

# ANTICIPATING NEEDS | DELIVERING RESULTS

## EDC in an Evolving Trade Environment



Submission to the 2008 Legislative Review of the *Export Development Act*

May 2008

Realize a World of Opportunity

Canada

 **EDC**  
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Development  
Canada | Exportation et  
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## FOREWORD

Global commerce has changed the way business is now done. Companies have new needs for research and development, supply chain management and logistics support, technology integration with business partners and, importantly, supply chain financial intermediation.

As Canada's export credit agency and an instrument of public policy, the role of Export Development Canada is to position Canadian companies and their employees to succeed globally by providing them with financial solutions, directly and in partnership with the private sector.

Originally, this was done solely through the provision of export credit insurance. However, over time as the needs of exporters and investors have evolved, EDC has broadened its offering to include buyer and pre-shipment financing, political risk insurance, project finance, bonding, equity and support for international investments.

At the same time, EDC has strengthened its presence in Canada and around the world, in order to be where Canadian companies are, and where they are going. This evolution in EDC's reach and offering has enabled the Corporation to remain a relevant and valued business partner for Canadian companies, and their financial intermediaries.

The Minister of International Trade has initiated a review of the *Export Development Act*, the legislation that establishes EDC's mandate and scope of operation. This is the second such review since the 1993 amendments. Those amendments significantly broadened EDC's mandate, giving it the flexibility to respond to a wide range of customer needs.

The world has evolved significantly since then with the importance of global supply chains becoming paramount as a result of integrative trade. The world is transforming as the traditional company versus company competition shifts to supply chain versus supply chain and even country versus country competition. For a trading nation such as Canada, anticipating and responding to the changes in global commerce has profound implications. The 2008 Legislative Review is, therefore, an opportunity for the Government of Canada and key stakeholders, including customers, to assess how international trade and investment have changed, and to consider EDC's role and its ability to act with clarity and flexibility in responding to this environment. The over-arching goal should be to identify how best to serve Canadian companies, to position them – and by extension Canada – to succeed now and well into the future.

This submission presents EDC's assessment of global commerce and what it means for Canadian companies and their financial partners. It will describe how EDC has responded to those challenges and opportunities, and further how the Corporation foresees its continued role in providing relevant, innovative and multifaceted solutions for Canadian exporters and investors.

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## EXECUTIVE SUMMARY

Trade is important to Canada's prosperity and quality of life. However, Canada is falling behind other countries in its trade performance. Export Development Canada (EDC) is part of the solution. For over 60 years, it has played a central role in trade by providing Canadian exporters and investors with the risk management and trade finance services they need to grow and compete.

The 2008 review of the *Export Development Act* provides an opportunity to review EDC's role in Canadian trade – to think about the longer term and to anticipate tomorrow's needs. The world of global trade has changed dramatically since the last review, and so too have the needs of Canadian companies. Trade liberalization, advances in technology and logistics have led to rising cross-border investment and a level of global connectivity never seen before. Canada's global champions are developing and leading supply chains, investing abroad and opening doors for smaller companies. Small and medium-sized exporters (SMEs) are availing themselves of new supply chain opportunities and taking on higher risks in emerging markets. Canadian companies of all sizes need financing and risk management services to compete. Their needs today are multi-faceted and include support for imports, foreign investments, domestic capacity building, foreign market expertise and access to business networks.

EDC serves a public policy role as a catalyst for trade. It complements the trade finance and insurance services available in the private sector by taking higher risks and helping SMEs grow into larger exporters. Other export credit agencies (ECAs) are also adapting to the new global trade environment, each in accordance with the needs of its respective trade environment. There is no standard ECA model. As a trading nation, Canada needs a responsive and modern ECA that can offer innovative financial and risk management services and expertise. It needs private and public sector institutions with the foresight to anticipate and understand the rapidly evolving models of trade and to explore new ways of meeting those needs. And with the current economic conditions, these tools are becoming essential just for survival.

EDC has worked with its customers to understand their changing needs and has responded with new products and services, including support for Canadian Direct Investment Abroad (CDIA) and a variety of new tools for SMEs. EDC has restructured along supply chain lines and strengthened its presence in Canada and around the world. It has a solid governance and corporate social responsibility regime. EDC has delivered results for Canada, and has done what it can within its mandate. But it needs to go further. Not only do its customers depend on continued access to EDC's traditional financing, insurance and bonding services, but they are also asking for even more support from EDC to respond to their changing needs.

EDC cannot do this alone. Today's business realities require private and public sector institutions to complement one another, and EDC does this with banks, private sector credit insurers, Business Development Bank of Canada (BDC) and a variety of other private and public sector partners. By leveraging our respective capacity, expertise, ideas and business networks, we have been able to enhance overall market capacity and ensure that more Canadian companies have access to the support they need in good times and bad.

EDC's model for provision of credit insurance, as a direct provider in the market, works well and positions EDC to fill private sector market gaps and to do so on a commercially self-sustaining basis. EDC intends to continue as a direct insurer

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upholding the following principles: ensuring the needs of Canadian exporters of all sizes are met; operating the program at no cost to the taxpayer; and growing the Canadian credit insurance market by leveraging strategic partnerships with banks, brokers and private insurers.

EDC plays a central role in the government's trade policy agenda. It has evolved and stands out today as a customer-focused and responsive institution. However, there is more that can and should be done to respond to evolving customer needs. This will require additional clarity and flexibility in EDC's mandate and regulations, particularly in the following areas:

- **Supply chain support** – EDC's current mandate focuses on a traditional definition of trade, and could be modernized to accommodate supply chain activities and relationships, as well as a potential role in developing supply chain infrastructure.
- **Domestic financing in partnership with the banks** – companies and their banks need EDC to provide domestic financing for trade-enabling purposes, such as support for start-up and emerging exporters, new infrastructure and general purpose financing and surety facilities for both domestic and foreign activities. While EDC's mandate provides flexibility for such support, its regulations limit it.
- **Foreign offices** – EDC's foreign representatives deliver in-market expertise and procurement opportunities through their networks of relationships with large foreign buyers. Flexibility to establish EDC offices outside of Canadian embassies will be required to support further growth in EDC's foreign market representation.
- **Ministerial authorizations** – a more streamlined process for ministerial authorizations of transactions outside EDC's regulations would enable EDC to provide a more timely response to customers seeking assistance in cases where the required support falls outside EDC's regulations. This could be accomplished by having an approval process for defined classes of transactions.
- **Board of Directors** – given the significant changes to the trade environment expected between formal legislative reviews, more authority and responsibility could be delegated to the Board of Directors on behalf of the government. For example, the government could allow EDC to follow a mandate test based on a directive issued and updated as needed by EDC's Board of Directors.

In conclusion, Canadian companies need EDC whether for a particular buyer, for a high-risk industry or during an economic downturn. SMEs need EDC to provide early-stage support and expertise. The current EDC model, blending a public policy mandate and commercial business practices, delivers results to Canada. With additional flexibility and clarity, EDC will be well positioned to work with its partners to anticipate and respond to the needs of Canadian exporters and investors for many years to come.

