



Canadian Bankers Association Response to the Export Development Canada Review 2008

June, 2008



CANADIAN BANKERS ASSOCIATION

The Canadian Bankers Association welcomes the opportunity to participate in the 10 year Legislative Review of Export Development Corporation. Canada's banks have, for many years, shared EDC's objective of enhancing Canada's export trade, and have worked collaboratively with EDC to grow Canada's trade finance capacity. Canada's banks are major users of EDC's risk mitigating products. These enhance banks' ability to lend where risks are higher than private sector lending thresholds, or terms longer than commercially feasible. The CBA considers the Legislative Review properly focussed on identifying gaps in the services available to Canadian exporters in the private sector marketplace, where EDC assistance can bridge gaps to make Canadian exports globally competitive.

In enhancing Canada's export financing capacity, however, EDC must take care not to duplicate financial services available through the private sector. As EDC observes in its response to the EDC Review Team, "today's business realities require private and public sector institutions to complement one another ..."¹ Since EDC's essential purpose, to promote export trade, is not commercial, EDC must take care, in fulfilling its public policy mandate, not to introduce harmful distortions to Canada's financial markets.

Filling Market Gaps

For more than twenty-five years, EDC has offered export credit insurance. In making export credit insurance available in the Canadian financial services marketplace, EDC has significantly enhanced banks' ability to lend against exporters' insured foreign sales receivables. As a crown corporation, EDC enjoys a Canadian sovereign risk rating, the highest credit rating available to obligors of Canadian banks. Moreover, there is a perception in the marketplace that EDC is unlikely to refuse claims given its government-mandated role to support exports. Borrowing at low, sovereign credit rates, EDC is able to enhance the value of its exporting customers' trade receivables. This, in consequence, enables banks to better price their loans to exporters. And exporters, in turn, are able to pass along savings to their foreign buyers, enhancing Canadian exporters' international competitiveness.

EDC Financial Advantages

The banking industry supports the role played by EDC in the export credit insurance market, as we do all EDC product offerings that complement private sector financing. We are concerned, however, about EDC expanding into areas that are well served by the private sector, with the adverse potential to distort those markets. Canadian sovereign risk credit rating is but one advantage that EDC enjoys as a government-sponsored export credit agency. EDC is also enabled by a lighter regulatory framework than that under which commercial banks operate. EDC pays no income tax, and has no need to earn a market-rate of return or to pay regular dividends. As such, EDC is not subject to market discipline with its pricing, earnings or activities. While this may be appropriate, given its governmental mandate to promote export trade, as noted in the 1999 EDC review by Gowling, Strathy & Henderson, "EDC's basic purpose is to promote export trade, not to maximize its return on investment..."²

¹ Submission to the 2008 Legislative Review of the *Export Development Act*, Anticipating Needs – Delivering Results, EDC in a Evolving Trade Environment, pg. 2.

² Report on the Review of the Export Development Act, for the Department of Foreign Affairs and International Trade, by Gowling, Strathy & Henderson, June 1999, Chapter 2.

Competition with the Private Sector

Indeed, a significant portion of the 1999 Gowlings Review focuses directly on EDC's competition with the private sector. EDC's 2008 submission to the EDC Review Team also proposes the expansion of its mandate to compete with the private sector. EDC argues that export financing agencies of other countries are moving to a more commercial mandate.³ Citing the export financing agency of the Italian government, EDC notes its participation in "general corporate facilities".⁴ More specifically, EDC argues for more commercial powers in the domestic Canadian financial market, for example, the ability to provide

- Certain general purpose corporate facilities (financing and surety) for mid-market and larger Canadian companies that use these facilities for their foreign operations and export programs;
- Financing for production projects and infrastructure projects not tangibly linked to export contracts; and
- Domestic mergers and acquisitions where the outcome would be more large, globally active and competitive players.⁵

Such broad-based expansion of EDC powers would move EDC toward direct competition with the private sector. Yet, as observed by Gowlings, "EDC is fundamentally different from the private sector financial institutions with which it competes ...".⁶ In addition to the advantages that EDC enjoys by reason of its crown corporation status, EDC is also subject to political pressures. EDC entry into domestic markets, motivated by non-commercial factors, and subject to political pressures, would serve as a disincentive to commercial banks operating in areas contested by EDC with its crown corporation advantages.

