in capital markets and for regulatory enforcement across Canada.

Vanguard supports a Cooperative Capital Markets Regulatory System, but feels that any new system, while needed, must also ensure the following:

- Knowledgeable staff in a fund-dedicated unit;
- A commitment to meaningful consultation with industry participants;
- A seamless interface and minimal disruption between jurisdictions during the implementation phase and thereafter with non-participating jurisdictions;
- Protection of the existing passport system, in order to work with non-participating jurisdictions;
- Reduction of the current regulatory burden and no unintentional increase of regulatory burden;
- That the system does not become a costly additional regulatory layer; and
- That any systemic risk that authorities ultimately adopt by the system are appropriately defined and that neither individual regulated funds nor their managers are designated as a systemic risk concern.

There is support from the federal government and most of the provincial governments to implement the Cooperative Capital Markets Regulatory System, inclusive of:

1. A single operationally-independent capital markets regulatory authority (CMRA); and
2. The introduction of a federal Capital Markets Stability Act and corresponding provincial legislation to install the Cooperative Capital Markets Regulatory System in each participating province.

The federal government, while supportive, has not made passage of the Capital Markets Stability Act a priority, which would be a crucial component of the Cooperative Capital Markets Regulatory System.

In light of the increased demands placed on the investment funds industry by the COVID-19 pandemic, it remains important to move forward with the Cooperative Capital Markets Regulatory System and for the federal government to introduce and pass the Capital Markets Stability Act.

Recommendation 2: That the Government of Canada support the Cooperative Capital Markets Regulatory System and introduce and pass the Capital Markets Stability Act.