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## EDC AT A GLANCE

EDC has been facilitating the international business activities of Canadian companies for over 60 years, contributing to their productivity, competitiveness and ultimate success. The Corporation's mandate is to support and develop, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade as well as respond to international business opportunities.

EDC conducts all aspects of its business in a socially responsible and environmentally sound manner, consistent with the expectations of Canadians. The Corporation's presence throughout Canada and the world continues to increase, with 14 offices across Canada and 13 foreign representations in key emerging markets.

In 2007, 6,963 Canadian companies – 84% of which were small and medium-sized exporters (SMEs) – benefited from EDC's solutions, in 183 markets. EDC facilitated \$77.7 billion of Canadian trade and investment activity.

- \$20.8 billion was in emerging markets, including \$7.4 billion in Brazil, Russia, India, China and Mexico;
- \$18.8 billion was in support of SMEs; and
- \$9.6 billion was to facilitate Canadian Direct Investment Abroad.

Of the total volume, EDC worked in partnership with private sector financial institutions to facilitate \$11.7 billion of Canadian trade and investment activity.

- \$4.8 billion was in emerging markets, including \$1.9 billion in Brazil, Russia, India, China and Mexico;
- \$1.3 billion was in support of SMEs; and
- \$637 million was to facilitate Canadian Direct Investment Abroad.

EDC estimates that the business it facilitated in 2007 helped generate approximately \$55.6 billion in gross domestic product (GDP) for Canada, which in turn was associated with sustaining some 624,000 jobs.

EDC conducts its operations on a self-sustaining basis, generating sufficient income to protect its assets and to support future business. It does not receive annual appropriations from government. Since 1993, EDC has paid \$720 million in dividends to its shareholder, the Government of Canada, including \$250 million in 2008.

The Corporation employs professionals of diverse talents, cultural heritage and linguistic skills whose international experience, in fields ranging from complex financing to economic forecasting, helps companies identify global trends and seize opportunities. For seven consecutive years, EDC has been named one of Canada's Top 100 Employers. Selected as one of *Canada's Best Diversity Employers* for 2008, EDC is the only Crown corporation among the 25 winning companies.

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## Chapter 1

### THE EVOLVING TRADE ENVIRONMENT

- The growth of international trade is critical for Canada, a trade-dependent country.
- Canada is falling behind other countries in trade performance, and EDC is part of the solution.
- To compete, Canadian companies must adjust to a new world of large global supply chains.
- It is a challenging environment – and current economic conditions suggest that the next few years will not be easier.

#### 1.0 Introduction

Trade is important to Canada and increasingly so. Total trade, both imports and exports, is responsible for about 70% of Canada's GDP, the measurement of Canada's wealth and prosperity. Today, exports alone account for one in five Canadian jobs and generate 30 cents out of every dollar earned. Yet **Canada is falling behind other countries in trade performance**. While global trade is increasing every year, Canada is not keeping pace with the rest of the world.

Since 1944, EDC has played a central role to the Government of Canada in developing this country as a trading nation. Created to support far-sighted public policy that recognized the link between trade and jobs for Canadians, EDC's role has evolved significantly since then. It is just as essential today, and remains integral to the government's trade agenda.

**EDC serves as a catalyst in helping make trade happen.** It creates synergies between foreign companies and Canadian exporters and investors. By complementing the trade finance and insurance services available in the private sector, it also provides competitive advantages through enhanced risk management and financial capacity. Because it can take more risks than the private sector, it has a central role to play in enhancing overall market capacity. EDC operates on a blended business model – it delivers on its public mandate by operating on commercial principles.

The world of global commerce has changed fundamentally in the last decade. Intense competition drives companies to identify innovative ways to provide value to their customers and to serve new markets. In such an environment, the ability to adapt is a key not just to success, but to survival – for Canada's global champions and for the first-time exporters alike.

Globalization used to be about companies selling their products and services to all four corners of the world. In 2008 that is only part of the story. Globalization is now characterized as a process in which companies locate each activity required to

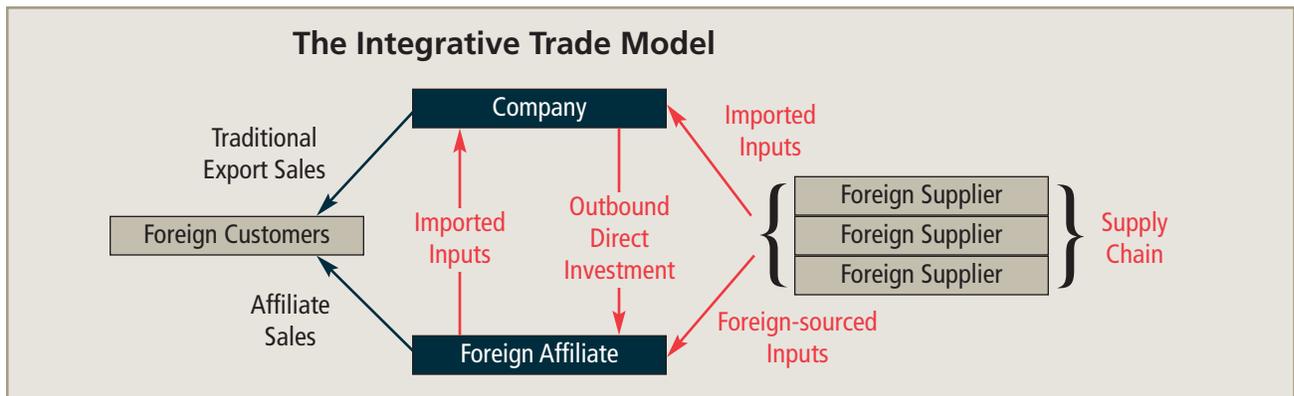
take their product or service from concept to consumer in the geographic location most advantageous to the firm. The activities then form a global value chain, with the links built through foreign direct investment and connected together by international trade. As a result, a new trade paradigm, one that EDC has described as “integrative trade,” has emerged.

While this transformation is affecting companies across the world, the implications for Canada are more significant as one of the G-7 countries most highly dependent on trade for jobs and quality of life. It is therefore critical that the changes in global trade and investment be well understood. Addressing the implicit challenges and opportunities for Canada will help Canadians compete and succeed.

### 1.1 Integrative Trade

The development of the internet and trade technologies, combined with the liberalization of international trade, has opened up a much broader set of production possibilities for companies. The traditional production model, in which companies develop and manufacture their products in a single, vertically integrated, geographic location, has been displaced by one in which each stage of production is located in the best possible place in the world. In effect, the world has become a virtual production platform.

Globalization of sales through exports has long been an objective of growing companies, particularly in small economies, like Canada, where the domestic marketplace simply cannot generate economies of scale like those available in large markets. This new, geographically dispersed organization of the firm means that companies must engage in international trade just to get their goods or services ready for sale. They then do so again to make their sales.



