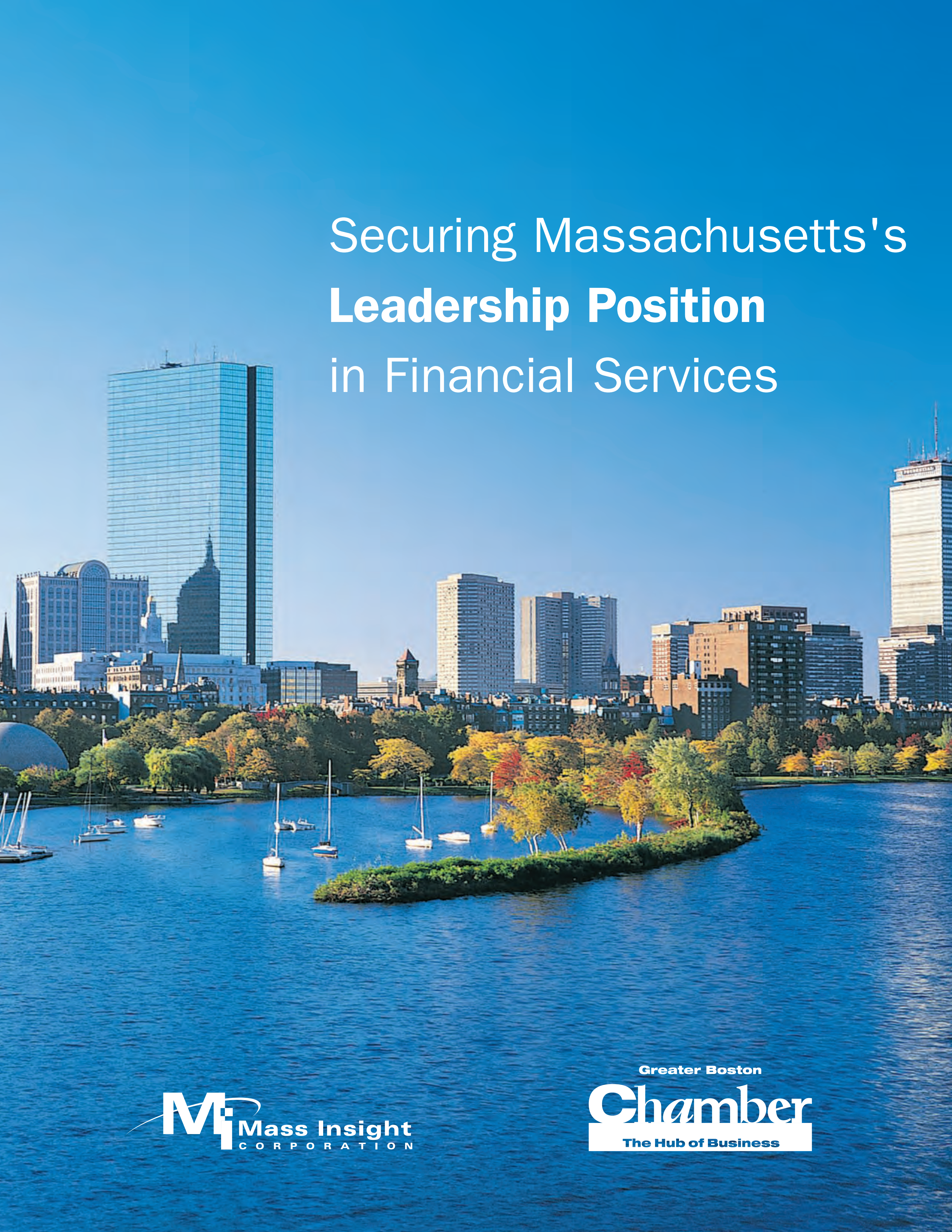
Securing Massachusetts's **Leadership Position** in Financial Services



Mass Insight Corporation

Greater Boston Chamber
The Hub of Business

The Greater Boston Chamber of Commerce is a broad-based association representing more than 1,700 businesses of all sizes from virtually every industry and profession in our region. The Chamber provides leadership in creating a healthy climate for economic development and job creation. It aspires to be a Chamber of Community as well as a Chamber of Commerce. The Chamber is deeply committed to promoting diversity in every aspect of its work, and throughout the business, government, and civic life of our community. It is an important resource to its members for advocacy, information, and marketing exposure that enhances their business success. And most importantly, the Chamber adds value to the community at large by working for legislative changes that are critical to economic growth.

Mass Insight Corporation is a research and consulting firm that seeks to keep Massachusetts and its businesses and institutions globally competitive. The firm focuses on talent and innovation-based economic development and builds strategic alliances between higher education, industry, and government, both regionally and globally. Mass Insight organizes collaborative leadership initiatives and uses communications, publications, policy research, and public opinion surveys to shape public-private actions and develop innovation partnerships.

Global Massachusetts 2015 is a two-year initiative organized by Mass Insight that brings together major business groups, industry, and higher education leaders to develop and advance a comprehensive economic agenda that will position Massachusetts to win the competition for talent – the key to securing the future prosperity for all our citizens. This report is the first in a series of connected industry sector reports to be released this year; others in the series will include Life Sciences, IT/Communications, and Defense.

The Chamber of Commerce and Mass Insight wish to thank McKinsey & Company for its pro bono assistance with this report. McKinsey & Company is a global management consulting firm that serves as trusted advisors to the world's leading businesses, governments, and other institutions. The McKinsey team played a lead role in interviewing business leaders, politicians, and members of the academic community, surveying a broad range of industry decision-makers, and conducting independent analyses to better understand the potential opportunities and challenges facing the financial services sector. Its subject matter knowledge and commitment to the project were invaluable.

Executive Summary

Massachusetts's financial services economy is at a critical inflection point. Local, regional, and global forces threaten to relegate Massachusetts to second-tier status in financial services, even in the sub-sectors where the state has traditionally excelled: asset management, asset servicing, and insurance. Though the sector is growing rapidly worldwide, Massachusetts's position as a global leader in it is far from certain. The industry – long a pillar of the state economy, employing 180,000 people and generating $38.5 billion in Gross State Product – faces the challenge of reinventing itself at a time when pressure from national and global competitors is more intense than ever before.

In many ways, the challenges in the financial services sector reflect those confronting the Massachusetts economy as a whole. Consolidation has eroded the state's position as a corporate headquarters for leading companies – only nine Fortune 500 companies are based in Massachusetts today, compared to 17 a decade ago. Many of the largest remaining companies are adding middle-income jobs in other states, such as New Hampshire, Rhode Island, and North Carolina, where the costs of living and doing business are considerably lower and executives find it easier to get things done. And while economic growth in financial services has been robust over the last several years, nearly all of those gains have come from advances in productivity rather than employment. Productivity growth is critical to maintaining a nimble, innovative financial services sector, but without enhancement of the job base across the economic spectrum, growth becomes increasingly dependent on a few, highly mobile individuals.

Recent actions by public and private sector leaders herald some changes in the way companies can do business in the Commonwealth. Successes by the Office of Economic Development and the newly formed Business Resource Team in creating a more attractive business environment – through improved business outreach and expedited permitting, among other efforts – have started to yield results. New state leadership has taken important steps to forge relationships with top executives of the Commonwealth's leading employers. And the John LaWare Leadership Forum is helping to drive increased collaboration within and among the public, private, and nonprofit sectors. While more work is required to make Massachusetts as business-friendly as competing states, the trajectory is positive.

Yet the financial services sector faces a variety of powerful market and competitive forces that are creating major changes in industry structure and redefining the demands of leadership. An aging population needs a new set of products that can help them sustain longer lives than were contemplated

A Vision for 2015:

Become a globally recognized, top-tier financial services center known for the top talent, the greatest innovation, and the best firms in asset management, asset servicing, and insurance

- A recognized global hub of innovation and thought leadership, built on a foundation of world-class universities, leading edge firms, and industry-shaping technological leadership
- A top five destination city and state worldwide for the best talent in asset management, asset servicing, and insurance
- A "must have" location for U.S. and foreign industry leaders in our targeted industry sectors
- A truly collaborative and interactive "cluster" of financial services players, including large and small companies, universities, professional service firms, and governmental institutions
- A top three sector for the Massachusetts economy as measured by total employment, economic output, and corporate leadership
- A great place for individuals to live and companies to do business

by public or private retirement schemes. A virtual revolution in technology and communications has turned companies like Fidelity and State Street into information companies first and foremost; in many ways, these institutions have more in common today with IBM than with the asset managers or asset servicers of a few decades ago. Globalization of markets is gaining momentum, as the world's financial stock and its population of skilled workers grow much more rapidly in Asia than in the U.S. In this challenging context, focused, concerted action by leading financial services companies, the public sector, and academia will be necessary to secure a permanent role for Massachusetts as a globally recognized, top-tier financial services hub.

As a first step, Massachusetts's top financial institutions should take the lead in uniting the private and public sectors around a clear, common vision for financial services in Massachusetts in 2015 (sidebar). Looking ahead, the financial services industry in Massachusetts can be a destination of choice for top talent, a welcoming and supportive home for the most innovative firms of all sizes, and an attractive place to do business for the Commonwealth's largest employers.

Pursuing and achieving this vision will have tangible benefits for financial services businesses operating in Massachusetts. Incumbent leaders will be able to grow faster and strengthen their competitive positioning by leveraging new sources of innovation, more high-quality talent, and heightened productivity. Financial services companies headquartered in other states and countries (and even many companies that don't yet exist) will look to Massachusetts as a "must have" location for accessing skilled talent and developing distinctive capabilities.

Strengthening the financial services sector is also good for the broader Massachusetts economy. By taking action now, as this report suggests, the sector has the potential to grow at the same rate as in other leading states. If it does so, it could add nearly 15,000 jobs by 2010 (relative to current projections of only 3,000 new jobs) and $12 billion in incremental economic output. These twin accomplishments would stand in stark contrast to recent trends of anemic or even declining employment and output, and would make a meaningful contribution to the Commonwealth's overall growth.

Massachusetts has all the ingredients for success: legendary educational institutions, an unparalleled talent base, a tradition of innovation, and a concentration of leading financial services companies. The Commonwealth has also shown an ability to reinvent itself in the face of fundamental changes to the underlying economy, most recently in the transition from a manufacturing base to an information economy. Our research – including more than 30 interviews with CEOs, politicians, and academic leaders, surveys of 70 other industry decision-makers, and a broad range of proprietary analyses – reveals that the key to success is coordinated, focused leadership. This report offers an assessment of the challenges and opportunities facing the financial services sector, as well as a roadmap for moving forward.

Specifically, this report proposes that leaders from the public sector, the private sector, and academia should work together to drive three important initiatives:

Initiative 1: Preserve and expand a diverse employment base.

The critical middle-income workforce in financial services faces slowing or even declining job growth, driven in part by a mismatch between skills and job requirements at many leading firms. These jobs are the foundation of a strong and vibrant economy, and must be an important priority in any economic development plan. The 15,000 jobs the Commonwealth could potentially add are high-quality – approximately one-third of Massachusetts's financial services jobs pay between $50,000 and $100,000 annually, and the average income is an estimated $95,000. By comparison, the average salary in Massachusetts across all jobs is about $50,000.[1] Preserving and expanding the state's diverse employment base will enable Massachusetts companies to compete more effectively without shifting jobs out-of-state, and will enhance average incomes across the state.

This initiative will require three specific steps:

A. Unite academic institution and industry efforts to strengthen the community and state college system, and increase the public and private higher education system's financial services focus. Link academic programs to the broader financial services economic development agenda, including emphasis on math, science, and other quantitative disciplines.

B. Expand state government-led outreach to leading Massachusetts employers, while launching a coordinated state, local, and private sector effort to attract the most innovative financial services firms. Recognizing Massachusetts's strengths in asset management (including private equity, hedge funds, and venture capital), asset servicing, and insurance, use outreach efforts to retain and grow the employment base in these important sub-sectors.

C. Adopt a state-wide strategy to enhance cost-competitiveness in targeted non-Boston locations and secure the Commonwealth's most important employers. Combine targeted tax incentives with upgrades to transportation, power, and communications infrastructure to make these locations competitive with other states.

Initiative 2: Become a global center for talent and innovation.

Massachusetts is home to a critical mass of financial services activities in asset management, asset servicing, and insurance, and an unparalleled natural talent base, thanks in part to its universities. The financial services industry has not yet fully exploited its natural advantages, allowing cities like New York, Greenwich, and London to take the lead in recent years in asset- and risk-related product innovation and new firm creation.

Financial services firms and companies and government leaders can band together across the Commonwealth to build stronger relationships with universities and foster an environment that encourages creativity and risk-taking. The stakes for being innovative are high. If, for example, Massachusetts had won the right to manage the same share of hedge funds as in mutual funds over the last several years, local firms would have $50 billion more in assets under management, generating approximately $1.1 billion more in annual output. This would have translated to a roughly 3.5 percent boost to financial services Gross State Product.

To drive this initiative, business and government should:

A. Create formal industry linkages with leading Boston universities to build a financial services-specific research center, with applied programs in advanced quantitative topics and jointly sponsored employment and internship programs with innovative leading companies. These linkages would build on an already-strong base of private-sector firms to reinforce the financial services "cluster" that the state already has. It would also serve as an effective tool for recruiting the best students locally, nationally, and globally.

Initiative 3: Make Massachusetts a more stable and competitive place to do business across sectors.

Many financial services executives still perceive Massachusetts to be a high-tax business environment. Some are also unsure about which rules will be enforced and with what consequences to their business prospects. Until industry executives see Massachusetts as a much more business-friendly environment, the Commonwealth will continue to wrestle with the loss of jobs, divisions, and even companies in financial services and other sectors; it will also struggle to attract new companies and jobs. States that have been particularly successful on this front have reaped significant rewards. North Carolina, for example, credits its business climate in part with its ability to recruit more than 160,000 jobs and $26 billion in investment since 2001 across all sectors – jobs and investment that have come at the expense of other states, including Massachusetts.

This suggests a three-part agenda for government leaders to pursue:

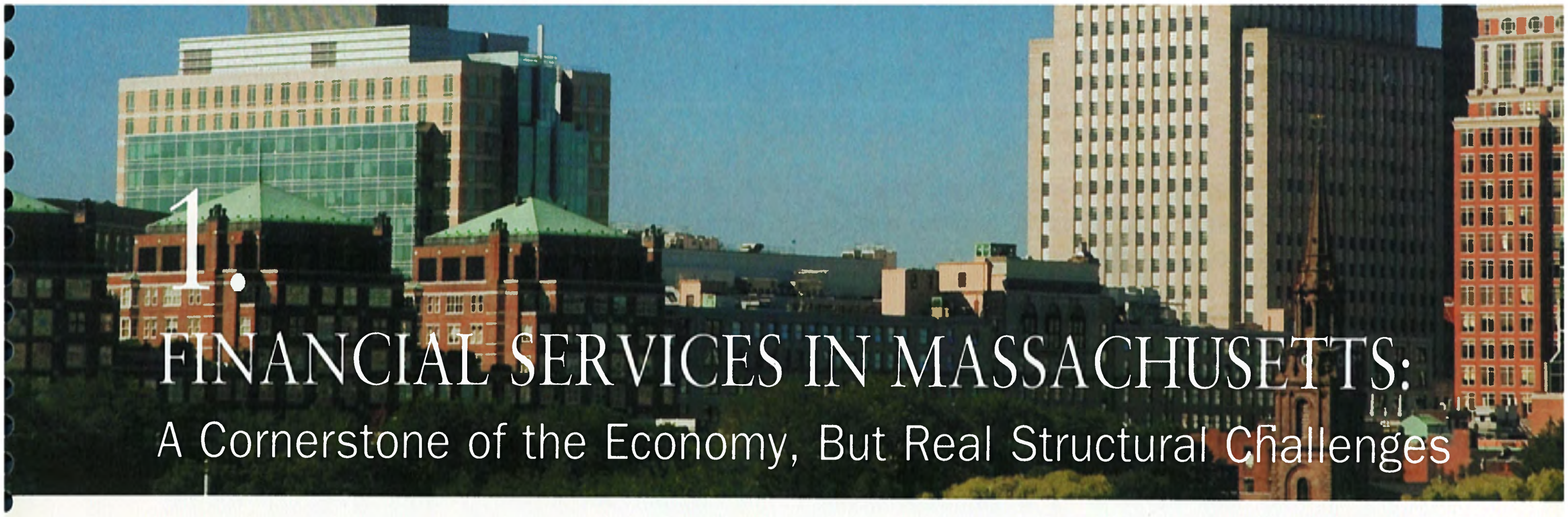
A. Retool state and local permitting to expedite commercial development. Create new state incentives for localities that designate expedited permitting zones. In addition, introduce a "shovel-ready" designation and identify and promote sites that companies could acquire and develop immediately.

B. Modify Commonwealth financial services regulatory structure, body of rules, rule-making process, and enforcement approach as necessary to create a more predictable environment for companies. Support efforts to promote a more streamlined federal regulatory regime.

C. Promote a more predictable tax environment while addressing structural issues underlying low-revenue, high-pain taxes to make them more consistent with approaches used in other states.

* * *

Massachusetts has all of the elements required to be a globally recognized, top-tier financial services hub by 2015. It ought to be known for top talent, the greatest innovation, and the best firms and companies in asset management, asset servicing and insurance. But long-term success will require a new level of focus, effort, and collaboration. Financial services companies and their leaders need to share responsibility for the agenda and for the Commonwealth's success. Similarly, the public and academic sectors need to understand the highly competitive global context in which its financial services employers are operating and take actions to help them win. Massachusetts has reinvented itself before; with the right joint effort, it can do so again.