Sensible Limits on EDC Domestic Financing

The *Export Development Act* provides that the federal government may permit EDC to enter into transactions that are not related to export financing. Section 10(6) of the *Act* allows EDC to enter into arrangements that have the effect of extending credit that "are made in respect to transactions not relating, directly or indirectly, to the carrying on of business or other activities outside of Canada ..." [Our emphasis]. In this connection, the EDC regulations, made under the *Act*, permit EDC to enter into "domestic financial transaction[s]" and "domestic insurance transaction[s]",⁷ subject to the approval of the Minister of International Trade and the Minister of Finance.⁸ This provides EDC with the flexibility to undertake domestic transactions that would normally be outside of EDC's scope, subject to government oversight that ensures that EDC participation is appropriate. Moreover, government approval requires the signature of two ministers. The approvals of Minister of International Trade and the Minister of Finance, serve, respectively, to balance Canada's interest in supporting worthy commercial endeavours that are not directly linked to export trade, with the need to maintain the competitiveness of the Canada's private sector financial institutions, themselves major exporters (of Canadian financial services).

³ At pg. 21.

⁴ At pg. 21.

⁵ 2008 EDC Submission, pg. 54.

⁶ Gowlings Submission, Overview.

⁷ Export Development Canada Exercise of Certain Powers Regulations, s. 2.

⁸ Export Development Canada Exercise of Certain Powers Regulations, sections 5 and 6.

In its submission to the Review Team, EDC characterizes the changes that it requests to its mandate and regulations as “small adjustments”.⁹ From the banking industry’s perspective, the removal from the regulations of the requirement for EDC to obtain ministerial approval to enter into domestic financing transactions is not small. For example, EDC argues for the capacity to undertake infrastructure and domestic mergers and acquisitions. Such transactions are usually far from small. Yet EDC argues for unrestricted ability to participate in domestic infrastructure financing on the tenuous basis that “stronger infrastructure not only helps Canadian companies get their goods and services quickly and efficiently onto world markets” but “also makes Canada a more attractive destination for trade”.¹⁰ Even more remotely from EDC’s mandate to support export trade, EDC argues for capacity to participate in domestic mergers without ministerial approval: “EDC is also not able to assist Canadian companies expand through domestic mergers and acquisitions even if the merged company plans to export in the future.¹¹[Our emphasis.]

We share the view expressed by the House of Commons Standing Committee on Foreign Affairs and International Trade in its 1999 Report reviewing EDC, that it is important to separate private sector financing from complementary EDC financing to fill market gaps. The Committee recommended that “the Government not amend EDC’s power to conduct domestic financing, but attentively monitor the transactions that EDC conducts or intends to conduct, and ensure that these transactions fall under EDC’s mandate.”¹² We agree with Professor Ragan, whose work EDC cites with approval, that “many and perhaps most activities in the economic sphere are best left to the private sector, and thus clear limits should be placed on the government’s role in the economy.”¹³ The requirement for ministerial approval to engage in domestic financing provides such limits.

EDC Complementary Financing

As we noted at the beginning of our discussion of EDC’s role in the financial services marketplace, we fully support the provision by EDC of financing and services that complement, rather than crowd out, domestic private sector financing. And we understand, as observed by EDC in its 2008 Submission to the Review Panel, that “EDC was created to compensate for perceived gaps in Canada’s international trade finance market.”¹⁴ We agree with EDC that “gaps still occur.”¹⁵ As well, we share the view of Professor Ragan that “a policy designed to increase the volume of exports is beneficial to Canada only if it redresses a market failure which itself tends to reduce exports.”¹⁶ However, while we support the important role that EDC can play in fulfilling a complementary role to the private sector’s facilitation of export trade, we are concerned that EDC should not be directly competing with private sector institutions in cases where the linkage to export trade is tenuous at best and where more than adequate competition exists, including in the potential situations noted above (e.g. mergers; infrastructure). We are concerned that an entity such as EDC, which is not subject to the same cost and competitive pressures as private sector companies, could create unfortunate distortions in the private sector market. For these reasons, EDC should continue to be limited to the positive role that it currently performs in support of private sector financial institutions in financing export trade.

⁹ At pg. 52.

¹⁰ EDC Submission, pg. 45.

¹¹ EDC Submission, pg. 45.

¹² Standing Committee on Foreign Affairs and International Trade, Recommendation 9.

¹³ Ragan, Christopher, Filling a Shrinking Gap at pg. 6. <http://people.mcgill.ca/files/christopher.ragan/EDC.pdf>

¹⁴ At pg. 51.

¹⁵ 2008 EDC Submission, pg. 51.

¹⁶ Ragan, pg 3.