Integrative trade<sup>1</sup> is so named because it integrates imports and exports, as well as the foreign investments necessary to set up global supply chains. **Trade has become more than just a tool of sales; it is now a tool of production.**

As the diagram above illustrates, under this model truly globalized companies are likely to be engaged in all of the elements of trade. They are sourcing inputs from

<sup>1</sup> The evolution of global trade has been described by various sources. Recent Canadian publications of note include the Department of Foreign Affairs and International Trade's Canada's State of Trade: Trade and Investment Update 2007 and The Conference Board of Canada's Mission Possible: Sustainable Prosperity for Canada (2007). The integrative trade model has been outlined by EDC in various publications and in successive Corporate Plans.

foreign suppliers (importing to export), setting up their own foreign affiliates to provide less expensive inputs (via intra-firm trade) and using these affiliates to establish a local sales presence, and finally engaging in traditional export trade. For these companies, development, design, production and sales are occurring on a global scale along supply chains.

However, this new model is not just for large companies. **Integrative trade also provides opportunities for smaller companies to become important suppliers.** In the past, these companies may have been reluctant to engage in international trade. Others may have seen themselves only as suppliers to larger, domestic-based companies and not engaged in trade. Today, these companies are competing for individual links in the global supply chains of larger companies, whether they are based next door or on the other side of the world. Whether a small company is trying to grow into a global leader or simply trying to make the next sale, there can be little doubt that the world of trade has changed irrevocably.

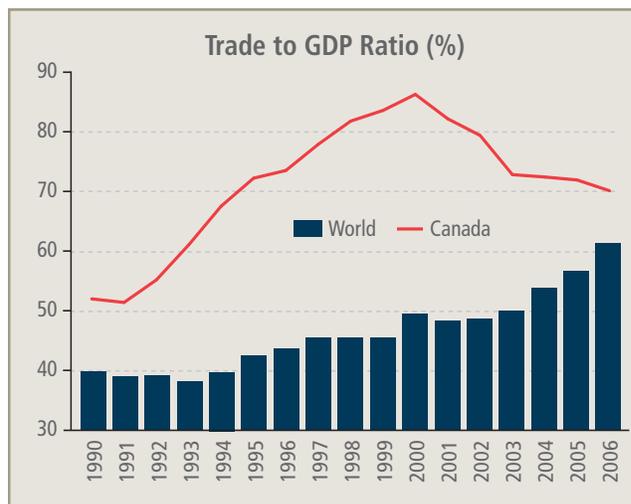
## 1.2 Investment: A Powerful Trade Driver

The growth in foreign direct investment (FDI) is one of the most important drivers of integrative trade. According to UNCTAD (the United Nations Conference on Trade and Development), global investment flows reached an estimated USD 1.5 trillion in 2007, representing an 18% increase over 2006.<sup>2</sup> As the use of FDI increases, so does the prominence of emerging markets. These markets have become more than just potential export destinations – they are also seen as crucial investment destinations as companies look to take advantage of lower costs in order to improve their productivity. In 2007, a third of global investment flows were to emerging markets. This amounted to some USD 438 billion, 60% of which went to Brazil, Russia, India, China and Mexico.<sup>3</sup>

## 1.3 The Importance of Trade to Canada

Increasingly, global prosperity is dependent on trade. In 1991, trade accounted for approximately 38% of global GDP. Today, the figure stands at 60%.

For Canada, this is not a new trend. Since 1990, trade penetration – the ratio of trade to the wealth of the country – in the Canadian economy has increased from approximately 50% to 70% in 2006. It hit 85% in 2000 due to the value of the dollar, which depreciated steadily through the 1990s as well as the short-lived but export-rich high-tech bubble. In other words, the “hump” in trade importance (as seen in the chart on this page) was primarily caused by the dollar, and then was exaggerated by the tech bubble.



Since then, Canada’s trade performance has been slipping and exporters have lost ground while the penetration rates of G-7 major competitors have grown, in some cases significantly. Canada’s performance in emerging markets is similar. While

<sup>2</sup> The data for 2007 are preliminary estimates provided by UNCTAD.

<sup>3</sup> This includes USD 54.4 billion destined for Hong Kong. Not including Hong Kong, the “BRICM” markets accounted for approximately 47% of global FDI flows into emerging markets.

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nations such as Germany, Japan and Australia have seen their trade penetration in these markets increase since 1995, Canada has recorded comparatively weak levels of growth. At best, trade penetration of about 70% of GDP, as in the mid-1990s, should be thought of as Canada's base for future trade development.

Roger Martin and Gordon Nixon<sup>4</sup> have argued that the world is becoming “spiky” – that large and growing corporations are gathering together in concentrated areas and their geographic clustering can be depicted as spikes. These clusters promote industry growth and innovation in the region. This can be seen internationally, especially in emerging markets. Their concern is that Canada will not have a second chance to win any spikes unless more attention is paid to issues of competitiveness and productivity. Access to financial intermediation is an important part of the competitiveness equation.

#### **1.4 The Current Environment**

Over the past two years, Canada's overall export performance has been flat. While strong growth was recorded in the commodities sector as prices reached record levels, other sectors – particularly manufacturing and forestry – have suffered.

Without question, the rising Canadian dollar bears some responsibility for this weak performance. In some cases, Canadian companies have cut profit margins in order to remain competitive. In other cases, companies have simply decided to forego export opportunities and focus on what has been a resilient domestic economy. Neither approach can be sustained in the long term.

A moderation in the global economy is now well underway. The credit crunch prompted by the bursting of the U.S. housing market bubble has raised fears of a recession in the world's largest economy, which in turn is dragging down global growth. As a result, global risks are increasing and liquidity is tightening.

This slowdown threatens to reduce demand for Canada's trade in goods and services, especially from the largest market by far for exports and investment, the U.S.

Exporters – always among the first to feel the pinch from tightening credit and greater risk – are pessimistic about trade prospects. EDC's recent Trade Confidence Survey (TCI)<sup>5</sup> showed a sharp decline in exporter confidence. The overall index declined to 67.4% in November from 72.9% in June 2007, the lowest since EDC began reporting on trade confidence in 2000. Canadian exporters are more pessimistic about all five of the core TCI indicators: trade opportunities, export sales, domestic sales, and both domestic and global economic conditions.

Beyond current economic conditions, there are other shifts taking place that underscore why trade matters to Canada.

Changing demographics are likely to have a significant impact on trade and investment. Well-capitalized pension funds are looking offshore to the booming

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<sup>4</sup> Roger Martin, Dean of the Rotman School of Management and Gordon M. Nixon, President and CEO, RBC, *Growing Global Leaders: The “Hollowing Out” Solution*, 2007.

<sup>5</sup> The TCI is a composite score based upon responses from Canadian exporters to five questions that measure increases or decreases in optimism on future global and domestic sales, economic conditions and trade opportunities for the next six months. A total of 1,000 Canadian businesses participated, and the TCI was calculated on a total of 826 respondents. The survey results are considered accurate to +/- 3.4%, 19 times out of 20.

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economies in emerging markets for active investments to diversify their portfolio and improve their return on capital. Such active investments need specialized financial intermediation.

Further, it is well understood that in developed countries like Canada, an aging population will result in fewer workers. While this has the potential to limit production capacity, the stretching of the production process on a global scale provides an opportunity for companies to continue to meet increased demand (particularly from a growing middle class in emerging markets). These companies can engage in integrative trade to tap into labour capacity in emerging markets, thereby allowing them to both create and meet demand.