1. FINANCIAL SERVICES IN MASSACHUSETTS:

A Cornerstone of the Economy, But Real Structural Challenges

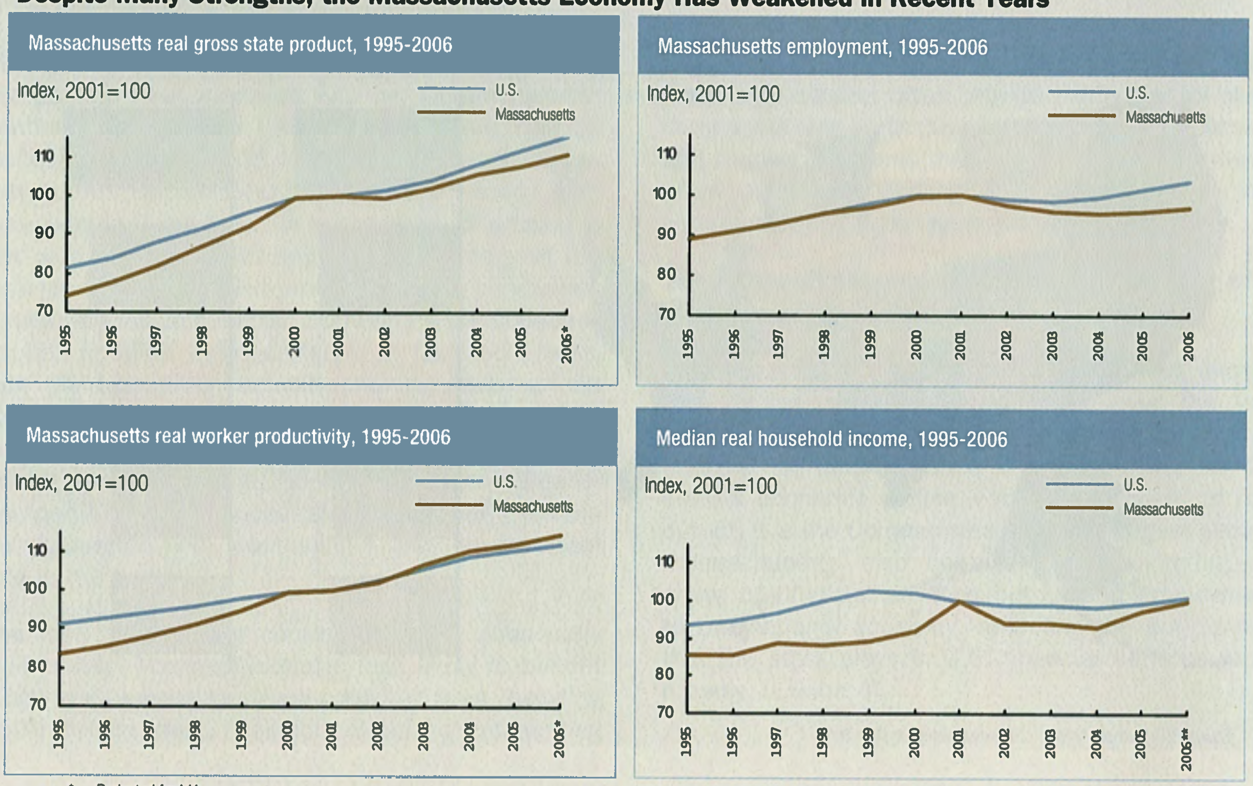
The past five years have generally been challenging for the Massachusetts economy. The 2000-2001 downturn hurt the Commonwealth disproportionately, and though Massachusetts has recovered in some respects, weaker long-term fundamentals remain an issue. Financial services, one of its largest and most important sectors, is emblematic of challenges Massachusetts faces; its revenue recovery lacks both employment momentum and corporate leadership.

The Massachusetts economy – a declining ability to shape our own future

Over the past decade, Massachusetts has been a tale of two economies. By the mid-1990s, the Commonwealth had successfully pivoted from a manufacturing-based economy to one built around biotechnology, health care, high technology, and financial services. Between 1995 and 2001, productivity and real median household income both grew at double the national average. Total employment grew by 2 percent annually, keeping pace with a broadly expanding national economy (Exhibit 1).

EXHIBIT 1

Despite Many Strengths, the Massachusetts Economy Has Weakened in Recent Years



* Projected for MA

** Projected for US and MA

Source: U.S. Bureau of Economic Analysis; CES, QCEW; Economy.com

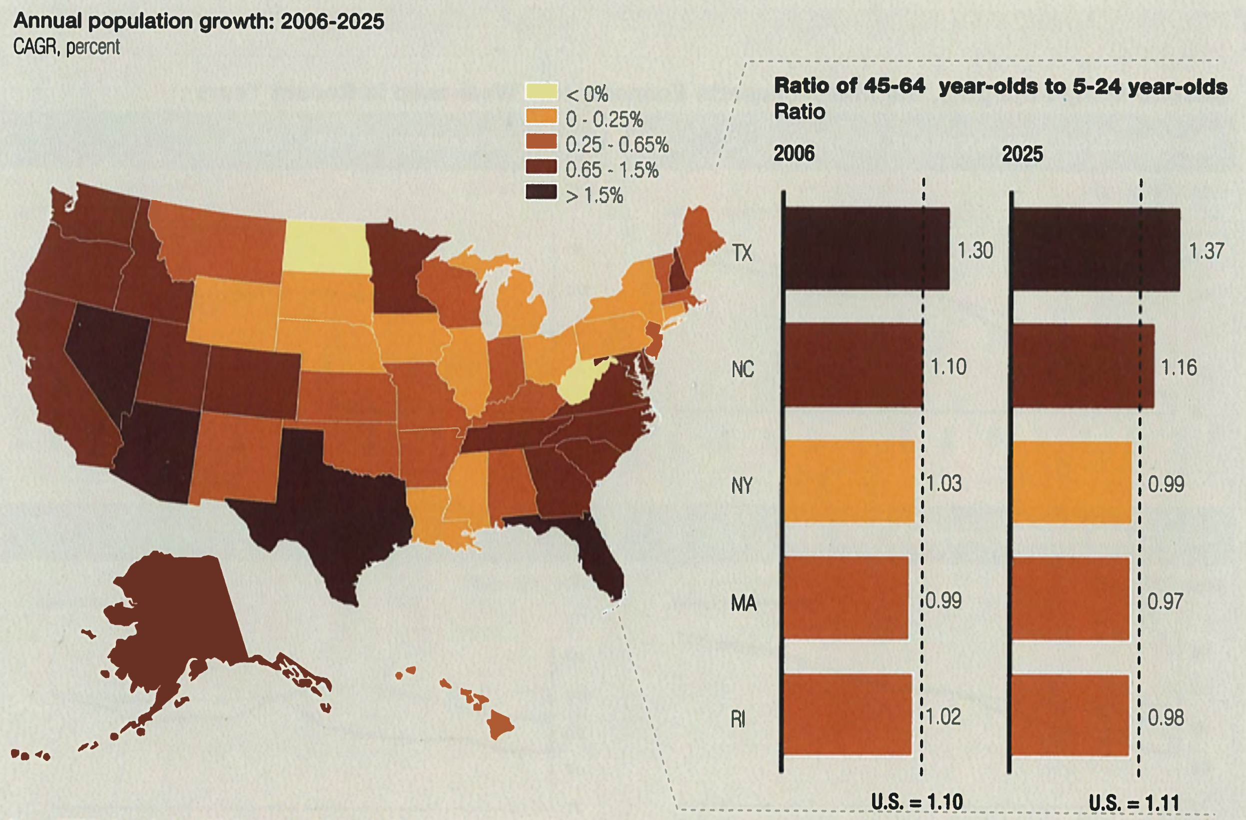
Following the technology collapse, Massachusetts paid a commensurately higher price than the rest of the country for its concentration in these relatively volatile sectors. Massachusetts employment fell by over 140,000 over the next two years, a job loss rate three times the national average. At the same time, real Gross State Product (GSP) grew by only 1.1 percent per year, compared with 2.1 percent for the U.S. economy as a whole. While growth in GSP has been relatively strong since 2003, expanding largely in step with national GDP, other economic variables have failed to keep pace. In the past 5 years, the Commonwealth's employment has failed to reach 2001 levels despite national gains, median income has been flat, and the size of the population has stagnated, even dropping into negative territory in 2004.

This represents a relatively "empty recovery" for the economy as a whole. Growth in Massachusetts employment and output continues to lag the nation overall. And there are troubling signs that the gap is widening between Massachusetts's middle- and higher-income workers. Broad, balanced growth in jobs and steady improvement in average household income are essential ingredients for a strong, dynamic economy. Without this kind of growth, it is difficult to attract and retain the talent that is essential to corporate expansion and industry leadership.

This is particularly critical because of the Commonwealth's demographic challenges: expected trends will put it at a competitive disadvantage relative to other, "younger" states. Massachusetts will likely experience only minimal population growth over the next two decades. Perhaps more troubling, the number of high school graduates in the Commonwealth will consistently decline over the coming decade. While these trends are not unique – other "mature" states like New York and Pennsylvania have similar patterns – they do pose significant challenges to Massachusetts's growth in the coming years (Exhibit 2).

EXHIBIT 2

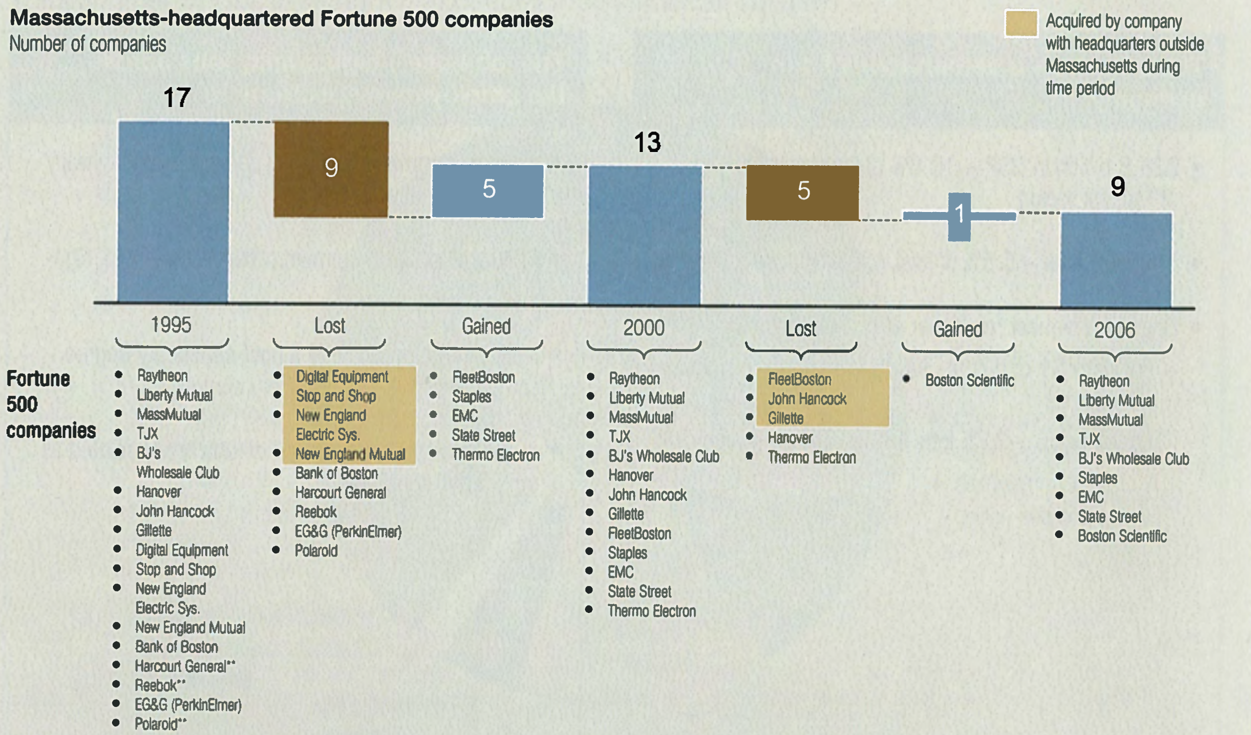
Population in the Northeastern U.S. Is Slow-Growing and Aging



Source:ESRI Business Analyst; U.S. Census population projections

EXHIBIT 3

The Overall Massachusetts Economy Has Experienced a Loss of Corporate Control Among Its Largest Companies



** Acquired after 2000

Source: SNL Interactive

Perhaps related to this demographic stagnation, companies headquartered in the Commonwealth continue to lose the battle for corporate control. Between 1995 and 2006, for example, Massachusetts lost half its Fortune 500 headquarters – today, only nine remain (Exhibit 3). In some ways, this trend is not particularly troublesome. After all, many of the jobs and functions performed by those companies remain in Massachusetts. Sometimes the economic capital remains headquartered in Massachusetts, with the acquisition actually creating new markets for "local" products (as is the case in Manulife's acquisition of John Hancock). Meanwhile, large private companies (e.g., Fidelity, Wellington), smaller companies, and successful boutiques remain headquartered here, continuing to play an important role in the sector.

The loss of corporate control, however, does carry real costs. Massachusetts is less likely to benefit from the corporate leadership – from heading philanthropic efforts to senior executives representing the community to external constituencies – that local large players often provide. The loss of large companies also hurts the talent base: the recruitment and training programs that larger companies provide often disappear, making it more difficult for the community to keep its best entry-level talent.

The financial services economy – a key part of Massachusetts's future

In many ways, the story of financial services mirrors that of the economy as a whole over the last decade. This should not be surprising given that financial services is such a critical driver of the state's economic engine – at 10.8 percent of real output, it is the Commonwealth's third-largest sector. Massachusetts also contributes the ninth-highest share of financial services output and employment to the national economy, reflecting the critical role that the state plays in U.S. financial services more broadly (Exhibit 4).

EXHIBIT 4

Financial Services Is a Critical Component of the Massachusetts Economy

The industry – a cornerstone of our economy	The job base – high quality jobs across the employment spectrum
• $38.5 billion in GSP – 10.8% of the state's total output (3rd largest sector) • 180,000 jobs – 5.5% of total state employment • One of the highest "multiplier effect" of any sector – For every $1 of output, $2.25 in total spending across all industries – For every job, ~2.75 jobs throughout the economy	• Average income of $95,000 per year, which is nearly double the statewide average • 85% are non-management occupations – solid, high-quality jobs • 65% of employees have a post-secondary degree, compared with 47% in all other industries • An increasingly large portion of jobs are IT-related as the industry transforms

Source: U.S. Bureau of Economic Analysis; Economy.com; Department of Workforce Development MA Industry Staffing Patterns; Current Population Survey, 2006; RIMS II Multipliers

It is troubling that the sector has failed to keep pace with national growth, losing share of total U.S. financial services output and employment. Indeed, real growth in the sector between 2004 and 2006 averaged less than 1 percent per year in the state compared to over 3.5 percent for the U.S. as a whole. The overall impact of this on the broader economy is dramatic. Each additional job in the securities, commodities, investments, and insurance industries generates approximately three jobs across all industries in Massachusetts. And for every million dollars of output delivered by these industries, approximately 14-17 jobs are created. A map of the landscape of firms directly and indirectly touched by financial services illustrates the reach and depth of the sector and its role in driving growth and creating jobs (Exhibit 5).

Like the economy overall, the financial services sector has also faced important recent challenges related to corporate control. Bank of America's acquisition of Fleet altered the Commonwealth's banking landscape, while Manulife's acquisition of John Hancock signaled the increasingly global nature of the insurance business. The most recent wave of Massachusetts-related mergers and acquisitions has yet to play out. The Bank of New York and Mellon have stated that three business units will be headed or co-headed by Mellon executives currently based in Boston; and Power Financial has stated that Putnam will remain headquartered in Boston and retain its brand following its acquisition. Fortunately, growth of small asset management boutiques and alternative asset managers has accompanied this gradual consolidation among Massachusetts's larger financial institutions. While these firms may lack high-profile name recognition, they are a major force in the industry and central to the Commonwealth's economic well-being.