Small and Medium Enterprise Financing

An area for complementary financing, where the private sector is constrained by reason of prudential regulation that binds it, is start-up capital financing for emerging exporters. We agree with EDC that emerging SMEs need EDC to provide early-stage support,¹⁷ where prudential considerations prevent the private sector from providing it. However, this is not to say that EDC should compete with the private sector for all SME financing. The SME sector, on the whole, is well served by the private sector. In 2007, Canada's banks authorized more than \$80 billion to over one million SMEs across the country and in every sector of the economy. Other, non bank, private sector players supplied a similar amount of financing to SMEs. On average, about 80% of SME funding requests are authorized. Statistics Canada surveys of SMEs in Canada indicate that very few SMEs shy away from seeking funding because of complexity or cost. Less than 5% fail to seek financing because it is too expensive, too hard to get or because they feel they will be turned down. Over 90% who do not seek financing state that they don't need it.

All of this suggests that the SME market is well served. Indeed, we note the observation of Canada's Competition Policy Review Panel that the frequent criticism of the SME lending practices of Canada's large financial institutions is misplaced. The Panel notes that "the evidence before the Panel has not convinced us that competition is lacking in the supply of credit for small and medium-sized businesses..."; and that "Competition has lowered the cost of banking services in Canada to the point where it is among the lowest cost markets in the world."¹⁸

Expanded Private Sector Financing

In addition, according to global surveys by Grant Thornton, businesses in Canada are less likely to consider access to financing, and its cost, as barriers to growth than are respondents in other countries. And, Canada is usually amongst the best performers of OECD countries. In this regard, Canada's banks are continually expanding their offerings to facilitate Canadian companies of all sizes. In just over three years, bank lending to businesses of all sizes has increased by 40% in Canada. The Bank of Canada attributes strong growth in 2008, in part, to "a substitution away from [capital] market financing towards bank financing in the current turbulent [capital markets] environment."¹⁹ In other words, banks are ensuring that Canadian businesses have the financing they need. They are able to do this because they are very well capitalized and, according to the Bank of Canada, "less exposed to the subprime mortgage market than their U.S. counterparts..."²⁰

Clearly, Canadian banks have both the capacity and willingness to serve a very large part of the market for financial services. In the context of expanded credit offerings, Canadian banks innovate, continually expanding their product offerings. For example, Canadian banks have begun to offer supply chain financing applications for both large corporate customers and to SMEs alike. We note that EDC proposes that it enter global supply chain financing infrastructure. In this connection, we again stress the importance of EDC playing a complimentary and collaborative role to that played by the private sector, and are pleased to note that EDC has had discussions with Canada's banks in this regard.²¹

¹⁷ EDC 2008 Submission, pg. 3.

¹⁸ Competition Review Panel, *Compete to Win – Final Report*, June 2008, at [http://www.ic.gc.ca/epic/site/cprp-gepmc.nsf/vwapj/Compete_to_Win.pdf/\\$FILE/Compete_to_Win.pdf](http://www.ic.gc.ca/epic/site/cprp-gepmc.nsf/vwapj/Compete_to_Win.pdf/$FILE/Compete_to_Win.pdf), pg. 51

¹⁹ Bank of Canada: *Monetary Policy Report*, April 2008.

²⁰ Bank of Canada: *Monetary Policy Report*, April 2008.

²¹ 2008 EDC Submission, pg. 57.

In conclusion, we agree with EDC that “EDC’s public policy mandate enables EDC to enhance private sector capacity, particularly in respect of high-risk markets, buyers and industry sectors; support SMEs; and provide stability through the economic cycle.”²² We also agree, that in the ten years since EDC’s last statutory review, “not surprisingly, the need for an instrument of public policy such as EDC to complement the offering of the private sector and ensure a level playing field for Canadian companies [to compete internationally] has become more compelling ... rather than less.”²³ [CBA emphasis]. Our caution, though, is that the entry of EDC into the highly contested areas of the domestic commercial finance space would serve as a disincentive to private sector offerings in that same space. While EDC points out, in support of its argument for domestic financing powers, that other export credit agencies are expanding into the commercial marketplace, we note the words of Malcolm Stephens, quoted by EDC: “Arrangements and systems in place in any one country should not ... be judged by reference to how they may or may not be different from what is happening in other countries. Rather, they should be judged by reference to the situation in the country itself.”²⁴

In Canada, business is well served by intense, private sector competition in banking. Thus, in the view of the Canadian banking industry, it would be a mistake to amend EDC’s mandate to include domestic financing in the private sector space. As we have noted, given EDC’s public policy mandate, its competitive advantages as a crown corporation, and its susceptibility to political pressure, EDC’s presence in the well-served, domestic private sector financial services market, is more likely to distort that market, than to enhance it.

²² 2008 EDC Submission, pg. 51.

²³ 2008 EDC Submission, pg. 51.

²⁴ 2008 EDC Submission, pg. 20.