## 1.5 Outlook for Canadian Exports

While the U.S. remains central to Canada's exports, most of the export growth has been in emerging markets. Indeed, Canadian merchandise shipments to emerging markets were up more than 18% in 2007, continuing the strong gains seen over the past few years. Countries such as Brazil, China, India, Russia and Mexico proved to be strong markets for Canadian exporters in 2007. Industrialized markets in Western Europe were also bright spots for Canadian companies during the past year, while sales to Japan and the Asian newly industrialized economies actually fell.

Looking ahead, this geographic dichotomy can be expected to continue over the forecast horizon. Canadian exports to emerging markets are expected to rise by 10% in 2008 and 6% in 2009, compared with -2% and 2%, respectively, for the industrialized countries.

EDC forecasts that deteriorating fundamentals – the still-strong Canadian dollar, the economic slowdown in the U.S. and lower commodity prices – will catch up with Canadian exporters this year. Overall, total exports are expected to fall by 2% in 2008, with broad-based losses across most sectors, except for key commodities associated with tighter global food and energy markets. A mild rebound of 2% is anticipated in 2009, in line with recovering global growth.

## 1.6 Looking Ahead

The events unfolding in the current global economy reveal the underlying weakness in Canada's trade performance. Compared to the rapid growth in the world economy, Canada's trade numbers are lacklustre. Catching up will require even more hard work, innovation and some new tools of trade.

Without question, many Canadian companies are doing what they can to respond to these challenges. The higher dollar creates incentives to invest in productivity-enhancing machinery and equipment, or to invest in the stronger growing emerging economies. Canadian exporters and investors are nothing if not resilient.

This short-term outlook should not divert attention away from the fact that Canada has strong potential to be a trade hub for goods and services across the continent. Its position as a result of the North American Free Trade Agreement provides a competitive advantage for international companies looking to access the North American market. The flow of foreign direct investment into Canada in recent years underscores this fact.

*"On the global front we are being outpaced by our competitors: not just by fast-growing emerging economies like China and India, but also by our more traditional competitors such as the U.S. and Europe, which are aggressively pursuing international policies to strengthen their competitive advantage."*

*The Honourable David Emerson,  
Minister of International Trade*

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Canada could look to Hong Kong or Singapore as examples of super hubs where specializing in trade is the business that drives the whole economy. Canada has goods and services for export that are second to none, whether one is looking for engineering services capable of building the most demanding infrastructure or aircraft to connect regions across the U.S. or niche products developed by a small exporter. With the right investments in research and development, and new infrastructure, Canada is perfectly positioned to be a trade hub for global supply chains driving the growth in the world economy.

The opportunities and the challenges are clear. **As a trading nation, Canada must make the right choices or risk falling behind. Businesses, government and the financial services sector must work together to bring out the best of what Canada has to offer, and position it against strong international competition.** Growth in trade and investment will in turn create more jobs and higher wages, thus increasing the GDP. Canada is at a cross roads and must decide whether the tools at hand provide the scope and flexibility for success. The rest of this paper will demonstrate the central role EDC plays, along with government, financial institutions and other partners, in meeting the needs of Canadian exporters and investors and building Canadian prosperity.

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## Chapter 2

### THE EVOLVING NEEDS OF CANADIAN BUSINESS

- Global champions, such as Bombardier and SNC-Lavalin, are key to Canada's future prosperity.
- They lead global supply chains and open doors for smaller companies.
- Global champions need financing that is flexible and responsive and supports their supply chains, foreign investments and provides capital for export-enabling infrastructure and expansion in Canada.
- SMEs play a vital role in trade and many are positioned to become future champions.
- SMEs need reliable access to financing to grow but can't always get what they need, especially when doing business outside of Canada.

#### 2.0 Introduction

Against the backdrop of integrative trade and challenging economic conditions, Canadian companies of all sizes are working hard to adapt. Exporting remains the challenge it has always been as SMEs and global champions alike must contend with currency fluctuations, border logistics, skilled labour shortages and competition from lower-cost producers. Yet they share a common trait. **All exporters and investors are looking to their financial partners to offer solutions tailored to their company, industry and market needs.**

This partnership is crucial if Canada is going to catch up and claim its share of world economic growth. Reliable access to financial resources will be a factor in whether that goal is achieved. This chapter will look at the financial demands that global supply chains are placing on Canadian business and their trade finance partners. It will examine the specific requirements of supply chain financing, including support for Canadian Direct Investment Abroad (CDIA), financing for export-related activity in Canada and foreign market expertise.

#### 2.1 Global Champions

The rise of global supply chains has greatly affected the way Canadian companies conduct their business. Global champions such as SNC-Lavalin, Manulife Financial, Sun Life Financial, Bombardier, Nortel, CAE, RIM, Agrium, Potash Corporation, Barrick Gold and Magna have expanded through strategic investments and acquisitions around the world, developed global networks of suppliers and customers, and leveraged Canadian R&D capability to bring Canadian innovation to the world stage. In doing so, they have also opened new global doors for many other Canadian companies.

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These global champions<sup>6</sup> have contributed significantly to Canada's trade success. In order to maintain their lead they must constantly innovate and upgrade: developing new and better products, services and processes. Dependable access to cost-effective external financing and risk mitigation tools is vital to their continued success.

In addition to the direct benefits they provide – exports, dividends and jobs – Canada's global champions contribute to the country's trade performance by encouraging their suppliers to enter new markets and constantly innovate. Examples of large companies leading the way for smaller companies and creating prosperity for Canada through their supply chains abound. Magna, for example, brought its Canadian suppliers to its state-of-the-art operations in Mexico, and is now poised to do the same in India. RIM's world-renowned Blackberry is made up of components from seven different countries, bringing ultimate benefit to RIM's Canadian operations, which include production, assembly, R&D and head-office functions.

Canada needs its global champions, and more of them. It is well understood that the creation of a global champion depends on a host of factors, such as rules and regulations, tax regimes, infrastructure and international agreements. The global model is based on foreign direct investment and an optimal division of labour across the globe.

Despite their success on the global stage, however, some of Canada's leading companies are dwarfed by their global counterparts in size. In some cases, they report being disadvantaged by not having the same access to financial services as their competitors. **While many factors influence competitiveness and productivity, reliable and timely access to financing and risk management products and services can help to level the international playing field and make Canada more competitive.**

Canada's aerospace sector is a case in point.

The aerospace sector, led by companies such as Bombardier, CAE and Pratt & Whitney, employs more than 70,000 Canadians in highly paid jobs and contributes more than \$3 billion to the country's trade surplus every year. The sector is high risk and volatile – and intensely competitive. Financing the huge amount of R&D required is often a challenge. At the same time, airline customers suffering profit squeezes need financial support to buy new aircraft, but private lending has diminished. In addition to traditional competitors from Europe and the U.S., new players are to be found in India, China, Mexico, Japan, Russia and Brazil where there is not only a cost structure advantage, but also significant capital available. Maintaining Canada's aerospace sector and increasing its technological and financial capacity will yield continued economic benefits to Canada.