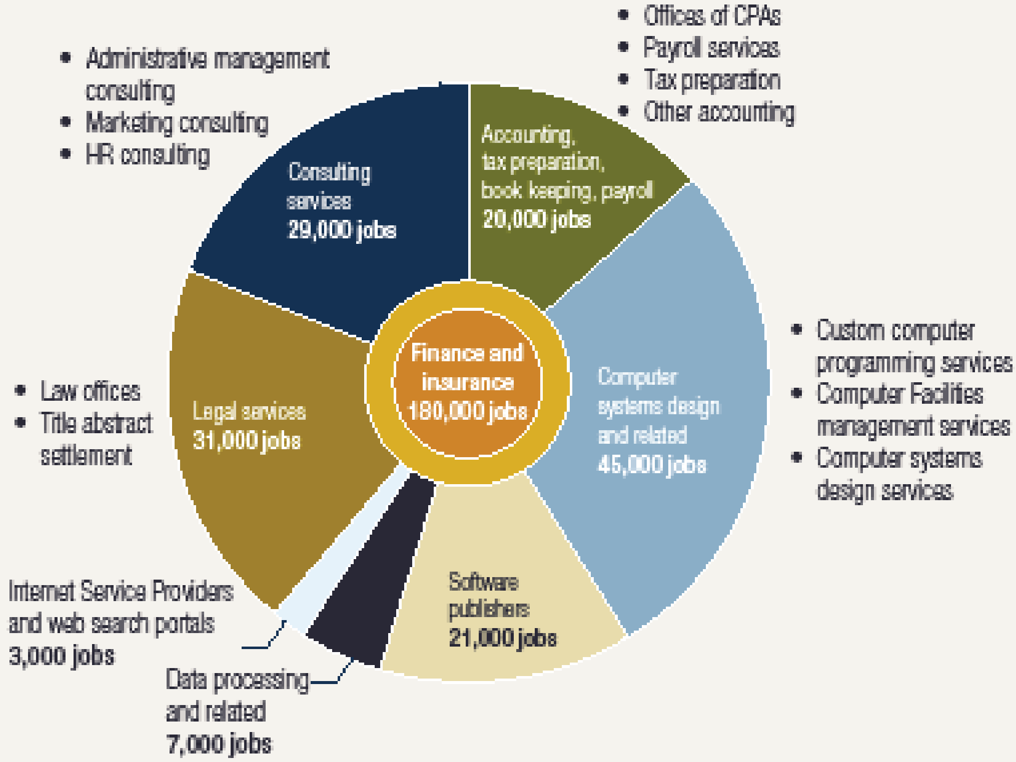
The growth that has occurred in Massachusetts financial services over the last several years has been due primarily to productivity gains rather than employment growth. Productivity and income growth are critical to maintaining a nimble, innovative financial services sector. And attracting higher-

EXHIBIT 5

ESTIMATES

The Financial Services Industry Has Links to Many Other Industries

Total number of jobs in sectors that directly touch financial services



Source: U.S. Bureau of Labor Statistics: Quarterly Census of Employment & Wages (QCEW Formerly ES202)

income leaders of financial services firms and companies makes the Commonwealth an attractive place for leading companies to locate. Of course, focusing only on a handful of "knowledge" jobs would put Massachusetts in a precarious position. These high-income leaders, after all, are often the most likely to relocate as the industry dynamics evolve. Massachusetts needs a dependable, broad-based pool of talent to sustain a strong financial services sector. Furthermore, reclaiming jobs across the economic spectrum offers an opportunity not only for the financial services sector but for the Massachusetts economy more broadly.

2.

LOOKING AHEAD:

Forces That Will Transform Massachusetts's Future in Financial Services

Massachusetts has historically enjoyed a very strong position in financial services. The mutual fund, after all, was born in Boston. The industry continued to benefit from the passage of the Investment Act of 1940 and the creation of the Employment Retirement Income Security Act (ERISA) in 1974. While Massachusetts's gradual decline as a transportation and manufacturing hub dampened its banking sector, its asset-related industries went first national and then global, enjoying decades of unbroken growth in revenues and job creation. Similarly, Massachusetts insurance companies thrived as local companies cultivated a strong talent base and benefited from a cluster of related business and professional services firms (e.g., lawyers, actuaries).

Reflecting this history, many Massachusetts financial services firms and companies (and their sub-sectors) still enjoy solid leadership positions in the national and global economy. In asset management, for example, Massachusetts ranks third among states in terms of total assets managed, trailing only New York and California. Within insurance, Massachusetts companies, despite their relatively small numbers, write 5 percent of all U.S. property and casualty premiums, and rank number 11 among all states for insurance employment. Even banking remains a critical employer, with over 60,000 jobs ranging from tellers to executives.

Industry forces creating challenges for Massachusetts's historic strengths

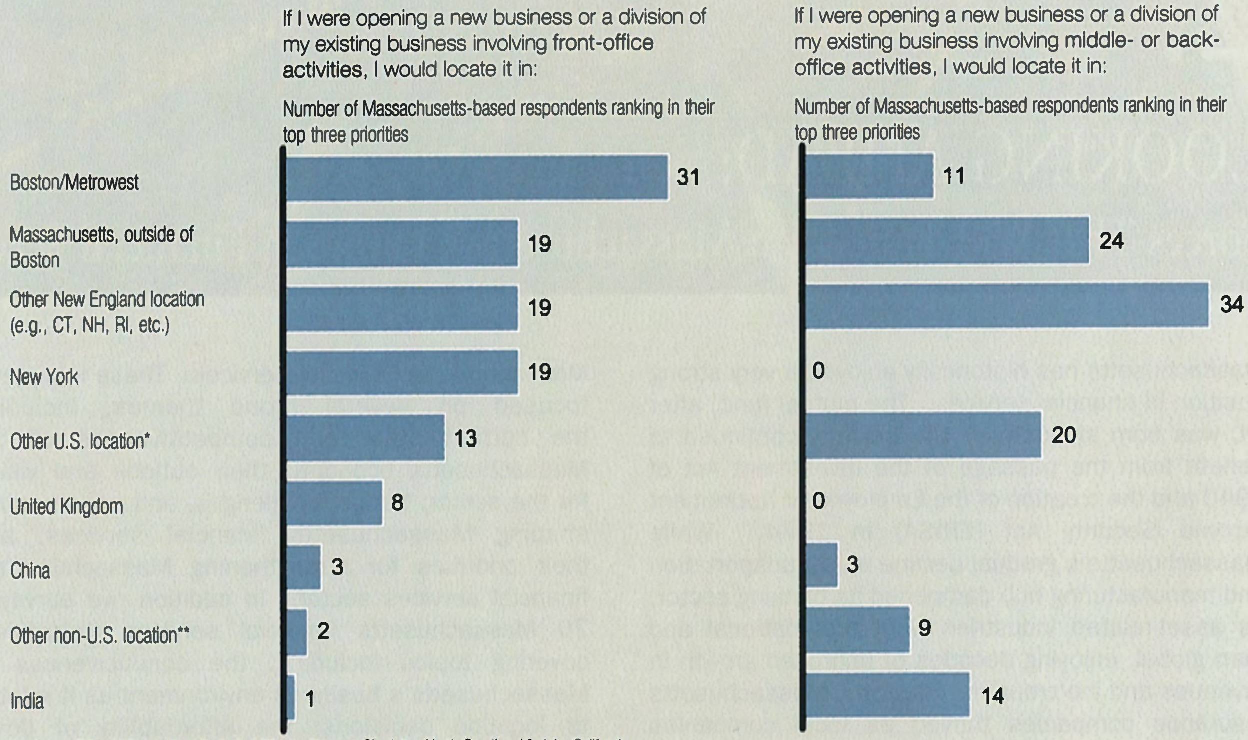
Unfortunately, the future does not look nearly as bright as the past. To understand Massachusetts's challenges and strengths, we interviewed more than 30 business and government leaders in Massachusetts Financial Services. These interviews focused on several broad themes, including the current state and competitiveness of the Massachusetts economy; their outlook and vision for the sector; trends, challenges, and opportunities shaping Massachusetts financial services; and their priorities for strengthening Massachusetts's financial services sector. In addition, we surveyed 70 Massachusetts financial services executives, covering topics including: the conduciveness of Massachusetts's business environment as it relates to location decisions; the affordability of doing business in Massachusetts compared with other locations; the attractiveness of Massachusetts's proximity to customers, suppliers, similar players, and other stakeholders; the availability of talent across the employment spectrum; their characterization of Massachusetts's financial services industry; and their priorities for the sector.

The historical core of Massachusetts's financial services economy and a key driver of location innovation – traditional, active asset management – faces increaing competition today. Other kinds of asset management – particularly alternative investments and passive/index funds – are increasingly driving industry growth, while the power of distributors (e.g., financial advisors) continues to increase relative to the product "manufacturers" who manage the assets.

Both trends tend to favor other full-service financial services hubs, such as New York and London. Manhattan's history as the U.S. center of trading activity has made it a natural talent source for trading-intensive quantitative asset managers and hedge funds; its cluster of financial institutions also

EXHIBIT 6

Market and Competitive Forces Are Encouraging Massachusetts-Based Companies to Consider Other Locations



* Other U.S. locations included Atlanta, Denver, Charlotte, North Carolina, Virginia, California

** Other non-U.S. locations included Ireland, Poland, and Eastern Europe

Source: **McKinsey survey of financial services executives**

makes New York City a natural place to locate as a distributor. London, meanwhile, is increasingly seen as a gateway to Eurozone investments, but with a currency that hedges against the Euro.

At the same time, other locations – some of which are in Massachusetts's backyard – are creating attractive conditions for middle- and back-office functions. States like North Carolina, Rhode Island, and New Hampshire have been building their financial services sectors by creating low-cost, low-tax environments for companies. Since financial services is more moveable than, say, manufacturing, companies are tempted to relocate or expand into these low-cost areas.

This squeeze is being felt by many of our interviewed executives, who would consider non-Massachusetts locations for new businesses or divisions (Exhibit 6). While Boston remains a favored location for many front-office jobs, lower cost locations in New England and other parts of the U.S. are clearly preferred for middle- and back-office jobs.

Given this competition, any plan that Massachusetts embraces to boost its financial services sector must explicitly recognize the Commonwealth's strengths and address its challenges (sidebar). There are natural advantages that Massachusetts can exploit to maintain its strong position as a fiduciary center. First, it has a great living environment: from the natural beauty of Massachusetts itself to the rich cultural life of the Greater Boston Area, the Commonwealth is a desirable place to live. It is no surprise, then, that companies are able to draw from an extremely rich pool of highly educated workers. The state also benefits from its history in financial services, and from the world-class financial brands that continue to call Massachusetts home. The Commonwealth's tradition of technological innovation is also a promising feature. As the financial services sector relies increasingly on information technology, Massachusetts is well positioned to be at the forefront of innovation.

On the other hand, there are some limitations that Massachusetts must acknowledge. For one, many

Massachusetts's Strengths:

- Excellent quality of life and rich culture
- Unparalleled academic institutions
- Rich pool of talented workers
- Long history of leadership in financial services
- Strong "brand" in technology and innovation

Massachusetts's Challenges:

- High cost of living
- Replenishing the pipeline of individuals well-trainied in math and science
- Challenging tax and regulatory environment
- Aging and inadequate infrastructure
- Increasing national and global competition, raising the bar for innovation

areas of the Commonwealth are burdened with a high cost of living. As described in more detail later in the report (in Initiative 3), Massachusetts's regulatory regime and enforcement approach is also more challenging than that of many other states, making it a more difficult place to do business. At the same time, Massachusetts's infrastructure is inadequate for the needs even of its current population, let alone for the additional population contemplated by this and other initiatives. To succeed, the Commonwealth must work to mitigate these challenges as much as possible.

Global forces transforming financial services

Global forces are also beginning to transform the financial services industry in ways that are not clearly advantageous to Massachusetts. Increasingly global markets for assets, capital transactions, and talent all favor mega-financial institutions – few of which call Massachusetts home. Global consolidation has already had a major impact on local industry: in insurance, with Manulife's acquisition of John Hancock; in banking, with Royal Bank of Scotland's acquisition of Citizens; and in asset management, most recently with Power Financial's acquisition of Putnam.

Looking ahead, we see five major forces transforming the global financial services industry, challenging traditional assumptions about how – and where – companies do business. Each of these forces has important implications for Massachusetts-based businesses in terms of securing and retaining a distinctive leadership position in sub-sectors like asset management, asset servicing and insurance over the course of the next decade. Massachusetts's financial services leaders have two choices: fight a losing battle to hold on to the old way of competing, or embrace these changes to carve out a distinctive place for Massachusetts in the new global financial services economy.

1. Aging population. By 2025, "dis-savers" over the age of 60 will outnumber "prime savers" between 45 and 60 in the U.S. and in Europe. This demographic trend, combined with the fact that each generation saves less than the one before, could reduce the net inflows of personal savings in the next 20 years by as much as 35 to 40 percent.

   Further, the retirees of the future will have very different product needs. "Buy and hold" products like mutual funds are fine for long-term capital accumulation and, to a lesser extent, inter-generational wealth transfer. But these new retirees will need help managing a wide range of new risks that could cause them to outlive their money, such as unexpectedly long lives, dramatic increases in health care costs, sudden market corrections, or a spike in inflation.

   This trend presents some challenges to Massachusetts's core asset management business. Increasingly, solutions for retirees' needs are emerging from life insurance companies, investment banks, and even directly from some financial advisors, as the "asset management" value chain gets reinvented. This opens up many of Massachusetts's traditional strongholds to new players from throughout the industry and the country.

   But if managed correctly, the changing needs of an aging population could be a major source of opportunity for the Commonwealth's most innovative providers of products and services.

Local Massachusetts insurers are among those developing new products that will help aging baby boomers manage longevity, health and other age-related risks. Similarly, asset managers are working on solutions to the problem of under-funded defined benefit retirement plans. Massachusetts is as well positioned as any other place in the world to be the home of cutting-edge research and ground-breaking product innovations to solve these and other problems relating to the aging population.

2. Transformation of global financial stock. With nearly $51 trillion as of 2005, U.S. financial stock – including equities, bonds, loans and deposits – is about a third larger than the $38 trillion combined financial stock of the U.K. and the 12 Eurozone countries. The composition of U.S. financial stock is also sophisticated, with equity and private debt dwarfing bank deposits (which still make up the majority of financial stock in most developed and developing countries). The size and sophistication of the U.S. financial stock will sustain many financial services providers for years to come.

   Between 2001 and 2005, however, the rest of the world was catching up. Non-Japan Asia, fueled by strong equity market development, grew its financial stock by 15.5 percent. The U.K. and the Eurozone grew at 8.4 percent and 6.8 percent, respectively. The U.S., meanwhile, grew at 6.5 percent. As global markets become increasingly sophisticated, they will be difficult to ignore. They will also be the source of innovations that will give global players a competitive advantage in the U.S., as in the international explosion of structured equity products for retail investors.

   As a result, Massachusetts-based financial services companies – particularly in asset management and asset servicing – must globalize their products and services. Already, they need to offer access to and support of non-U.S. investment products to U.S. domiciled clients. But even more is required. To meet growth aspirations and remain globally competitive, it will be increasingly important for them to compete head-to-head in international markets for the growing stock of financial assets controlled by foreign central banks, pension funds, insurance companies, and individual investors.

3. Revolution of product innovation. Technology, trading market structures, and communications infrastructures are evolving to make real-time interactions and transactions possible and affordable from virtually anywhere. Simultaneously, new financial products are emerging – as asset managers increasingly separate alpha and beta for varying risk-return objectives, as innovative structured products become more commonplace, and as technology becomes an increasingly important tool for financial innovation.

   Massachusetts's leading asset managers (like Fidelity) and asset servicers (like State Street and Mellon Financial) recognize the increasing ability of technology to redefine their businesses. Competitive success or failure for these companies is defined by rapid application development, flexible and secure management of vast quantities of data, and near-instantaneous communication with customers/clients and the markets.

   Massachusetts's asset managers and insurance companies are participating in, but not yet clearly leading, the transformation in investing and risk management. The Commonwealth is home to many innovative product manufacturers (e.g., hedge funds, quantitative managers, leading life insurance companies). Yet the lion's share of revenues comes from traditional "long only" funds in the asset management industry and from classic life insurance and property and casualty insurance. Massachusetts has the potential to employ its intellectual capital to help drive developments in both industries.

4. Globalization of talent markets. In 2005, India and China produced 2.7 million and 3.1 million university/technical graduates, respectively. The U.S. produced 2.1 million, of which 55,000 graduated from Massachusetts universities. As the globalization of talent markets continues, companies will be tempted to hire abroad. After all, entry-level graduates with advanced degrees expect anywhere from $5,000 to $20,000 in annual compensation in both India and China, compared to about $40,000 in the U.S.

   American and European financial services companies continue to transfer activities to remote locations. In India, the financial services off-shoring sector provides remote application development and maintenance, call center services, and back office support to U.S. and European institutions. It employs about half a million people – about three times the size of the financial services workforce in Massachusetts, and 8 percent of the total U.S. financial services workforce. Indian and Chinese nationals are also becoming important contributors to leading financial institutions' work forces in developed markets around the world.[2]

This trend presents the Massachusetts financial services sector with both a threat and an opportunity. Over time, the Commonwealth is clearly vulnerable to having its lower-income financial services workforce displaced by very low-cost, well-educated workers in offshore locations like India and China (and even in lower-cost U.S. locations, such as North Carolina). Yet armed with its world-renowned universities, the Commonwealth is well positioned to attract and selectively retain an inflow of highly talented students from around the world. Massachusetts can become the global leader in financial services education, and it can offer the largest pool of highly trained talent to local financial services employers.

5. Rise of mega-financial institutions. In 1980, the combined market capitalization of the top 30 U.S. and European banks was about $100 billion. By 2005, through a combination of mergers and global expansions, the same number was over $2.5 trillion, an increase by a factor of 25 in the same number of years. During the same time, these banks increased their share of global banking assets from 8 percent to almost 30 percent.

   These mega-financial institutions are in a better position than smaller companies to reap the benefits of scale and scope across product lines and geographies. They can afford to be at the cutting edge in innovation. They have the operating skills necessary to manage global business systems that combine local proximity to customers with low-cost remote delivery of routine activities.

   Unfortunately, Massachusetts's financial services sector has been on the acquired, rather than acquiring end of large merger activity, particularly in banking. As described earlier (p. 9), the Commonwealth has recently seen a number of its Fortune 500 company headquarters move elsewhere, including Fleet (sold to Bank of America), John Hancock (sold to Manulife), and Hanover. Moreover, since 2001, the value of acquisitions of Massachusetts-based financial services companies has been nearly double the value of acquisitions by Massachusetts-based financial services companies. This has raised public concerns about Massachusetts's place in the financial industry while broadening the debate about the importance of corporate control.