Other mid-sized Canadian companies like Delcan, Groupe Solmax, Allianz Madvac, DCM Erectors and Mechtronix may not yet meet the definition of global champions but nonetheless require access to capital as well as guarantees and insurance to prosper and grow. The mid-market represents the future of Canada's exporting community.

Cultivating successful companies such as RedKnee Solutions and positioning them to grow into competitive global players is critical to Canada's future prosperity.

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<sup>6</sup> The Ontario Institute of Competitiveness and Prosperity defines global champions as companies with annual sales revenues over \$1 billion and in the top five companies globally in their industry.

RedKnee Solutions is an example of a mid-sized company positioned for strong global growth. From its beginnings in 1999, the company has grown its revenues to over \$50 million through development and marketing of a unique suite of communication software products, solutions and services for wireless carriers. A focus on top-of-the-line technology for high-end operators has positioned this company well against much larger foreign competitors. Ranked as one of Canada's best-managed companies, RedKnee expects to progressively grow its revenue through a strategy of acquisition and growth in emerging markets where it is targeting emerging mobile operators, as well as ongoing growth in developed markets.

## 2.2 Small and Medium-Sized Exporters

Small and medium-Sized Exporters (SMEs) are an integral part of the Canadian business landscape and the backbone of the Canadian economy. Defined by EDC as companies with total annual sales of up to \$25 million, they represent 97% of Canada's exporters and provide 6 out of every 10 jobs in Canada. SMEs such as RVA Aerospace Systems, Distribution Laurent Leblanc, Farmers Direct Cooperative, Sustainable Energy Technologies, Editions L'artichaut and Burgess Baskets, make a significant contribution not only to the economy and prosperity in general, but also to the export of goods and services. Recognizing and responding to their unique needs has been a core public policy initiative of the Canadian government and of EDC for many years.

Yet, the number of Canadian SME exporters has been declining over the past five years. While there are reasons for this decline, such as the value of the dollar and stricter security requirements at the border, it is evident that larger firms have been better able to respond and adapt to the challenges of globalization than their smaller counterparts.

Some SMEs supply only the domestic market but could still be part of supply chains of larger Canadian exporters. Others follow their larger customers into their global supply chains and benefit from "matchmaking" with other suppliers and potential partners in foreign markets. For example, global champions such as Bombardier and Magna often need their Canadian suppliers to invest in foreign markets to become or to remain part of the company's large global supply chain. In these cases, the success of the SME is tied to the growth of the larger firms. Other SMEs find success and direct access to foreign markets themselves by offering a specialized niche product or service. In all cases, SMEs need low-cost products, timely service and expert advice in order to succeed.

**Global expansion is often limited by capital constraints. Early-stage SME exporters are more than four times as likely to be turned down for operating loans compared with established firms.**<sup>7</sup> Companies with annual sales under \$1 million typically finance their business through a personal or small business banking relationship. Some may find themselves ineligible for commercial banking arrangements such as operating lines of credit, even with a guarantee or insurance on foreign receivables.<sup>8</sup> In a world of multiple challenges and opportunities, the failure to access financial services can seriously affect a company's ability to grow.

RVA Aerospace Systems is a SME that supplies and installs specialized instrumentation for airport navigational systems. When it received a \$5 million contract in China, its biggest obstacle was financing. The contract required large down payments and expensive performance bonds – which its bank was not able to provide because of the size of the transaction relative to RVA's normal business. EDC's guarantee paved the way for the bank to provide the necessary financing. This helped RVA as well as a number of other Canadian subcontractors gain access to an important new emerging market.

<sup>7</sup> Dr. Allan Riding, University of Ottawa School of Management, *Minding the Gap: Assessment of Financing Gaps Related to SME Exporters in Canada*, 2007.

<sup>8</sup> This has been communicated to EDC by its customers through various channels over the years. The most recent study highlighting the issue is *The Antima Group, Small Business Qualitative Research* 2007.

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## 2.3 Canada's Other Exporters: Pension Funds and Banks

### *Pension Funds*

In Canada, large private capital sources such as Ontario Teachers Pension Plan and the Canada Pension Plan Investment Board are looking to international investment opportunities and infrastructure development to enhance their fund returns and finance shortfalls between contributions and benefits. Given Canada's aging population, such investments abroad are increasingly important as the number of contributors falls and the number of beneficiaries grows. The funds are driven to make such investments to earn returns for their pensioners that are simply not available in Canada. **In their drive to find higher-yield opportunities, these funds are creating future wealth and prosperity for Canada by investing in emerging markets.**

This shortage of domestic investment opportunities has in recent years manifested itself in Canada's pension fund space. Canada's pension assets have been estimated by Watson Wyatt (2008)<sup>9</sup> at USD 1.03 trillion, or 4.3% of the world's total. This is more than double Canada's share of the global economy. As a result, Canada's top seven pension funds are big investors abroad, with some 30% to 40% of their assets in foreign countries.

A key focus of Canada's pension funds is investment in infrastructure, because of its especially long duration, which is a good match to their liabilities. Although they have substantial equity to invest, it is far more efficient for them to use a degree of leverage to optimize their debt-equity positions in these foreign plays. Canadian banks are frequent participants in these investments, but they have limited appetite for long-duration assets, preferring instead to recycle capital at a high rate to generate higher returns. As a result, the participation of foreign banks is more common.

These investments are generally aimed at influential levels of participation, which implies that the pension funds are in a position to generate managerial or technical fee income back to Canada, and sometimes to tilt procurement in Canada's direction.

### *Banks as Exporters*

Canadian banks are important participants in Canada's international business activity. Recognizing the mature nature of the domestic economy, Canadian banks are increasingly looking to their own international growth opportunities. This includes acquisitions of foreign financial institutions, expansion of international branch networks and representative offices abroad. For some Canadian banks, international activities now account for close to half of their annual revenues, and this trend is expected to continue.

## 2.4 Financing the Supply Chain

While traditional exports remain an important tool for Canadian companies of all sizes, much of the growth in trade in recent years has been in supply chain trade, as companies rationalize production by securing components worldwide. Of

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<sup>9</sup> Watson Wyatt, Global Pension Assets Study, January 2008.

400 EDC customers surveyed in 2007,<sup>10</sup> 63% said their exports include material or components imported from outside Canada. Not only do supply chains redefine the way business is done, they require new types of financing at each stage as components, services and investment flow back and forth across borders. These trade flows require new forms of financial intermediation that do not fit easily into previous notions of exports and imports.

In the past, reflecting the economic thinking of the time, export credit agencies initially linked their support to national content on the assumption that the prosperity of a nation depended on the growth of nation-based companies. Exports were encouraged, imports discouraged. This mercantilist view of the world meant limiting support to locally registered companies, goods produced in the domestic market and high domestic content. In the new world of integrative trade, the global economy is virtually borderless.