   Nonetheless, the shift towards large institutions does offer the Commonwealth two important opportunities. First, the rise of mega-institutions also heralds the atomization of financial expertise into small, heterogeneous units. Massachusetts's many successful boutiques and smaller firms allow it to remain more nimble and innovative, introducing the kind of disruptive developments that tend not to survive inside large, complex organizations. Second, with careful focus, Massachusetts has the potential to become the U.S. gateway for many global financial institutions as they make their entry into the world's largest financial services market.

3.

ACHIEVING THE 2015 VISION:

Initiatives for Massachusetts and Greater Boston

Given the context and changes described in the previous sections, Massachusetts clearly needs a deliberate and aggressive strategy for achieving the vision this report outlines for 2015. The complexion of financial services is more global than ever before. To succeed, this report suggests a three-part agenda for re-asserting Massachusetts's leadership in financial services:

- Preserve and expand a diverse employment base to grow jobs across the income spectrum and support a growing, vibrant financial services sector.
- Become a global center for talent and innovation by fostering a leading center of financial education.
- Make Massachusetts a more stable and competitive place to do business by streamlining our permitting processes and creating a predictable regulatory process and tax regime.

Some projections suggest that if nothing is done to enhance Massachusetts's competitive position, the Commonwealth will regain only about 3,000 financial services jobs by 2010, leaving employment below 1999-2002 levels, even while Gross State Product (GSP) from financial services grows to $46 billion, or almost 11 percent of the economy. A more dynamic trajectory – attainable through joint public and private sector effort – could enhance both employment and GSP.

Were Massachusetts to revitalize its financial services sector, the results for Greater Boston and the Commonwealth could be substantial. By closing two-thirds of the current growth gap with North Carolina in financial services, for instance, Massachusetts would generate nearly 15,000 new jobs and $12 billion in GSP growth by 2010 (Exhibit 7).

Of course, there are other, critical steps that Boston and Massachusetts must take more broadly to compete, and which will vie directly for the resources needed to execute the initiatives described in this

Recommendations for 2015 Vision

Initiative 1: Preserve and expand a diverse employment base

A. Strengthen the community and state college system and increase the public and private higher education system's financial services focus

B. Expand state government-led outreach to leading Massachusetts employers while launching a coordinated state, local, and private sector effort to attract the most innovative financial services firms

C. Adopt a state-wide strategy to enhance cost competitiveness in targeted non-Boston locations.

Initiative 2: Become a global center for talent and innovation

A. Build a financial services-specific research center, with applied programs in advanced quantitative topics and jointly sponsored employment and internship programs.

Initiative 3: Make Massachusetts a more stable and competitive place to do business

A. Retool state and local permitting to expedite commercial development

B. Modify state regulatory structure, principles, and processes to create a more predictable environment for companies operating in the state

C. Promote a more predictable tax environment while addressing structural issues underlying low-revenue, high-pain taxes.

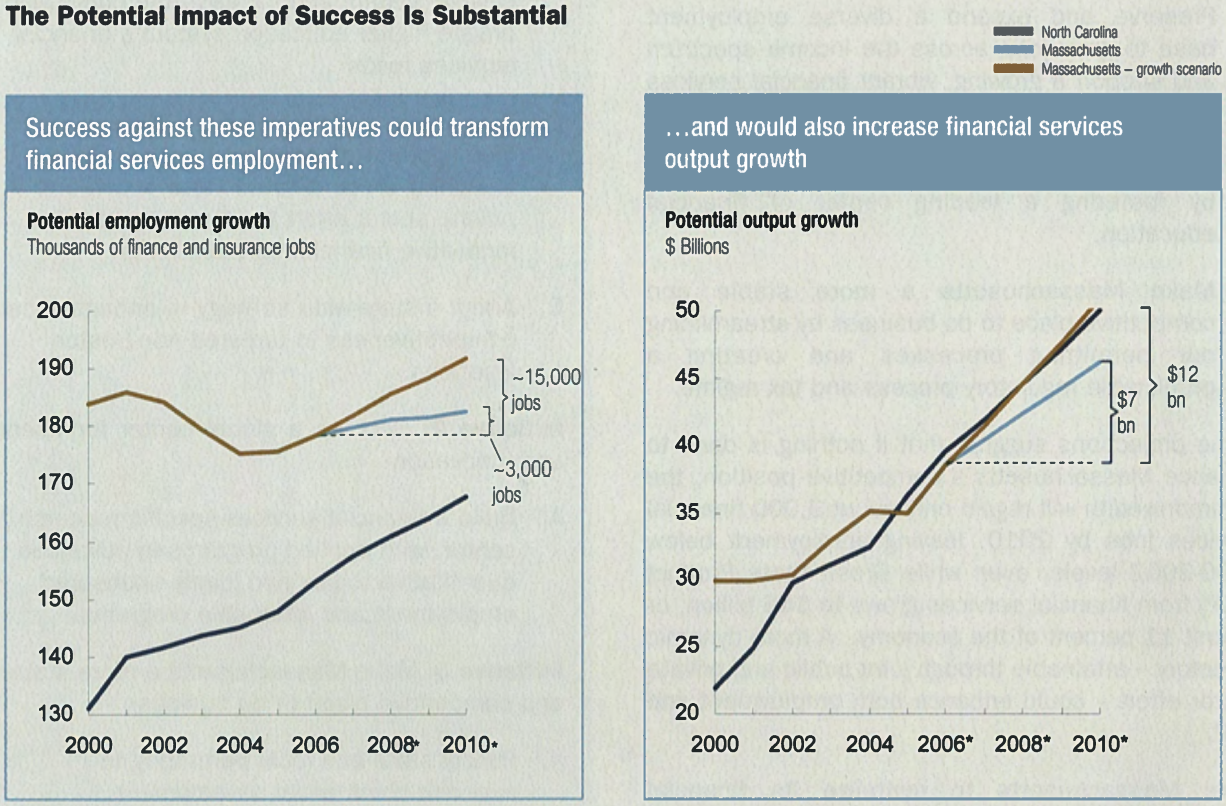
report. Chief among these are affordable housing (discussed briefly on p. 38), and infrastructure improvements within Boston (addressed in an upcoming report from the Transportation Finance Commission). Improvements in these areas are necessary for Massachusetts to compete across all sectors. Since this report is geared towards financial services, it does not dwell in detail on them. Yet they remain central to the Commonwealth's success.

Since most of the prerequisites for growth in financial services – leading educational institutions and a strong concentration of leading financial services companies – are already in place, the 2015 vision for financial services is well within reach. After all, other cities and states with far less impressive starting positions are succeeding in developing their financial services sectors. Massachusetts has the potential to solidify and strengthen its position as a leading center of financial services innovation in institutional asset management, asset servicing, and insurance.

To achieve its objectives, however, Massachusetts will need to overcome a prevailing complacency. Public and private institutions will need to work together across geographic, industry sector, and organization lines and collectively reach for attractive opportunities.

EXHIBIT 7

The Potential Impact of Success Is Substantial



* Projection

Source:Economy.com

INITIATIVE 1:

Preserve and Expand a Diverse Employment Base

Robust, sustainable growth depends on a diverse employment base across the spectrum of incomes. Of the 180,000 financial services jobs in Massachusetts, nearly 20 percent are non-management business and financial operations jobs – insurance claims adjusters, accountants, and auditors, etc; and another approximately 5-10 percent are similarly compensated support jobs – statistical assistants, information clerks, etc. While some of these jobs (like claims adjustors) are inherently local, others are increasingly mobile and transferable to other locations. In recent years, states with lower average financial services wages have pulled activities like fund accounting and operations from states like Massachusetts, driving faster growth in financial services employment in other states (Exhibit 8).

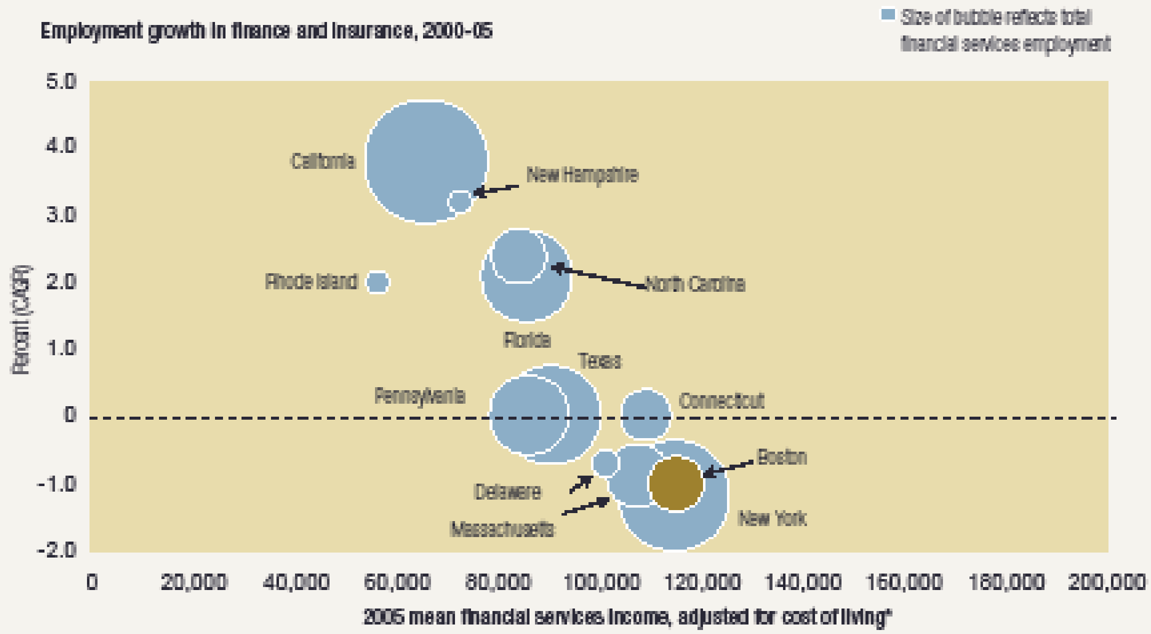
Higher-income jobs also make an important contribution to economic stability and growth, in

EXHIBIT 8

Middle-Income Jobs Are Key to Growing Financial Services Employment

Financial services employment growth vs. mean cost of living-adjusted income

Percent; dollars



* Adjusted for cost of living using the 2004 ACCRA Cost of Living Index for Bristol County, MA, Suffolk County, MA, Providence, RI, Wake County, NC, Duval County, Florida, New York County, NY, San Francisco County, CA, and Fairfield County, CT; NH is an estimate from Global Insight; Mean financial services income for Boston is 2004

Source: Global Insight; BLS; Economy.com

Massachusetts in particular. These jobs contribute disproportionately to state GSP and are also critical to driving the innovation that keeps Massachusetts companies competitive, as discussed in Initiative 2 below. Financial services jobs with average annual income of above $75,000 – including insurance sales agents, financial analysts, and loan officers, account for approximately one-third of Massachusetts financial services employment. The employees who hold these jobs enjoy a reasonable degree of geographic mobility. They tend to cluster together in cities with good quality of life and with high concentrations of other people like themselves.

Together, the presence of these middle-income and higher-income jobs in Massachusetts supports the critical office and administrative jobs that today comprise nearly half of financial services employment. These are also the jobs most at stake if Massachusetts does not improve its ability to create and retain financial services jobs across the income spectrum.

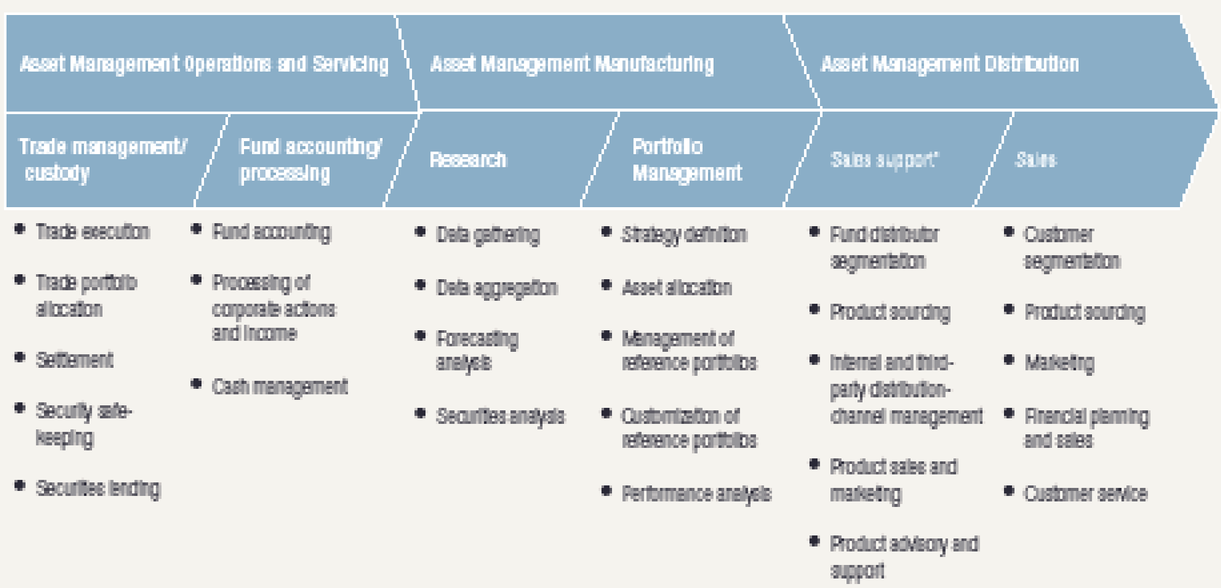
Within each of the financial services businesses – asset management, asset servicing, and insurance – Massachusetts is well positioned to compete for specific functions across the value chain (Exhibit 9). In asset management, for example, Massachusetts is already dominant in "manufacturing" (research and portfolio management). In addition, Massachusetts has a strong local employment presence in "operations" (trade management, custody, fund accounting, and processing) and "sales support" functions. These functions include jobs across the income spectrum. Many of these jobs – particularly the middle- and back-office operations jobs – also tend to be highly mobile and other states are actively seeking to attract these employees. If Massachusetts is to continue to have a robust asset management and asset servicing business that is consistent with a diverse employment base, it must continue to grow jobs across this value chain.

That requires a specialized, skilled workforce. The Commonwealth's ability to create and retain middle-

EXHIBIT 9

Massachusetts Can Compete for Jobs Across the Value Chain

Asset management business functions



* Interface and service provided to the fund distributors by the asset management firms

income positions has in part been hurt by some inexorable forces related to globalization, but a skill mismatch has played a powerful role as well. In the survey conducted in conjunction with this report, leading executives pointed to middle-income positions that they have been unable to fill locally. Interviews suggested that 2,000 to 3,000 unfilled jobs currently exist in Massachusetts because of a mismatch in skills. As one executive told us, "The jobs are available. We have jobs that are going unfilled across a number of functions. But we just can't find the right talent." Addressing this gap is critical to securing growth in Massachusetts's financial services sector going forward.

While Massachusetts's financial services workforce has declined, New Hampshire, Rhode Island, Florida, and North Carolina have all experienced growth. In part, this is due to systematic efforts by employers and educational institutions to shape a workforce with the desired skills. It is also thanks to outreach by state and local governments to build relationships with financial institutions and to meet their needs with lower costs, including tax incentives, and easier business processes. As one Massachusetts executive told us, "the Governor of [another state] has me on speed dial."

Massachusetts will likely never be the lowest-cost location, but it must become more competitive. It can preserve and enhance a diverse job base across the income spectrum in financial services by pursuing three key efforts:

1A: Unite academic institution and industry efforts to strengthen the community and state college system, and increase the public and private higher education system's financial services focus. Link academic programs to the broader financial services economic development agenda, including emphasis on math, science, and other quantitative disciplines.

Massachusetts currently faces a significant gap between the capabilities demanded by the financial services jobs that drive growth and the skills delivered by its four-year public and private universities and community colleges. Massachusetts is rightly famous for having some of the world's finest universities. But the financial services leaders we surveyed rank Massachusetts only slightly above average in its supply of support employees and workers qualified to fill quantitative jobs, although respondents view these factors as "very important" in determining the attractiveness of the state. The drivers of this skill gap vary by institution type, but the role of educational institutions is a consistent theme.

The challenges facing the Massachusetts community and state college systems are fundamental. As previous studies have indicated, Massachusetts's community colleges receive less financial support and have lower retention rates than those in other states. In addition, the community college system lacks a central body to coordinate the development of workforce training programs that best match the needs of business. And despite several job-related funding sources, including the Workforce Training Fund and the Workforce Competitiveness Trust Fund, financial services executives interviewed consistently raised the need to improve the skill level of community college graduates. Some companies do offer career training programs at the community college level, but these do not yet fully meet the industry's needs. Interviewed executives consistently expressed concerns about the readiness of community college graduates to enter the financial services workforce.

Other states have made huge strides by deepening academic/financial services collaborations at the community college level that link to a broader economic development agenda. In particular, North Carolina's New and Expanding Industry Training (NEIT) program offers community college trainers and facilitators at no cost to participating companies. It even refunds unemployment insurance taxes on those employees from the program unable to perform their jobs. Approximately 200 companies benefit from free NEIT training programs each year. In 2005, nearly 24,000 employees trained in the NEIT programs at an average cost to the state of $352 per employee. With programs like these, North Carolina is successfully building a robust financial services-competent workforce for the future.

Looking more broadly at public and private four-year colleges, many students lack awareness of and interest in the long-term opportunities in financial services. Although many of the world's top students attend college or graduate school in Massachusetts, efforts by local companies or industry organizations to reach out to them are at this point drowned out by the siren song coming from New York and Connecticut. Without coherent education and career direction, they view entry-level financial services jobs merely as stepping stones to "something else."

Massachusetts attracts a talented student body to its many institutions, but a lack of alignment between academia and industry results in too few of these students choosing and preparing for careers in financial services.

It is true that several universities offer specialized centers, programs, and opportunities for financial services. For example, Boston University offers a collaborative actuarial studies program that integrates actuarial science, statistics, and financial coursework with industry experience. The UMass Isenberg School of Business's Center for International Securities and Derivatives Markets runs the first alternative investment analyst accreditation program in the U.S. Boston College, Babson, and Bentley also offer specialized programs. Despite these success stories, however, Massachusetts universities and employers are clearly not all pulling in the same direction. Financial services employers in Boston and Massachusetts seek more outreach and coordination from local schools.

On the other hand, universities express their desire for employers to be more collaborative with university career programs. While the University of Massachusetts has guest lectures, business advisory boards, and industry-sponsored scholarships, career services leaders observe a lack of interest on the part of companies to participate in these programs. As a result, graduates are missing opportunities to pursue careers in financial operations, underwriting, actuarial science, fund accounting, and other skilled entry-level financial services occupations.

In contrast, other states have made notable progress with targeted university-level financial services training programs that build both relevant skills and student connections with industry. The University of Illinois at Chicago offers one of the best examples: it recently used a grant from the Chicago Mercantile Exchange's trust fund to found a new International Center for Futures and Derivatives. One of the Center's main goals is to prepare undergraduates for careers in the futures and derivatives industry through collaborative programs designed in consultation with industry. Similarly, the Bryant University in Rhode Island offers partnerships with financial services firms in which Bryant courses help students pass certification exams (e.g., National Association of Securities Dealers Series 6). Employers guarantee summer employment to students studying in these programs, and provide prospects for employment following graduation.

> Other states have made notable progress with targeted university-level financial services training programs that build both relevant skills and student connections with industry.

To address these challenges, Massachusetts could build its financial services workforce at the four-year college and community college levels, potentially through four key steps.

First, industry practitioners could help Massachusetts's community colleges strengthen their programs and graduates with a targeted set of financial services skills. This could even include bolstering the Commonwealth's K-12 math and science programs. In addition to counsel, the industry could provide teachers and offer internship, co-op, and job opportunities to community college graduates.

Second, the Workforce Training Fund and Workforce Competitiveness Fund could expand. Using North Carolina's NEIT program as an example, the Commonwealth's community college strategy could intentionally consider and integrate with its economic development goals.

Third, new programs for in-demand financial services, such as actuarial studies or financial technology or derivatives accounting, could be introduced at four-year colleges and universities. In concert, companies could help introduce students to lesser-known career opportunities in financial services.

Fourth, as recommended by the Massachusetts Taxpayers Foundation and other groups, UMass could receive direct control over its tuition revenues. This proposal should be revenue neutral for the state budget but would allow the university greater control and flexibility over its budget. The current approach, in which UMass's tuition goes into the state's General Fund for gradual disbursement throughout the year, is one of only two such systems in the country. Because funds received from the state appropriation face restrictions and because unused appropriations expire on June 30, this system limits the university system's budgetary flexibility.

Financial services executives overwhelmingly perceive the Commonwealth's government as having been less active in growing the Massachusetts financial services sector than other state governments.

This combination of better education, training, and employment placement should help Massachusetts offer companies a more productive workforce that can meet the needs of the financial services industry, making the Commonwealth a better place to locate and grow a business.

1B: Expand state government-led outreach to leading Massachusetts employers while launching a coordinated state, local, and private sector effort to recruit the most innovative financial services firms. Recognizing Massachusetts's strengths in asset management (including private equity, hedge funds, and venture capital), asset servicing, and insurance, use outreach efforts to retain and grow the employment base in these important sub-sectors.

For many years, the Massachusetts state government leaders underemphasized the task of reaching out to its most important employers in financial services to preserve the strong, existing base of jobs while encouraging local expansion. Financial services executives overwhelmingly perceive the Commonwealth's government as having been less active in growing the Massachusetts financial services sector than other state governments. Looking back over the past five to ten years, nearly every financial services executive interviewed for this report lamented the lack of government outreach geared toward helping them remain in and grow in Massachusetts.

In contrast, leading public officials from other states make frequent, personal contact with top executives from important companies. According to the CEO of one leading Massachusetts financial services company and employer, "The governor of their state frequently calls me to ask what more they can do for our company. He even lobbies for initiatives that matter to me in Washington."

Executives do acknowledge some recent progress on this front. The prior Secretary of Economic Development of Massachusetts built relationships with many senior executives in financial services and other industries, and took steps to help companies that want to expand in-state. The Business Resource Team (BRT), created in 2004, combined 23 state agencies and quasi-government agencies to provide a single point of contact for large-scale development. It has been successful in responding to major development deals generated by expanding Massachusetts-based companies. Further, Governor Deval Patrick's administration has already reached out to key Massachusetts employers, with the governor making personal phone calls to chief executives in a number of industries, including financial services. Government leaders must accelerate and formalize this early process.

Massachusetts also lags in sales and marketing of the state as a location. According to one former government official interviewed for this report, Massachusetts has eight people focused exclusively on "selling" the state's benefits to in-state employers; in contrast, Texas and New York each have 32 and North Carolina has 25. Their employees reach out of state in pursuit of Massachusetts's companies. The Commonwealth's Executive Office of Economic Development has only a limited budget for advertising and other non-sales outreach to companies.

Three steps could dramatically expand outreach to and collaboration with leading Massachusetts

financial services employers.

First, a new full-time financial services liaison with significant public and private sector experience could serve as the internal and external voice for the state's financial services industry. This liaison could work for the Secretary of Economic Affairs, and could work with a separate chairman, ideally a retiring senior executive with significant stature in the Massachusetts financial services community. Together, the liaison and chairman would serve as state-wide advocates for the industry, advise government officials on pressing issues, and coordinate across numerous city and state advocacy organizations.

Second, the governor could build on his early personal outreach campaign by routinely calling on leaders of financial services companies in Massachusetts, with three priorities: expressing the value that government leaders see in the financial services sector, educating executives about programs in place to address their concerns about doing business in Massachusetts, and offering executives a forum for sharing ideas and explaining challenges.

This should not be limited to CEOs of companies that are headquartered in Boston. Boston, after all, enjoys a position as a "second headquarters" city for a number of companies that headquarter in other countries and states. In asset management, for example, six of the top ten players in Boston are headquartered elsewhere, including Mellon Financial, Natixis, and Old Mutual. Similarly, Manulife/John Hancock and Bank of America remain among the strongest and most visible institutions in the community despite non-Massachusetts ownership. The Administration could therefore extend its outreach campaign to heads of business units as well as heads of companies.

Finally, the outreach and marketing efforts of the Office of Economic Development could be formalized. Members could meet with private sector operations executives to share information about available sites, case studies of successful incentive packages, and expansion opportunities. The Office of Economic Development could also host and participate in events to introduce financial services companies to expansion opportunities in Massachusetts. Qualifying municipalities would have the opportunity to suggest sites to financial services companies that are seeking to expand, facilitating a matching process between companies and locations.

> Dialogue between state officials and industry executives should pave the way for a coordinated economic development strategy, introducing attractive Massachusetts locations as viable alternatives to out-of-state locations for middle-income jobs.

Along these lines, one important recent step was Mayor Thomas Menino's launch of "Boston World Partnerships," an independent, non-profit corporation charged with marketing Boston to national and international business leaders. The goal is to attract new companies, fuel Boston's economic growth, and create jobs by leveraging Boston's global leadership in key sectors, including life sciences, health care, higher education, and finance. This Partnership should be supported and encouraged by state government and industry, and should be a key partner in recruiting financial services companies to Boston.

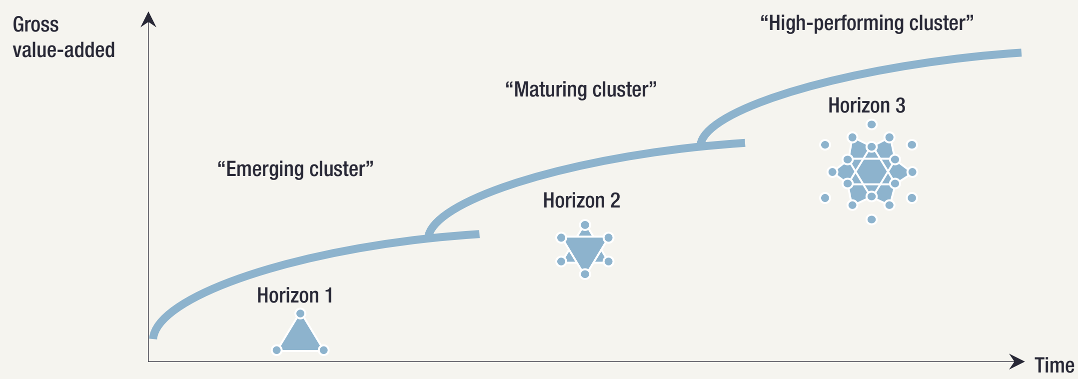
As the dialogue improves between state officials and industry executives, negative impressions about Massachusetts should dissipate, and the state's advantages as a location for financial services employment should become more apparent. This should pave the way for a coordinated economic development strategy, introducing attractive Massachusetts locations as viable alternatives to out-of-state locations for middle-income jobs. This coordinated, better-resourced outreach program should contribute meaningfully to improved job growth across the income spectrum in Massachusetts financial services.

It can also help improve collaboration even within the financial services community. Interviews and survey results consistently point to a lack of collaboration –

EXHIBIT 10

Massachusetts Has an Emerging-to-Maturing Cluster in Financial Services

Massachusetts's strengths today



	Horizon 1	Horizon 2	Horizon 3
Key characteristics	• One/few companies based in the region with growing production/ employment • Significant trends toward – Increase in production value – **Concentration of economic activity in the region** – **Potential for sustainable growth and distinctiveness as a region**	• **Few/many companies in the region, with significant production/employment** • **A set of associated institutions** • **Availability of talent** • **Sustained growth in the past, potential growth for the future** • Experience of collaboration among players	• Many companies in the region, attracts out-of-the-region players • **Region is great source of talent, ideas, and innovation** • Strong associated institutions with strong commitment to business • Mutual trust and cooperation, shared vision • Sustained growth, constant evolution of competitive advantages

both formal and informal across companies – as the key barrier to growth in the Commonwealth's financial services sector. Indeed, achieving such collaboration would help move Massachusetts towards a high-performing cluster for financial services (Exhibit 10). By aggregating many finance-related businesses together and establishing open lines of communication among them, such a cluster would attract out-of-the-region players and help sustain growth for years to come. Many executives agree with one leader who told us that today, "there's no sense of community or camaraderie among our financial services leaders – certainly not in the way that there used to be."

Increased collaboration both within the private sector and between the public and private sector can go a long way towards bringing new firms into Massachusetts. As one interviewee put it, "We could just get the right six folks together to go out and start doing this – it's not rocket science." Others agree. "There are firms out there that could be drawn to Boston," one executive said. "We just need to get business and the government working together to go after them."

This is not to suggest the creation of a separate financial services "leadership group"; instead, leading members of the many disparate groups could ideally consolidate and sharpen their objectives. Chicago's collaborative effort among city and state government, industry leaders, and business advocacy organizations managed to lure Boeing's headquarters away from Seattle, and can serve as a valuable model (Exhibit 11).

Better internal collaboration would help create a unified message to share with the rest of the world. This would help bolster the Commonwealth's position as a great place for 22- to 30-year-olds to live and work, and as a "must have" location for companies headquartered elsewhere to base strategic operations. Top financial services executives could also collaborate with government officials in recruiting firms to Massachusetts. Outreach efforts should target asset management and insurance firms seeking to enter the U.S. market, while recruiting the asset management, private wealth,

EXHIBIT 11

Chicago Used a Collaborative Effort to Attract Boeing's Headquarters

Background

- In 2001, Boeing decided to relocate its headquarters from Seattle to one of three finalist cities: Denver, Dallas, or Chicago
- Chicago offered richest package: estimated $56 million in incentives
- Chicago's recruitment seen as model for public-private partnerships

Public efforts

- State Department of Community Affairs led effort
- State legislature authorized the state and city to offer aggressive incentives
- Chicago Mayor's office committed staff resources to secure permits
- State and city leaders entertained Boeing executives during visits

Public-private efforts

- World Business Chicago helped Boeing study demographics, infrastructure, and services
- WBC also helped find headquarters site and helped suspend certain permitting rules

Private efforts

- Civic Committee, an elite group of business leaders, leveraged business connections to market the city to Boeing executives

Source: Crain's Chicago Business, *Chicago Tribune*, *Site Selection* magazine, WBC website

and other front-office operations of diversified U.S. financial services firms.

Massachusetts would also reinforce its leadership position in private equity and venture capital. Today there are more than 250 venture capital and private equity firms with offices in the Commonwealth, and Boston ranks third in per-capita private equity spending (behind San Francisco and San Jose).[3] Massachusetts ranks as the number two state for venture capital firms (after California).[4] Solidifying this leadership position will enhance the Commonwealth's financial services cluster – and will also support growth and innovation throughout the Massachusetts economy.

1C: Adopt a state-wide strategy to enhance cost-competitiveness in targeted non-Boston locations and secure the Commonwealth's most important employers. Combine targeted tax incentives with upgrades to transportation, power, and communications infrastructure to make these locations competitive with other states.

Other states are competing with Massachusetts for jobs across the income spectrum. In the survey conducted for this report, executives disagree with the characterization of Massachusetts as cost effective (Exhibit 12). The high cost of doing business is becoming a serious obstacle to the state's long-term economic health. Rhode Island and New Hampshire cost less, seem more business-friendly, and are within relatively easy driving distance of Boston.

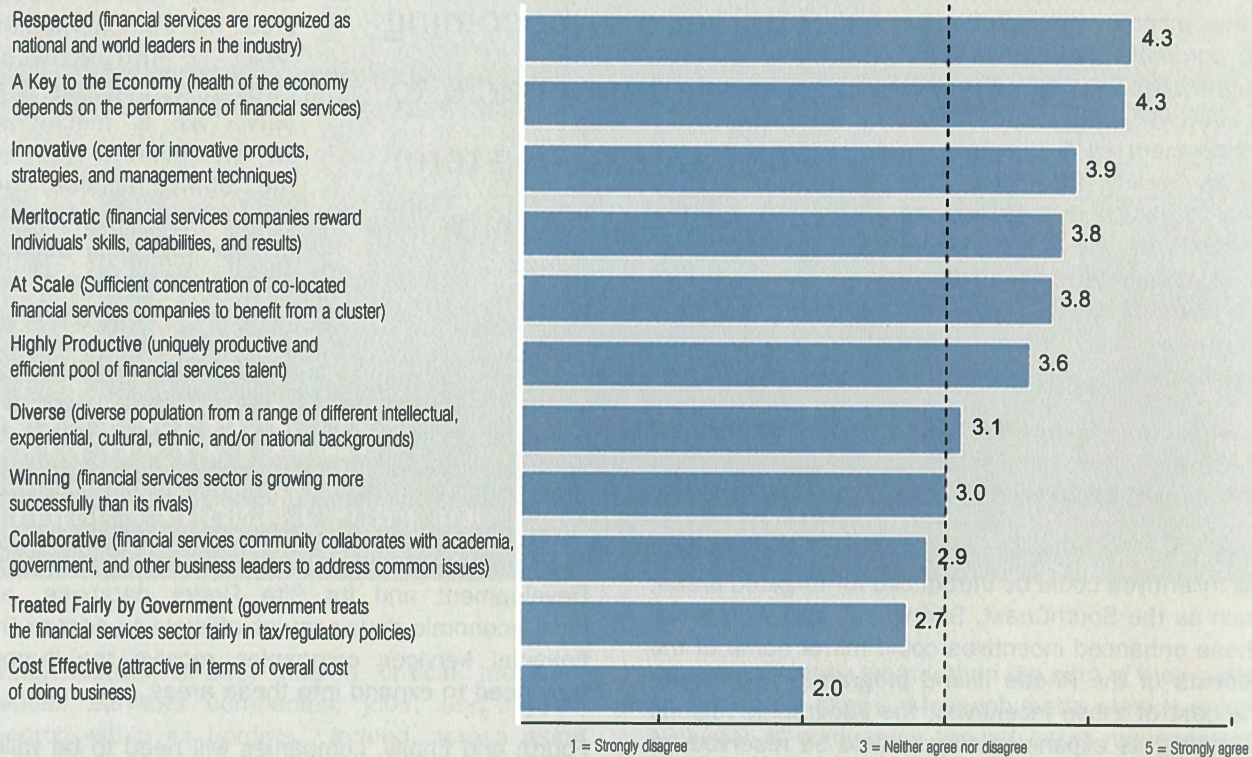
Rhode Island has encouraged companies to grow its high-paid workforces with a "Jobs Growth Act," passed in 2005. It provides tax exemptions and tax rate reductions for employees who make more than 125 percent of the state's average annual salary. Fidelity credits those changes with providing incentive to shift several business divisions to that state. Fidelity has grown its workforce in other states, too, including Kentucky, Texas, and North Carolina, even as it remains headquartered in Boston.