### Canadian Exports and Investments in 2007

- In 2007, Canada's exports of goods and services grew by an estimated 2.6%. The U.S. remains the primary destination for Canadian exports, accounting for 79%.
- Exports in the manufacturing and forestry sectors declined by 9%, while exports of commodities increased by 6.5%.
- CDIA increased to \$45 billion, with companies in the mining, energy, insurance and banking sectors accounting for 95% of the total.

Examples of companies growing their business through global supply chains abound. One such company is a manufacturer of large construction equipment. For many years, this manufacturer imported key components such as motors and control systems and did the assembly in Canada. Today its supply chain is globally integrated, with sales offices and joint ventures around the world, a production facility and assembly lines in Europe and Asia responding to the infrastructure boom in these markets, and sophisticated machine tools being developed in China.

**In light of integrative trade and global supply chains, imports are as important as exports.** Exporters require new forms of import facilitation, such as a supplier payment program that leverages a buyer's access to credit and is often cheaper than their supplier's cost of capital, thereby lowering the cost of capital in the supply chain.

## 2.5 Canadian Direct Investment Abroad

One of the most dramatic changes brought about by the rapid pace of growth in global trade is the increase in cross-border investment. Research shows that Canadian Direct Investment Abroad (CDIA) facilitates improved R&D, productivity and innovation, thereby helping Canadian firms compete internationally. Each \$1 of investment is said to generate approximately \$2 of additional exports in emerging markets and \$0.6 in developed markets. The government's Global Commerce Strategy stresses the importance of CDIA.

**More than one third of EDC's customers report that they are either currently engaged or planning to be involved in CDIA activities, which are at the core of integrative trade.**<sup>11</sup> CDIA is riskier and requires more capital than traditional trade,

<sup>10</sup> EDC, Export Monitor, an annual survey of exporters, export ready companies, and those with foreign direct investment outside of Canada, 2007.

<sup>11</sup> EDC, Export Monitor.

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Minaean International Corporation builds low-cost, environmentally friendly modular structures. Following years of R&D into light-gauge steel technologies and a partnership with Tata Group in India, it now has several plants in India, enabling it to source steel locally and to respond quickly to customer needs and opportunities, including a major contract with Shell India for modular gas stations. Minaean needed to grow its business and further invest in its Canada R&D capability but had difficulty securing financing for its Indian operations from either Canadian or Indian banks, until it obtained an EDC guarantee.

As a leader in energy transportation and distribution in North America, Enbridge is building new infrastructure for oil and gas, including pipelines to carry crude oil to new and existing markets. The company has an ambitious infrastructure expansion plan in the short to medium term, with commercially secured projects totalling \$12 billion for oil pipelines and another \$15 billion in development. Enbridge counts on EDC, as one of its financial partners, to provide financing for this expansion.

which calls for more sophisticated financial intermediation. This takes the form of financing to acquire and invest in a foreign affiliate or a joint venture. Investing and working in higher-risk markets often requires other products such as political risk insurance. For companies in the services sector, notably construction, additional protection is often required to manage risks associated with joint venture partners providing local labour.

**As foreign affiliates become an extension of their parent, they need the same level and type of support that is available to the Canadian parent.** They do not always make a distinction between their parent and subsidiary financing or insurance needs, but rather seek support for a complete package.

SMEs face a particular challenge investing in foreign markets; their own domestic banks are often unwilling to support their foreign operations, and they are too small to access financing in the local market, particularly if it is an emerging market.

## 2.6 Financing Export-Related Activity in Canada

As the distinction between domestic and foreign activities of Canadian businesses becomes increasingly blurred, financial requirements for domestic and foreign activities are likewise being consolidated. Companies are increasingly demanding general purpose debt and bonding facilities to raise capital for various corporate purposes, including expansion of both domestic and foreign capacity and investment in trade-related technology, without any segregation as to the use of funds or surety capacity.

Companies expect financial service providers to provide this kind of broad-based and flexible support which, some exporters believe, is often available to their competitors elsewhere.

Global champions are also in need of financing and bonding support to build or expand infrastructure projects in Canada to increase their export capability.

SMEs require financing for export-enabling capital expansion or for general purpose use at the pre-export stage. Companies in the services sector face a particular challenge due to their lack of tangible security. Young technology-based companies are in a similar situation, as they often begin exporting from the outset before establishing a strong domestic presence or assets.

## 2.7 Foreign Market Expertise

Doing business abroad, particularly in emerging markets, exposes companies to new risks and drives the need for more information, business contacts, expertise and market knowledge to help successfully grow the business and manage risks. For those that establish production facilities, partnerships or new investments abroad, the risks of failure are even greater.

Business development assistance and access to market intelligence and experience are invaluable. While information is to be found everywhere, Canadian companies say they need easy access to up-to-date resources that will help them where and when they need it. They need solid business leads that are relevant to their industry and areas of expertise. They are more likely to find what they need

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through a financial provider that has an international network working in concert with other experts in international trade.

Providing timely and flexible financial solutions, coupled with knowledge of Canadian sectoral strengths and access to foreign buyers, is essential for Canadian business to remain competitive.

As Canada expands the number of free trade agreements and foreign investment protection agreements it signs with other countries, the opportunities for increased trade in goods and services come into sharper focus. The North American Free Trade Agreement has dramatically increased trade between Canada and Mexico, and Canadians have benefited from EDC having representatives in both Mexico City and Monterrey.

Canadian exporters and investors need access to a variety of resources to facilitate doing business internationally. While the Trade Commissioner Service plays the lead role in this regard, there is an increasing need for specialized services to “follow the exporter” into overseas business locations, and even to “lead the exporter” into new global supply chains. Provincial governments, banks and other Crown corporations have established a presence in key markets.

EDC’s representative in Russia used local market knowledge and relationships to help several Canadian agricultural equipment manufacturers compete with larger competitors offering supplier financing packages. By setting up a financing facility with the Russian Agricultural Bank, EDC assisted the exporters to make the sales and positioned the Canadian industry for growth in this key market.

## 2.8 Looking Ahead

Global champions and SMEs alike, including those mid-size companies on their way to becoming future global champions, need access to financial intermediation that understands and supports supply chains and foreign investments. Often, they need support to finance infrastructure development and capital expansion projects in Canada to position themselves for export growth. They require expertise and local market knowledge, particularly in emerging markets. The next chapter will examine how the financial services industry is adapting to these changing needs, globally and within Canada.



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## Chapter 3

# FINANCIAL SERVICES – A KEY TRADE FACILITATOR IN CANADA AND ABROAD

- Like the companies they serve, financial services providers are innovating, evolving and consolidating.
- Canadian banks are expanding their international reach and partnering with EDC to leverage capacity.
- Export credit agencies have had to adapt to the unique needs of their own customers and countries.

### 3.0 Introduction

Over the last decade, the business environment has changed radically, resulting in the redesign of business models and the blurring of traditional lines between import, export and investment as well as distinctions between domestic and international business.

Integrative trade and the rise of global supply chains have dramatically changed the landscape of trade finance. There are now more options, offered by more and diverse players, but at the same time demands for larger amounts of capital, different kinds of risks, new structures and other considerations such as the environment and human rights. As with all other industries, the finance, insurance including surety, and banking sectors are becoming globally integrated, while more competitive than ever before. The increasing complexity and sheer size of financial transactions has made collaboration and specialization a critical success factor.