Massachusetts already has the "raw material" to create a lower-cost environment that spurs middle- and back-office job growth in particular. The costs of

EXHIBIT 12

Executive Perspectives on Massachusetts's Financial Services Industry

I would characterize Boston's/Massachusetts's overall financial services industry as…



Source:McKinsey survey of financial services executives

living and doing business in and immediately around Boston may never be the lowest in the country, but cities like Worcester and Franklin offer lower-cost housing, affordable commercial real estate, and easy commutes. The cost proposition for more remote cities like Springfield is even more attractive. But today, the Commonwealth lacks the systematic program of tax incentives and improvements in transportation, power, and telecommunications infrastructure necessary to realize this potential in the financial services sector. Executives interviewed overwhelmingly supported the need for "zones specifically designed to attract business growth and [to] show companies where they can get access to low-cost facilities in Massachusetts."

Massachusetts does promote locations outside Boston. Economic Target Areas (ETAs) are zones where companies can receive special tax benefits from the state and local municipalities for commercial development and job creation. For an area to qualify as an ETA, it must be underperforming on one of nine metrics and receive approval from the state Economic Assistance Coordinating Council.[5] ETA status allows companies to negotiate long-term local property tax reductions in the form of tax increment financing, and be eligible for a 5 percent investment tax credit for state taxes.

ETAs present several limitations, however, that mute their impact on the state's middle-income financial services workforce. The extent to which tax benefits tie to specific job growth or investment targets is locally driven and varies widely from community to community. Also, the local approval process occasionally proves cumbersome and time-consuming, limiting the attractiveness of ETAs to companies making location decisions. Furthermore, with over 200 towns currently part of ETA zones, ETA status is no longer an effective tool to target development to the state's most economically depressed areas. The ETA program is more than ten years old, and while it has proven effective over the decade in encouraging growth and job creation, it is due for an overhaul. Attempts in 2002 by Governor Jane Swift to create Enhanced ETAs with triple the tax benefits are now dormant.[6]

Rhode Island's ten "enterprise zones" may offer a model for revamped ETAs. Within these zones, companies receive state income tax credits for 75 percent of new employees' wages (up to $5,000 per employee) if they grow local employment by 5 percent. In 2005, nearly 900 new jobs were created in these zones – some of the state's most economically depressed areas – representing a 0.15 percent increase in total state employment.

The high cost of doing business is becoming a serious obstacle to the state's long-term economic health.

To encourage companies to locate their middle- and back-office operations in Massachusetts, the state government could take four steps.

First, ETAs could be overhauled, and new state-level tax incentives could be introduced for targeted areas, such as the SouthCoast, Springfield, and Worcester. These enhanced incentives could mirror some of the aspects of the Rhode Island program. To mitigate the cost of these incentives, the geographic regions qualifying as expansion zones could be reserved for a few, consolidated, but more attractive "enhanced ETAs," and the incentives could link directly with ongoing job retention and growth.

Second, infrastructure improvements could accompany these tax incentives, ensuring that targeted "enhanced ETAs" in particular have sufficient telecommunications, power, and transportation infrastructure to support a growing workforce. It is well known that Boston has critical infrastructure upgrade requirements, and they must continue to be a priority. But upgrading Massachusetts's broader infrastructure in a targeted manner will also be central to the Commonwealth's success in supporting a broad spectrum of financial services employment options. Financial services executives have expressed the most interest in expanding into locations that offer them backup locations for their Boston headquarters. Infrastructure upgrades and expansions should seek to create or preserve this sort of "redundancy" with the greater Boston area. The Commonwealth's new Infrastructure Investment Initiative could serve as a mechanism for communities to meet the utility, access, and telecommunications needs of the financial services industry to encourage and facilitate in-state growth.

Third, the financial services liaison (identified in 1B above) could work with financial services companies to identify the most attractive location outside Greater Boston to meet their expansion needs. The liaison could also work closely with the governor, statewide groups such as the Massachusetts Alliance for Economic Development and its Site Finder database, and local economic development officials to ensure that financial services companies receive the support they need to expand into these areas.

Fourth and finally, companies will need to be willing to accept and support Massachusetts's efforts to become a viable, competitive alternative to expansion elsewhere in the U.S. To grow financial services jobs across the income spectrum, the Commonwealth will require a commitment on the part of business leaders to showcase the business advantages of being here. As part of their commitment to Massachusetts, executives could regularly point out how they are creating jobs and income thanks to the unique opportunities provided by Massachusetts.

Increased tax incentives and upgraded infrastructure should help Massachusetts capture more middle-income job growth, while bringing needed economic development to underdeveloped areas. This will help sustain a cost-effective state that can compete

INITIATIVE 2:
Become a Global Center for Talent and Innovation

Massachusetts already has a critical mass of financial services companies, jobs, and related research within its borders. Indeed, across asset management and asset servicing, the state enjoys top five positions nationally in both employment and output, while it is among the top 15 states in insurance. Despite major changes in banking, that sub-sector is still a major source of employment for the state.

Massachusetts also leads as a center of education, innovation, and productivity. The state boasts several of the world's leading universities with advanced degree programs capable of producing industry-leading thinking in a broad range of financial services. Boston ranks in the top five cities in the world on many measures of R&D expenditures and knowledge intensity. In 2005, it was second only to San Jose in the "World Knowledge Competitiveness Index," a measure of the quality and capacity of knowledge-based activities in the local economy.[7]

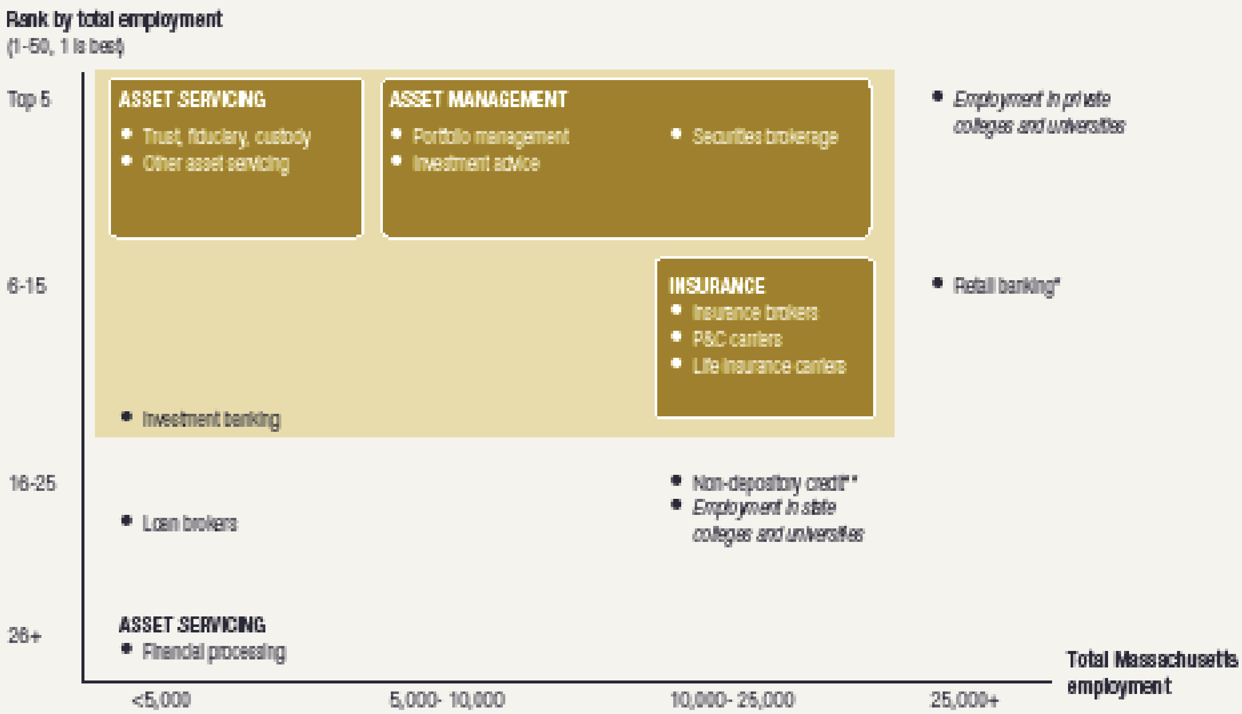
As the analysis in Section 2 suggests, however, the Commonwealth has not fully translated these natural advantages into economic results. The financial services sector should strive to become a "high-performing cluster" – a network of companies, government officials and agencies, educational institutions, and other organizations that generate value significantly greater than the sum of their parts. As Exhibit 13 shows, Massachusetts already enjoys a cluster of companies around asset management, asset servicing, and insurance. In successful sectors in other economies, whether high-tech in Silicon Valley or pharmaceuticals in New Jersey, high-performing clusters lead not only to growth in output, but also to long-term sustainability and reinvention.

Massachusetts's position as a globally competitive, high-performing financial services cluster can continue to drive improved productivity, new business formation, and, most importantly for maintaining leadership, continuous innovation. Innovation carries huge rewards: in 2002, Massachusetts had a nearly 15 percent share of the global mutual fund asset management market but only approximately 6.5 percent of the top 100 hedge funds, a market that was undergoing significant innovation and explosive growth. If Massachusetts had "caught up" to a 15 percent share in the hedge fund market, as an example, it would have controlled a further estimated $50 billion in assets under management and added approximately $1.1 billion to gross state product. Many other opportunities to innovate remain. Regaining the cutting edge will help restore Massachusetts's primacy in financial services.

It is critical, therefore, that Massachusetts capture

EXHIBIT 13

Massachusetts Has the Industry Components for Leadership in Asset, Asset Services, and Insurance



* Includes commercial banking, credit unions and savings institutions

** Credit card issuing, sales financing, consumer lending, real estate credit, etc.

Source: U.S. Bureau of Labor Statistics: Quarterly Census of Employment & Wages

the next wave of innovation. Given the rising interest in financial products that rely on information technology and expertise, such as quantitative asset management strategies, the Commonwealth is well positioned to flourish. This is especially true given the number of technology firms that support and are supported by financial services institutions (sidebar).

Industry changes point towards future trends: the ongoing evolution of alternative asset classes, changing distribution models, and the retirement of the Baby Boomers. Focusing Massachusetts's financial services sector around the next wave of innovation and growth is vital to maintaining the cluster's leadership position.

The opportunities for collaboration are substantial – as are the risks of maintaining the status quo. The business community, in partnership with universities and state and local government, can make more of these opportunities.

2A: Create formal industry linkages with leading Boston universities to build a financial services-specific research center, with applied programs in advanced quantitative topics and jointly sponsored employment and internship programs with leading innovative companies. It would also serve as an effective tool for recruiting the best students locally, nationally, and globally.

With Harvard, MIT, and other leading educational institutions making their home in Massachusetts, the Commonwealth produces thousands of graduates every year with the sophisticated quantitative skills that the financial services industry craves. The reservoir of talent and innovation currently employed in the industry is equally impressive. In asset management, for example, Massachusetts is home to many of the leading traditional players, a critical mass of venture capital and private equity firms, and an emerging hedge fund industry. As one executive put it, "both the big financial services companies and the smaller, more innovative firms are here for

Example Massachusetts Technology Firms That Focus on Finance and Insurance:

Asset Management Software
- Archimedes Systems
- Base-Two Investment Systems
- Cheshire Software
- FireStar Software
- Intex Solutions
- Northfield Information Services
- Smartleaf
- Upstream Technologies

Insurance Software
- American Financial Systems
- Boston Software
- EZ-RATER Systems
- Promontory Software Technology

IT Consulting
- Eastmark Group
- Koehler Consulting
- Mosiki Consulting

Networking, Internet, and Security
- Financial Fusion
- Global Data Systems
- Pyxis Mobile
- Tizor Systems
- Wave Systems

the high-end, innovative talent."

Indeed, local financial services executives identify the state's ability to attract and retain highly educated people as one of the critical factors driving the sector's current and future success, according to the survey conducted for this report. Fortunately, Massachusetts is already a locus for sophisticated financial services talent: the Commonwealth ranked well above average compared with other geographies in the ability to attract and retain professional employees.

Academia and business have each taken important steps to accelerate this virtuous talent cycle and to foster dynamic connections. State Street, for instance, enables leading academics from Harvard and MIT – as well as their graduate students – to conduct innovative proprietary research into securities and capital movement through their State Street Associates venture. Boston College's Center for Asset Management, meanwhile, increasingly serves as a forum for leading practitioners to collaborate and to link into the latest applied research. Similarly, Boston University's Master of Science in Actuarial Science integrates coursework with industry experience. The program helps students prepare for the examinations of the Society of Actuaries and Casualty Actuarial Society, and offers internships in insurance companies and other financial institutions.

That said, the financial services industry is not yet taking full advantage of the potential for partnering with academia. Most of the links between industry and universities are ad hoc – typically company-specific relationships built primarily around recruiting and internships. This is clearly true for many smaller high-end firms (which interviewees sometimes described as "fragmented" and "insular"), but also for larger companies that are responsible for so much of the employment base.

This absence of collaboration at the high end of the market represents an important missed opportunity for Massachusetts, given the aggressive recruitment of top students by employers in other states. As previous studies such as "Preventing a Brain Drain in Boston: Talent Retention in Greater Boston" have suggested, Massachusetts is increasingly failing to capture its fair share of the local talent pool.[8] As one interviewee said, "Kids straight out of the top colleges get the best jobs they can; increasingly, in financial services, that's in New York or Connecticut."

This is particularly true for many types of alternative investment firms, where Massachusetts has positive momentum but clearly lags New York/Connecticut and California in terms of sheer numbers and growth. Finance-bound MIT PhDs who graduated in 2006 reported taking positions at Barclays Capital, BNP Paribas, Goldman Sachs, UBS, and Fannie Mae – none of which are Massachusetts-based.[9]

Partnerships between universities and industry could position Massachusetts at the forefront of the next wave of financial services innovation. By collaborating to solve pressing problems in financial services, such as the under-funding of defined benefit retirement plans, and by commercializing cutting-edge research, collaboration can place Massachusetts at the forefront of emerging industry trends.

Massachusetts can take several critical steps to enhance such partnerships.

Again, Chicago offers some lessons. The University of Chicago's successful, targeted financial services education program draws on the resources of the local financial services community. Chicago's Master of Science in Financial Mathematics combines theoretical math with core finance and economics to apply recent academic research to practical financial problems. This program, developed and taught by a multi-disciplinary faculty that includes leading industry practitioners, draws on Chicago's unique strengths, including its options and futures exchanges and its long history as a center for asset management. Its graduates are quickly employed by Chicago-based companies (among others). There's no reason that local industry couldn't collaborate with Boston's top universities to create similar programs that draw on Boston's unique strengths.

Even simpler collaborative programs can have powerful effects. In the life sciences, Novartis holds weekly seminars in Cambridge where leading academics and researchers from local institutions speak with employees about cutting-edge research. This series is frequently cited as a source of the intangible benefits that help sustain a high-performing cluster.

These links create a self-reinforcing cycle: more vibrant companies, more entrepreneurship in financial services, and a more attractive environment for recent graduates. As students work with leading companies through internships and industry-partnered research projects, they will build local relationships and become increasingly likely to remain in Massachusetts following graduation. Collaboration offers industry the opportunity to tailor research projects to emphasize end-products with commercial potential by focusing top researchers on specific needs. Through this feedback loop, Massachusetts can help secure its position as a financial innovation capital.

As a first step, a subset of Massachusetts's leading financial institutions could work with Harvard, MIT, or another leading university to launch a joint "financial services institute" that is explicitly tied to meet the needs of local industry and is collaborative across multiple academic institutions. This institute would likely be broad-based, addressing topics that cut across the many sub-sectors that would participate. As a first step and to create early momentum, the institute might focus on retirement and/or pension reform. After all, both topics are critically important to many of our local financial services companies, and are areas in which industry and academic leadership are clearly required. Over time, this effort could evolve into a collaborative, multi-institutional program among several major universities.

Under the umbrella of this institute, industry and academia could pursue a broad range of initiatives such as:

- Specific research programs linked to tactical priorities, such as product development, within financial services firms
- Courses jointly developed by business and academic leaders focused on preparing students for cutting-edge, intellectual-capital intensive careers at leading financial services companies
- Applied finance programs integrating academic and industry experts, linking the programs to internships, rotations, and other hands-on experience with local firms
- Seminars, speaking series, and roundtables to enhance networking and connectivity among academic and industry players throughout the region.