The traditional trade finance model has evolved in tandem with the environment it serves, from one of short-term risk mitigation and longer-term foreign buyer financing to a model that also includes the extra dimensions of supply trade, investing in foreign affiliates and servicing third markets from those affiliates – all of which necessitate some form of financial facilitation. This chapter presents the drivers of change affecting trade finance and insurance and how the main providers are responding.

### 3.1 Drivers of Change

As discussed in Chapter 1, global supply chains increasingly drive trade flows and shape the product and service offerings of every significant player in the trade facilitation chain, from logistics specialists to banks and insurers, including export credit agencies. For companies, the competitiveness equation has moved from one of local efficiency and productivity to one that also encompasses foreign suppliers, logistics providers, financial intermediaries and foreign affiliates. The pressure is increasingly on the financial services sector to find new ways to service their clients of all sizes, not just on a transactional or borrower-specific basis, but for the benefit of the full global supply chain.

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Banks are disaggregating risks and seeking solutions and capacity. They are working more as arrangers and outsourcers in providing packaged solutions for their customers. In such a relationship, EDC becomes a source of capacity for the banks.

Internationally as well as in Canada, the need for new financial services is accentuated by a number of factors. Traditional Documentary Credit is often replaced by less costly Open Account transactions; however, buyers are insisting on longer terms, while suppliers, especially in low-cost countries, often insist on terms of less than 30 days. This presents a cash flow pressure to which banks are being asked to respond.

Additionally, the convergence of the physical flow of goods, combined with the informational and financial value chains (often referred to as supply chain finance), is a trend that adds pressure on the financial services sector. Internationally, global banks are responding to this trend by extending their business models beyond traditional finance.

Banks are developing new tools such as supplier payment programs that benefit both buyers and suppliers in the supply chain and help to strengthen the relationship among all components of the chain, creating a new “value network.” New tools such as electronic documentation and automated trade platforms are being developed for the benefit of large international buyers and their global networks of SME suppliers. Banks and logistics providers are leveraging new technologies and introducing end-to-end solutions through partnerships which incorporate logistics, information and payment flows that are redefining global trade management.

### 3.2 Export Credit Agencies Today

Export credit agencies (ECAs) are integral and important contributors to their host country’s supply of trade finance services. Certain countries are evolving their ECA model to keep abreast of their stakeholders’ short, medium and long-term needs as well as to a new competitive environment.

**ECAs differ from one another in terms of status, organization and programs – there is no standard ECA model.** Most recognize the need to adjust to new realities and environments of the customers they are created to support and are becoming far more commercial in their orientation. Although the following observation was provided in the context of an analysis of the credit insurance sector, it also applies to the full gamut of financial intermediation services offered by ECAs:

*“Arrangements and systems in place in any one country should not, in my view, 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. ... A question of central importance is how well the arrangements meet the legitimate needs and aspirations of exporters and those who provide the financing for the exports.”<sup>12</sup>*

To understand how various ECAs are addressing their role of levelling the playing field for their related exporters, EDC conducted a survey in late 2007 of major

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<sup>12</sup> Malcolm Stephens, Short Term Export Credit Insurance, June 2007, p. 28.

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ECAs.<sup>13</sup> The survey found that a number of ECAs are moving toward a more commercial mandate. Approximately half of the ECAs surveyed indicate that they have or are in the process of refreshing their mandates to better reflect the way companies do business in the integrative trade environment. Several, including SACE of Italy, have revised their national benefits policy to one that supports transactions that are “in the national interest,” putting the emphasis on benefits other than just national content. They may, for example, be able to support sales of foreign affiliates, participate in general corporate facilities and/or have programs for supply chain and import activity.

ECA-type institutions have also been established in China, India, Korea and other Asian economies, with aggressive mandates to support their own countries’ rapid growth. Some were created with particularly broad mandates, often extending beyond facilitating exports. In general, they were created to respond to supply chain requirements and are tied into an integrated approach to trade and development in each of their respective countries. Countries establishing these ECAs are not members of the OECD; thus, they are not bound by the same agreements as EDC.<sup>14</sup>

In becoming more commercial in their orientation, ECAs have focused on customer needs and have responded to changing market demands. The ECA model is eclectic, designed by each government to serve the realities of their exporter clientele.

#### *ECAs and Credit Insurance*

Until the 1980s, private sector insurance was limited to domestic risks. Export credit insurance was offered by ECAs supported through governments as a means of enhancing export trade. However, in the last 20 years the private sector has entered the export credit insurance market and today dominates the market through three big private sector insurers, all of which had their roots as official ECAs in Europe.<sup>15</sup>

Some ECAs have privatized their credit insurance operations in response to local market drivers. For example, in 2003 EFIC, the Australian ECA, privatized its credit insurance program because it lacked the critical mass and scale required to fully support its exporters. It was also expected that privatization would attract the major private sector players that had not been particularly active in the Australian market. In 1991, ECGD, the United Kingdom’s ECA, privatized its credit insurance business mainly in anticipation of the proposed European Union (EU) regulations that would restrict ECAs from providing cover for sales within Europe.

A 2005 survey conducted by the EU<sup>16</sup> provides early indications that gaps may have arisen in the European credit insurance market. The study suggests that the

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13 Twenty ECAs were surveyed and responses were received from Australia (EFIC), Belgium (ONDD), Brazil (SBCE), China (Sinosure), France (COFACE), Germany (Euler-Hermes), India (Eximbank), Italy (SACE), Japan (NEXI, JBIC), South Korea (Eximbank), Spain (CESCE), Sweden (EKN, SEK), UK (ECGD).

14 See Ch. 4 for a description of the international agreements to which EDC is bound, including the OECD Consensus.

15 COFACE, originally the ECA of France, was privatized in 1994, at the same time as a number of other European ECAs. Euler Hermes was created in 2001 through the merger of SFAC, previously the French domestic private sector insurer, and Hermes, the private insurer that acted as Germany’s ECA. Atradius was created through the 2001 merger of Gerling, a German private sector domestic insurer, and NCM which was previously the official ECA of the Netherlands.

16 European Union (EU), The Report on Market Trends of Private Reinsurance in the Field of Export Credit Insurance, IMCC 2005.

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private sector has limited interest in serving smaller companies because of their low volumes, undiversified risk portfolio and relative inexperience. Where small business solutions were provided by the private sector, they were available electronically. These concerns prompted several European ECAs, such as Italy and Belgium, to create wholly owned commercial subsidiaries to continue to operate in the market.

According to a recent study by Economics Professor Christopher Ragan of McGill University, **“It is too early to conclude that privatization of the short-term export credit insurance markets in Europe and Australia has been a success. The coming economic cycle will likely provide a useful test of the private insurers’ willingness to adequately ‘stay on risk’.”**<sup>17</sup>

Other countries’ ECAs, such as Japan, India and China, have remained quite active in the credit insurance field and have taken a very nationalistic approach to ensure their exporters, particularly SMEs, remain competitive.