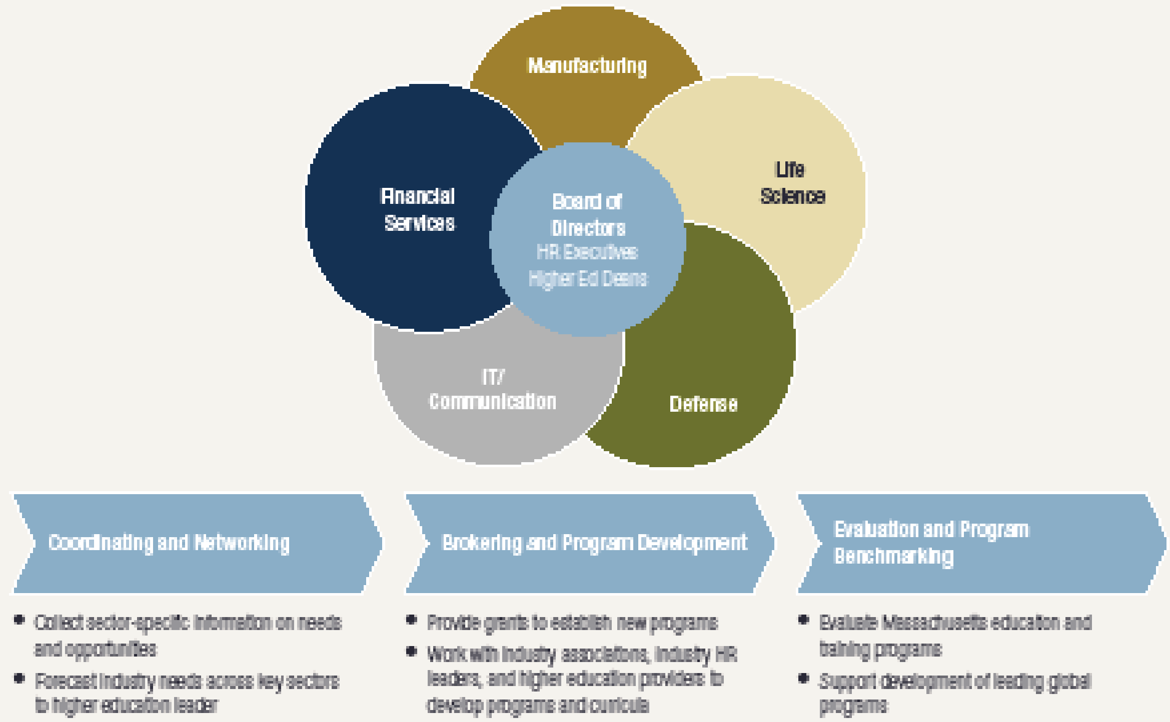
As a first suggestion, this institute could be led by a joint team from the Boston Federal Reserve and the Sloan School of Management and/or Harvard Business School. This would create an impartial leadership group that could collect cutting-edge research from financial services firms across Massachusetts. By publicly broadcasting that research, the institute could reinforce the Commonwealth's reputation as a center for innovation.

A model for such collaboration comes from Mass Insight's proposed Talent Development Bank, which provides a framework for networking, program development, and benchmarking as universities seek to collaborate with corporations across a number of industries (Exhibit 14).

Implementing such initiatives will require real commitment from industry and academia. Companies will need to provide significant resources to the new venture and deliver jobs and experiences to make

EXHIBIT 14

Massachusetts Talent Development Bank



Source: Mass Insight Global Massachusetts 2015

real-world applications meaningful. For their part, schools will need to be open to changes in their curricula and committed to devoting research time and attention to these topics. The success of the effort will only be as great as the importance the players ascribe to it.

In addition to these collaborative efforts, Massachusetts should build upon its current talent advantage by actively recruiting foreign talent to our universities and companies. As part of this effort, Massachusetts's leaders should support federal efforts to raise the annual cap on H1B visas, as proposed in the recent Bloomberg/Schumer report, *Sustaining New York's and the US' Global Financial Services Leadership*.[10] As the market for talent becomes increasingly global, Massachusetts needs to be the destination of choice for leading talent, both homegrown and from other states and countries. The Bloomberg/Schumer report suggested that New York pursue similar recommendations. We believe that both states could profit as global centers for talent and innovation. There is even room for them to work together collaboratively.

INITIATIVE 3:

Make Massachusetts a More Stable and Competitive Place to Do Businesses

Economic vitality depends on a creating an attractive business climate – one that supports business and employment growth. *Site Selection* magazine has ranked North Carolina the most attractive business climate five times in six years. Its success in recruiting more than 160,0000 jobs and $26 billion in investment since 2001 is partially attributable to the business climate and ease of doing business there.[11]

Massachusetts has a long way to go on this measure. In interviews, local financial services executives expressed important concerns about the Massachusetts's regulatory and litigation environment. They are concerned about "red tape" in state financial services regulation – particularly the drawn-out insurance product approval process. Executives are even more concerned about the regulatory enforcement environment, pointing to certain high-profile, seemingly adversarial cases. If Massachusetts is to begin capturing its share of employment and investment flows, it must develop a more favorable business climate.

In the past few years, Massachusetts has made some progress in becoming friendlier to business. For example, the Business Resource Team's creation of an umbrella organization – combined with passage of Chapter 43D, which creates zones for expedited permitting of commercial land – has driven job growth and created a pipeline for future business investment. Early wins, such as the successful wooing of Bristol-Myers Squibb to build a facility on the former site of Fort Devens, helped demonstrate the value of government outreach at both the state and local level. As one financial services executive observed, "What Massachusetts needs most is to turn the Bristol-Myers Squibb example into the way we do business every day." In addition, the Commonwealth Housing Taskforce and others should be commended for passing Chapter 40R, which seeks to increase housing production by offering financial incentives to municipalities for adopting special residential zoning districts, and Chapter 40S, which reimburses cities and towns for the school growth costs associated resulting from 40R (sidebar).

Throughout the 1990s, Massachusetts made great progress in improving its tax position. But in recent years, the Commonwealth's business tax burden has been increased by over $1 billion. Our interviews with and surveys of financial services leaders – as well as other research by Global Insight and the Pioneer Institute – indicate that it is still expensive and difficult to do business in Massachusetts (Exhibit 15). To illustrate, recent legislation and changes in leadership notwithstanding, the commercial permitting process and associated attitudes toward commercial expansion continue to frustrate and impede economic development.

There are also important structural impediments to attracting talent to the state. 40R and 40S are still unproven in modifying the township-driven residential permitting process: "Not-in-my-back-yard has still got a stranglehold on our housing stock," said more than one interviewee. Another added, "It's very difficult for me to keep my entry-level employees once they want to own a home and start a family; there are a lot of other great places to live with much lower housing costs."

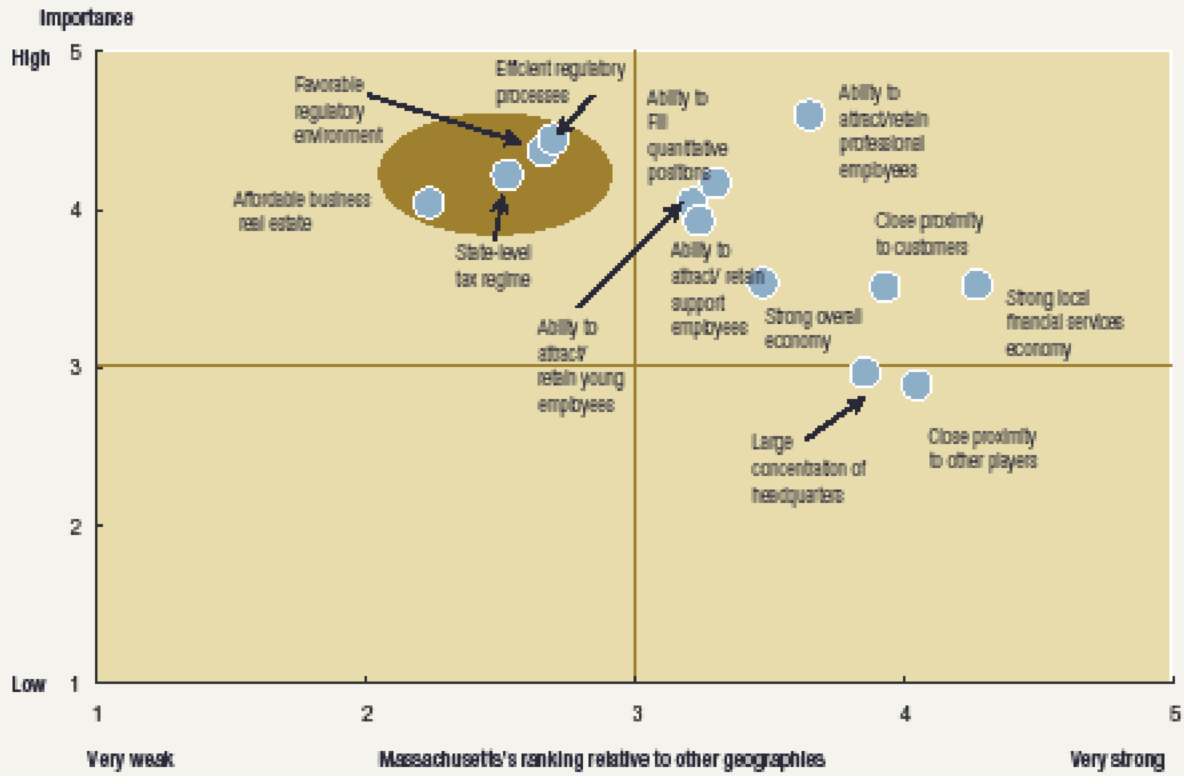
While Massachusetts strives to reinvent itself as a magnet for business in financial services, other states continue to use aggressive programs meant to lure business opportunities away from the Commonwealth. For example, North Carolina's Business Servicenter offers certified sites for rapid development, and a single point of contact for all state development services.

Many states have structured corporate tax regimes – or business-specific tax incentives – to make relocation palatable and attractive. Some, such as New York, have restructured state regulatory agencies and restricted the imposition of additional regulations – to good effect, according to some executives and experts in the field.

Changing the regulatory culture in Massachusetts will require a fundamental shift in the way state government, local government, and industry leaders work together. The health care reform bill, passed in April 2006, offers an example of how such collaboration can benefit every party. The bipartisan support for this legislation, and the process by which community, government, and corporate leaders achieved this solution, could serve as a model as these same leaders work to improve the business climate in Massachusetts.

EXHIBIT 15

Survey Results Suggest the Regulatory Environment is a Pressing Challenge



Source: McKinsey survey of financial services executives

Recent initiatives intended to enlarge the housing stock for middle-income households

Massachusetts has a shortage of housing stock for middle-income households. In 2005, 44 percent of households making between $35,000 and $75,000 a year spent over 30 percent of their income on housing ownership costs – a level considered "unaffordable." By contrast, in 1999 only 26 percent of these middle-income homeowners paid unaffordable housing costs. Middle-income renters were also hard hit, with over 30 percent of households paying unaffordable rent costs in 2005 versus 12 percent in 1999.

High ownership and rental costs have been one factor underlying the loss of 30,000 middle-income households in Massachusetts since 2002. Prompted by the efforts of the State Housing Task Force and others, the Massachusetts Legislature passed two laws to stimulate the creation of housing stock for middle-income households. Chapter 40R, passed in 2004, created Smart Growth Zoning Districts. Under 40R, the state provides towns with volume-based payments to zone for dense developments near town centers or mass transit, and to permit for construction within these zones.

Under Chapter 40S, a related law passed in 2005, the state created a Smart Growth School Fund to reimburse towns for school costs associated with children living in 40R developments at an average rate of $320 per child per year. In addition, in recent years the Boston Redevelopment Authority and private developers have been particularly energetic in using Chapter 40B, the 1969 "Anti-Snob" zoning law, to promote creation of affordable housing units in conjunction with other residential real estate development.

While the spirit behind this legislation and associated public activity is commendable, implementation of 40R and 40S has been slow. No towns adopted 40R districts until passage of 40S late in 2005, due to worries about additional school costs. Since passage of 40S, six towns have created 40R districts that will generate 1,700 affordable housing units. Still, towns continue to delay adopting 40R, citing concerns that adoption of 40R will permanently decrease the local municipality's control over the town's character, and that the state is not committed to sufficiently funding 40R and 40S over the long-term. Greater Boston municipalites have made more progress in using 40B, which simplifies the permitting process for development projects with an affordable housing component. From 2001 to 2005 they have added over 4,000 affordable units and over 10,000 other units to its housing stock.

Absent more substantial improvements in the quantity and price of the housing stock available to its middle-income workers, the Massachusetts financial services community remains concerned about retaining them. Many executives echoed the sentiments of the CEO of a leading Massachusetts company who said, "I can get young college graduates to take my entry-level positions in Boston, but once they get married and start families, they move away from Massachusetts to places where they can afford to buy houses. That's not a sustainable formula."

As communities adopt 40R and 40S, it will be important to monitor the success of these Chapters in creating affordable housing units, and their impact on housing prices. Increasing the supply of affordable housing and slowing the rise of median home prices will allow workers across the economic spectrum to afford to live and work in Massachusetts. Employers will benefit, too, as wage pressures are alleviated.

Massachusetts and Greater Boston should take three specific actions to become friendlier to financial services and other sectors:

3A: Retool state and local permitting to expedite commercial development. Create new state incentives for localities that designate expedited permitting zones. In addition, introduce a "shovel-ready" designation and identify and promote sites that companies could acquire and develop immediately.

Companies considering expanding in or relocating to Massachusetts face a fragmented set of local decision-makers and often cumbersome development processes. State land is incorporated across 351 separate municipalities, whose zoning and development laws vary widely. In most municipalities, commercial buildings above a minimum square footage or number of stories require special permits, which often have no approval timetable. As a result, according to the Massachusetts Council of Chambers, the average permitting process in Massachusetts takes between 8 and 24 months, the longest in the country. This compares to an average of four months in San Diego, and a maximum of two months in North Carolina's Research Triangle Park. A top Massachusetts official surveyed reported that the permitting process in the next-most time-consuming state – California – averages only six months.

Concerns about the difficulty of commercial permitting and development in Boston in particular, and Massachusetts more broadly, surfaced as a top competitiveness issue in our interviews with financial services executives. They generally agreed that "things simply take too long to get built." One executive described having to time approval for a major development with more pressing public agenda items to avoid the development process being delayed by officials seeking – not offering – financial concessions.

While Massachusetts waits to feel the effects of recent positive developments, other states are already integrating economic development activities and promoting "shovel-ready" sites.

Without exception, financial services executives interviewed applauded the state's economic development leaders for attracting Bristol-Meyers Squibb. Many shared the concern of one executive, however, who said, "the BMS deal was still only a one-off, and it was possible only because they used [public] land. Massachusetts needs to be able to get things done efficiently most of time, not just occasionally."

Some progress is already underway to address this crucial issue. In an attempt to make commercial permitting more navigable and predictable, the Legislature passed an Expedited Permitting Program in 2004 and amended it in 2006. The program allows towns to designate certain areas as expedited permitting zones; in return, towns receive payments from the state, assistance from Mass Development, priority for state infrastructure improvement funds (e.g., MORE, PWED), and marketing of expedited sites. So far, seven towns – Uxbridge, Medway, Worcester, Attleboro, Franklin, Bulington, and Leominster – have passed at the town level, and a number of others are well down the road to adoption. Adoption by this first set of communities should encourage other municipalities throughout the state to do the same: as companies begin favoring towns who have adopted expedited permitting, communities will see the value of expedited permitting zones in attracting development and jobs.

On a state-wide level, Massachusetts has created a single point of contact for site selection (via Massachusetts Alliance for Economic Development's SiteFinder), permitting, and other economic development inquiries. The BRT also offers financing assistance through state incentive packages and quasi-public groups such as CommCorp and MassDevelopment. The Patrick Administration recently created a Permit Regulatory Office headed by a Permit Ombudsman. The ombudsman's mission is to provide direct assistance to proponents of development projects with respect to state and local permitting, licensing, and regulatory matters. This includes working with municipalities and state regulatory agencies to streamline both state and local permitting processes.

While Massachusetts waits to feel the effects of these positive developments, however, other states are already integrating economic development activities and promoting "shovel-ready" sites.[12] Rhode Island's Economic Development Corporation and New Hampshire's Business Resource Center, for example, offer one-stop-shopping, streamlining processes for companies seeking to locate there. New York State pre-permits sites, with the Empire State Development and the Governor's Office of Regulatory Reform offering a program to certify and market sites as Shovel Ready. Similarly, North Carolina's Certified Sites program pre-qualifies sites suitable for rapid construction.

Three steps could further the progress that has been made in expedited permitting.

At the local level, certain municipalities critical to Greater Boston's development should be encouraged to modify commercial permitting processes with an eye toward retaining and attracting business. Some Boston townships have already taken initiative in this direction: the Town of Harvard recently waived its 75-foot height restriction to support the Bristol-Myers Squibb development. They should emphasize that changes in philosophy and attitude – not just changes to the letter of the law – will help enable businesses to thrive and grow in Massachusetts. The governor or legislature may also be able to create some linkage between statewide economic incentives and more liberal local development, although they would no doubt need to tread carefully and respect local sovereignty.

At the state legislature level, state-based incentives should be expanded to help localities designate expedited permitting zones. Chapter 43D appears structurally sound, but implementation needs to be quicker. Ideally, state officials would monitor town adoption rates, meet with town leaders to understand any remaining impediments to adoption, and modify 43D if necessary. As municipalities adopt 43D, the BRT and Legislature could monitor the efficacy of the law, which would help to understand the economic implications of expedited permitting zones. Further, municipalities that have adopted expedited permitting merit superior marketing "placement" with companies seeking to expand.

Finally, Massachusetts could introduce a "shovel-ready" designation for sites and build an arsenal of such sites for companies seeking to acquire and develop new facilities. The current Mass Alliance for Economic Development's (MAED) SiteFinder is a step forward in cataloging available sites. Building on the expansion of 43D districts, MAED should identify properties with expedited permitting available, and, as a shovel-ready certification program comes online, introduce this designation into SiteFinder as well. Massachusetts should establish a stringent definition for shovel-ready properties in line with those of North Carolina and New York and work with municipalities to enhance the readiness of prospective sites for rapid acquisition, development, and operation.

A competitive, efficient, and responsive commercial permitting process and development environment would make the state more viable and attractive. This would especially affect the siting decisions of existing companies for whom proximity to existing sites creates efficiency and collaboration advantages.

Executives rank "efficient regulatory processes" and "favorable regulatory environment" as the two most important among seven factors driving decisions to locate, grow or keep their business in a particular geography. Unfortunately, they rank Massachusetts poorly on both dimensions, tied for worst.

3B: Modify the Commonwealth's financial services regulatory structure, body of rules, rule-making processes, and enforcement approach as necessary to create a more predictable environment for companies. Support efforts to promote a more streamlined federal regulatory regime.

Changes in the financial services industry have outpaced the Commonwealth's regulatory structures and oversight. According to interviews and surveys, financial services executives believe that Massachusetts is missing the mark in regulatory efficiency and effectiveness. They rank "efficient regulatory processes" and "favorable regulatory environment" as the two most important among seven factors driving decisions to locate, grow or keep their business in a particular geography. Unfortunately, they rank Massachusetts poorly on both dimensions, tied for worst.

Insurance executives are more concerned about regulatory efficiency than executives from other sub-sectors are: high mandatory coverage levels and slow product approval processes put insurers operating in Massachusetts at a disadvantage. Indeed, one executive told us that the product licensing process in life insurance, in particular, can stretch for six months in Massachusetts, compared to six weeks in most states. Governor Patrick's administration has already flagged this as a competitive concern for Massachusetts's insurance industry and has pledged to cut licensing time for these products, with a goal of two months. Industry leaders should assist and support the administration in this effort.

While the Commonwealth's regulatory environment has remained static, other states have redrawn their regulatory structures and the rules they produce. New York is widely considered a model for regulatory reform. Beginning in the mid-1990s, that state's Governor's Office of Regulatory Reform sought to eliminate duplication, reduce inconsistent interpretation of the laws, and improve the relationship between regulators and the regulated. Governor Pataki declared a moratorium on all new regulations pending cost/benefit analyses. As a result, New York cut the pace of new regulation in half, saved businesses billions in compliance costs, and created an environment that is friendlier to existing and prospective businesses. More recent regulatory enforcement actions against a number of financial services companies were received with less enthusiasm by the industry; those actions are, however, independent from the improvements to the state's regulatory structure and body of regulations.

While the Commonwealth's regulatory environment has remained static, other states have redrawn their regulatory structures and the rules they produce.

Very recently, many U.S. policy-makers, among them Secretary of the Treasury Henry Paulson and Securities and Exchange Commission Chairman Christopher Cox, have expressed interest in reforming Federal regulatory structures and processes, spurred by increasingly intense international competition with other leading financial centers like London. Mayor Michael Bloomberg's and Senator Charles Schumer's recent report, *Sustaining New York's and the US' Global Financial Services Leadership*, also based on research by McKinsey & Company, lays out an agenda for addressing these issues.

Among other recommendations, the Bloomberg/Schumer report suggests that regulators adopt common principles like those recently recommended by the Institute of International Finance (e.g., materiality, cost/benefit analysis, consultation) that would result in more predictable and apparently fairer outcomes for regulated businesses. They suggest forming a National Commission on Financial Market Competitiveness tasked with simplifying the structure of U.S. financial services regulators, including considering an Optional Federal Charter for life and/or property and casualty insurance. They also advocate greater cooperation and communication between the executive branch (regulators) and the judicial branch (attorneys general and prosecutors) on enforcement.

To help promote a more predictable regulatory environment, Massachusetts could take two steps.

The Governor could join the heads of state regulatory agencies to commission the kind of streamlining that New York benefited from in the mid-1990s. Such an effort would aim to minimize the number of regulatory authorities and clarify their responsibilities. It would introduce common principles, such as those under consideration at the national level, which would guide regulators toward balanced, predictable, and fair interactions with businesses. Ideally, it would also cut the number of regulations, or at least slow the pace of their introduction.

In addition, the Administration could work with Representative Barney Frank of Massachusetts, the new Chairman of the House Financial Services Committee, to promote a streamlined federal regulatory regime for financial services. This collaboration could include consulting with Massachusetts-based insurance companies to clarify the state's position on the Optional Federal Charter for life insurance and property and casualty insurance. In particular, Massachusetts businesses would benefit from a consistent set of principles governing regulators at the federal and state levels. They would also benefit from greater coordination and communication among regulators, attorneys general, and prosecutors.

3C: Promote a more predictable tax environment while addressing structural issues underlying low-revenue, high-pain taxes to make them more consistent with approaches used in other states.

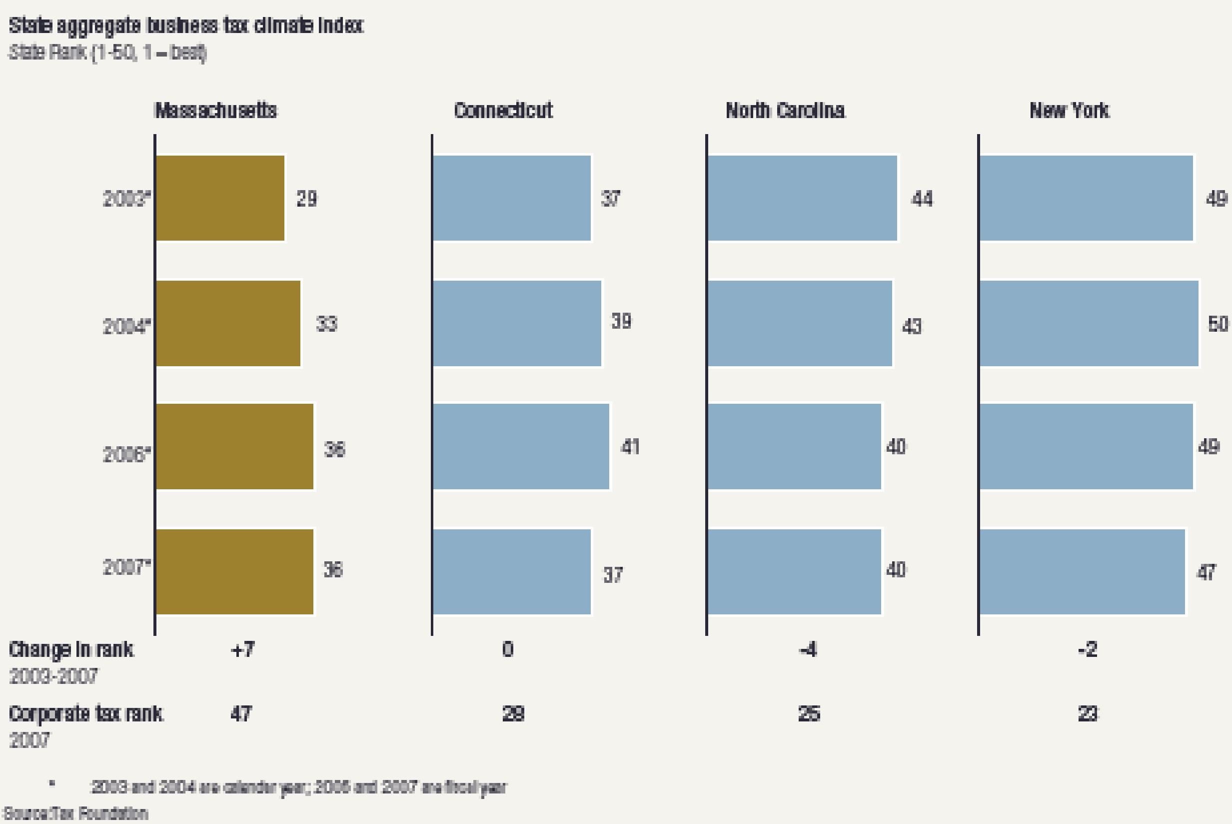
Since the 1990s, Massachusetts has experienced slippage in its relative tax position. Massachusetts's overall state business tax climate fell from 29th in 2003 to 36th in 2007: other states continued to reduce taxes while Massachusetts raised taxes five times (Exhibit 16). Those five increases have raised Massachusetts businesses' state tax payments by over $1 billion per year. In particular, Massachusetts's corporate tax continues to rank near the bottom – 47th out of 50, ahead of only Michigan, New Hampshire, and Delaware. Due to these shortcomings, financial services executives who responded to our survey rated a "favorable state-level corporate tax regime" tied for first in terms of importance but seventh (out of nine factors) in terms of Massachusetts's performance.

This recent decline in Massachusetts's competitive tax position underlies a serious concern facing financial services executives today: the fear that the Commonwealth's tax environment is unpredictable. In particular, executives are concerned about repeal of 1990s reforms such as the single sales-factor tax, which offers significant savings to companies with many physical resources in-state and offers them incentives to grow or maintain jobs and property in the state. By qualifying for the single sales-factor, corporations pay tax only on sales in-state, rather than paying on sales, payroll, and property in-state. The fear that Massachusetts will return to this three-factor apportionment is a key concern facing executives.

Recent proposals to change Massachusetts corporate taxation have heightened executives' concerns. In general, financial services leaders interviewed for this report are not seeking a comprehensive overhaul to the tax code – they acknowledge the progress made during the 1990s, while remaining guarded about some of the increases they have seen in recent years. Rather, they are seeking significantly greater predictability with respect to how tax policy will evolve in the future. As a result, it is critically important that the administration and

EXHIBIT 16

Massachusetts's Tax Competitiveness Has Slipped Relative to Important Peer States



the legislature safeguard against further declines in the Commonwealth's competitive tax position and preserve the significant progress that was made on this front in the 1990s. In doing so, they should also commit to, and promote, a predictable tax environment for business.

This recent decline in Massachusetts's competitive tax position underlies a serious concern facing financial services executives today: the fear that the Commonwealth's tax environment is unpredictable.

Three critical steps could help address these concerns.

First, Governor Patrick has taken an important first step by clearly stating his support for the single sales-factor as sound tax policy and vowing to veto any repeal or modification to the single sales provision. Not imposing other business tax increases would go a long way towards signaling a new era of tax predictability.

Second, two taxes that generate low revenues (about 3 percent of Massachusetts's total tax revenues) but significant pain for Massachusetts businesses could be structurally reformed. The corporate net worth (formally known as the non-income excise) tax requires a cumbersome calculation of Massachusetts-related net worth. The administrative burden is particularly high for those smaller firms that the state needs to form the foundation of an innovation-centered strategy. The Massachusetts Legislature could repeal or significantly modify the non-income excise tax to bring Massachusetts's policy in line with that of peer states, including Illinois, Connecticut, and New York.

In addition, the Massachusetts short-term capital gains tax rate is the highest in the nation, tied with North Dakota. Massachusetts also deviates from other states by taxing short- and long-term capital gains at different rates – 12 percent and 5.3 percent, respectively. Unifying these rates at 5.3 percent would bring Massachusetts in line with other states and save millions of dollars in accounting fees, while only reducing state tax revenues by approximately 0.5 percent. If this more than 50 percent decrease in the short-term capital gains tax rate is too drastic, the state could approve a decrease of 25 percent to bring Massachusetts in line with the highest of its peer states, California, at 9.3 percent.

Third, Massachusetts could offer specific tax incentives to companies considering major relocations and expansions, as do neighboring states. Although municipalities have the necessary tools to offer property incentive packages, few state-level incentives are available to financial services companies. Rather, these programs emphasize research and development and manufacturing growth. Of the major state-level incentives available today, financial services are eligible only for the single sales-factor tax credit. As one leading financial services executive put it, "tax incentives matter because they offer the state a way to make up for other high costs like real estate and housing."

By introducing these changes, Massachusetts could increase the predictability and flexibility of the tax regime, while addressing underlying structural challenges. And through these changes, the tax environment could be less of a deterrent for businesses looking to expand in Massachusetts.

4.

THE PATH AHEAD:

Collaborating to Make the Change Happen

There is an urgent need for Massachusetts to take concerted action to protect and enhance its position in financial services. At stake are the jobs, revenues, and stature that the sector contributes to the Commonwealth. The recommended agenda contained in this report is an important contribution, but it is only as valuable as the actions that it inspires or supports. To ensure action, ownership of this agenda needs to transition from the co-sponsors of this report – the Greater Boston Chamber of Commerce and Mass Insight – to those with control over policy, business decisions, and resources, both private and public.

This means that government, industry, and academia will need to work together better to build on Massachusetts's long history of leadership in financial services. This collaboration will require leaders who will unite the state's financial services community and help it find a common vision and a single voice. Many interviewees expressed concern about the fragmentation of public and private efforts in Boston and Massachusetts more broadly, and agreed with the executive who said, "We need to rally the business community behind a common vision."

Clearly, more commitment and leadership by top executives in the financial services industry will be required. Ideally, much of this commitment can come in the form of their more active involvement in setting and executing against the agenda of public/private advocacy groups and forums. To achieve meaningful, lasting impact, Massachusetts might also consider forming a bi-partisan commission of leading financial services insiders who would dedicate substantial, near-term energy to the project.

Mass Insight and the Greater Boston Chamber of Commerce will work jointly to advance these initiatives while seeking greater support across the private, public, and academic sectors. Such support will be necessary because ownership of many of the specific recommendations will fall to individual actors in each of these sectors (Exhibit 17).

EXHIBIT 17

Implementation Requires Ownership Across the Public, Private, and Academic Sectors

	1. Preserve and expand a diverse employment base			2. Become a global center for talent and innovation	3. Make Massachusetts a more stable, competitive place to do business		
	A. Community / state colleges	B. State-led outreach	C. Develop non-Boston locations		A. Expedite permitting	B. Modify regulatory structure	C. Predictable tax environment
Public sector	• Increase financing for workforce training programs • Allow UMass to retain tuition revenue	• Designate liaison and envoy • Expand and institutionalize outreach campaign	• Overhaul ETAs • Introduce infrastructure improvements in targeted areas • Identify and prepare sites outside Boston		• Expand incentives for expedited permitting • Introduce shovel-ready designation	• Commission regulatory streamlining • Promote a national financial services agenda	• Commit to single sales-factor • Review excise and short-term capital gains taxes • Commit to a consistent tax environment
Private sector	• Provide counsel and teachers to programs • Offer jobs and internships to graduates	• Designate specific group to lead effort • Identify list of "top targets"	• Align growth strategies with Massachusetts locations	• Provide industry leadership and funding for institute(s) and programs • Coordinate existing training programs			
Academia	• Improve training programs • Expand career coaching			• Launch "financial services institute" • Pursue other collaborative initiatives with industry			

- Public sector priority actions. Ongoing and sustained leadership in financial services requires an environment conducive to sector growth – measured by the number of firms that choose to locate in Massachusetts and by the size and diversity of the financial services workforce. To promote this goal, the public sector can focus on three priorities. First, state and local government can join hands to own Initiative 3 – to change the perception of Massachusetts as a difficult place to do business. In addition, the public sector can assume responsibility for 1B, institutionalizing programs that focus on retaining and growing the state's financial services employment base, and 1C, designating and promoting cost-effective locations with world-class infrastructure.

- Private sector priority actions. A growing, vibrant financial services cluster offers wide-ranging benefits to business – in particular, more innovation and higher productivity. Leading financial services businesses can take ownership for Initiative 2 – promoting and strengthening the financial services cluster by increasing linkages with universities to further develop world class talent. Leading executives can also "meet the government half way" in its efforts to retain top employers and make Massachusetts more business friendly. Even a "ties go to Massachusetts" mindset toward location decisions would go a long way in preserving and enhancing the Commonwealth's financial services footprint.

- Academic sector priority actions. Massachusetts's universities and community colleges can shape the talent pool that the financial services sector needs to thrive, innovate and grow. They can take charge of 1A, engaging with industry leaders to introduce academic programs that meet the needs of local employers. They can also help drive Initiative 2, launching the next wave of innovation in products and services by integrating theoretical research with industry applications. Collaboration between academia and industry will benefit colleges and universities, their students and faculty, and the entire Massachusetts financial services community.

Massachusetts has a choice. It can pull its amazing assets together to be an important, distinctive part of the global financial services landscape. Alternatively, its leaders can sit on the sidelines and allow forces at work to relegate the Commonwealth to second-tier status in financial services, even in asset management, asset servicing, and insurance. The difference between these two paths is thousands of jobs and billions of dollars in gross product to the Commonwealth. This report outlines a practical set of recommendations to take the Commonwealth down the first path. The dozens of financial services executives, public sector officials, and academic leaders consulted in this project have it in their power to turn these recommendations into action.

End Notes

1. Bureau of Labor Statistics and the Commonwealth of Massachusetts.

2. See *The Emerging Global Labor Market: The Demand for Offshore Talent in the Retail Banking Sector*, by the McKinsey Global Institute, for more detail on this topic.

3. Huggins, Robert, Hiro Izushi, and Will Davies. *World Competitiveness Index 2005*. Robert Huggins Associates.

4. PriceWaterhouseCoopers/Thomson Venture Economics/ National Venture Capital Association MoneyTree Survey Report, Fourth Quarter 2006.

5. Chapter 23A: Section 3D. Economic target areas.

6. Massachusetts is closer to offering the infrastructure improvements necessary to make locations outside of Boston viable for financial services companies. Both the MORE Jobs Program and the recent Infrastructure Investment Incentive promise to invest a combined total of up to $300 million in targeted infrastructure projects.

7. Huggins, Robert, Hiro Izushi, and Will Davies. *World Competitiveness Index 2005*. Robert Huggins Associates.

8. See *Preventing a Brain Drain: Talent Retention in Greater Boston*, 2003. Prepared by The Boston Consulting Group for the Greater Boston Chamber of Commerce and The Boston Foundation.

9. 2006 MIT Careers Office Annual Graduating Student Survey Report.

10. *Sustaining New York's and the US' Global Financial Services Leadership*, 2007. Prepared by McKinsey & Company for Mayor Michael R. Bloomberg and Senator Charles E. Schumer.

11. *Site Selection* magazine, November 2006.

12. According to *Business Facilities Magazine*, a “shovel-ready” site is one that is: 1) available for sale, ideally with established terms and conditions; 2) fully served, with all utilities already at the site with capacity to meet the added demand; and 3) developable, that is, free of easements, rights-of-way, or environmental impediments.