### **3.3 The Credit Insurance Market in Canada**

As in Europe, the private sector credit insurance market in Canada has grown significantly in recent years. Since 1989, the total Canadian credit insurance market (domestic and export) has grown by almost a factor of 10 (from \$18.6 million in premium to \$122.3 million in 1999 to \$175.6 million in 2007), and this growth is expected to continue.

Until 1989, the Canadian market providers were essentially EDC and the German-based ACI (now known as Euler Hermes). Since then, all major private credit insurers have become active in the Canadian credit insurance market. Their market share, expressed as a percentage of premium revenues, rose from 30% in 1989 to 53% in 2007. Additionally, from 1990 to 2005 the private sector insurers in Canada grew more rapidly than the private sector in all of the Berne Union states combined.<sup>18</sup> EDC expects its share of the credit insurance market to continue to decline over the next three to five years as the private sector increases its presence in Canada.

Professor Ragan’s review of the Canadian marketplace for credit insurance provides empirical evidence of the existence of a gap in the private sector’s capacity in Canada. Private sector insurers impose risk and volume thresholds beyond which they will not provide coverage to exporters. According to Professor Ragan, “Private insurers appear to be unwilling to take on some risks, and also appear to reduce insurance coverage during less certain economic environments.”<sup>19</sup> Yet the most important features of credit insurance, according to many Canadian exporters, are credit capacity and credit stability, along with timeliness and responsiveness of service, price, and a strong record of paying claims.

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17 Christopher Ragan, *Filling a Shrinking Gap, EDC’s Changing Role in the Market for Export-Credit Insurance*, April 2008, p. 5.

18 The Berne Union is the leading international organization of public and private sector providers of export credit and investment insurance, of which EDC is a member.

19 Ragan, p. 4.

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### 3.4 Canada's Trade Finance Market

The global trade finance market is in a state of flux. On the demand side, companies require more from their financial providers to meet the demands imposed by today's international trade realities – larger companies need financial solutions for their entire global business operations; smaller companies need financing to develop and enhance their capacity to link into global supply chains. On the supply side, providers work to identify, validate and implement new value propositions. In response to the global integration of the business environment it supports and to remain relevant to its customers, the global banking sector has been consistently consolidating to provide global reach and efficiencies.

Canadian financial institutions are strong and growing. They have helped facilitate much of Canada's export growth in recent years. Canadian banks have taken advantage of EDC's insurance programs for more than 15 years to mitigate the risks associated with foreign bank payment obligations issued in favour of their Canadian customers, such as letters of credit. As their global footprint has grown, their trade finance activities have expanded to include a significant and growing international clientele.

Recognizing the mature nature of the domestic economy, many are pursuing growth through international expansion, in the form of acquisitions of foreign financial institutions, expansion of international branch networks and representative offices abroad. **As Canadian banks continue to grow internationally, they increasingly turn to EDC to support more of their own international activities, not just the business they do for Canadian clients venturing abroad.** EDC has responded by extending insurance coverage directly to Canadian banks in support of third-country trade flows where a bank is exposed to default risk. This is the first step in a broader engagement by EDC in supporting Canadian banks' international activities.

### 3.5 Other Players Shaping Capital Markets

In addition to banks, private insurers and ECAs, other players, some new and some well established, are part of the playing field for financial intermediation. Each player comes with its own agenda and purpose, from increasing shareholder value and return for the private sector players, to influencing and supporting local procurement for the ECA. The players are also subject to different sets of rules. Some follow pure market rules while others have agreed to abide by rules or guidelines to level the playing field between themselves.

On the small business side, non-bank specialized players such as credit unions, factors and asset-backed lenders play an important role. The Canadian Bankers Association estimates that the Canadian banks provide about 54% of overall debt to SMEs, with the balance coming from these non-bank specialized financial institutions as well as from international banks operating in Canada.<sup>20</sup>

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<sup>20</sup> Canadian Bankers Association, Taking a Closer Look, November 2007.

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### 3.6 Looking Ahead

Access to financial services able to handle the extra dimensions of today's trade environment is crucial to the competitiveness of a domestic company. Increasingly, financial intermediaries, each with their different purposes, scope and rules, must be ready to offer a multi-dimensional package of services to their client companies, just to keep them in the game.

With clear evidence of more and more players in the market, one may ask if EDC is still needed. What role should it play? What would the trade finance and credit insurance markets look like if it did not exist? While these questions will be answered in the next chapters, the reality is that many of these players, such as banks, look to EDC to partner in syndications and other forms of financing as well as to help them meet their customers' needs. They are drawn to EDC as a source of capacity, for its foreign and domestic market expertise and to take advantage of its strong deal-structuring capabilities.

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## Chapter 4

### EDC IN 2008

- EDC has responded fully to the recommendations from the last Review.
- EDC has used its mandate to the fullest to meet customer needs in a financially sound manner.
- EDC's corporate social responsibility practices are on par with its peers and it leads in environmental review.
- EDC is a unique export credit agency with strong governance and sound relationships with the shareholder and stakeholders.

#### 4.0 Introduction

This chapter will discuss key areas of particular relevance during the current Legislative Review, including governance, the evolution of the mandate and the interpretation of Canadian benefits in the transactions EDC facilitates. It will describe how EDC's operations have evolved in keeping with its public policy mandate and the demands of global commerce, including corporate social responsibility.<sup>21</sup> Many of these areas have evolved significantly in response to engagement with customers, partners and civil society, as well as to act on recommendations from the last Review.

#### 4.1 Developments Since the 1998 Legislative Review

This paper has described a world that is constantly evolving, where companies of all sizes have had to adapt to new realities in order to remain relevant and successful. EDC is no different.

The last review of the *Export Development Act* concluded in 2001, with amendments made to the Act, most notably the establishment of the Environmental Review Directive, or ERD<sup>22</sup> and the change in the Corporation's name to Export Development Canada.

In addition to these legislative changes, the review and subsequent government response highlighted other areas for EDC to review and strengthen its activities. This included areas as diverse as corporate social responsibility (CSR), support for SMEs and collaboration with the private sector.<sup>23</sup> **Since then, EDC has implemented**

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21 For details on EDC's business strategy and financial results, please see the Corporate Plan Summary 2008-2012 and the 2007 Annual Report, *Delivering Results for Canada*. For a comprehensive report on CSR at EDC, please see EDC's 2007 CSR Report at [www.edc.ca/csrreport2007](http://www.edc.ca/csrreport2007).

22 In 2001, the amended Act established a legal requirement (based on a Board-issued directive) for EDC to determine whether a project would have adverse environmental effects, and if so whether EDC would be justified in entering into such a transaction.

23 Government of Canada, *Government Response to the Standing Committee on Foreign Affairs and International Trade: Reviewing the Export Development Act*, May 2000.

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**a number of changes to its activities and practices in direct response to the review and to the views expressed by Canadian companies, parliamentarians and the Government of Canada.**

For example:

- CSR has been embedded as a corporate operating principle, and policies have been put in place to strengthen environmental review, transparency and human rights assessments.
- A strategic review was undertaken on the credit insurance program, leading to discussions between EDC and the private sector to explore other forms of cooperation.
- EDC's foreign representation has been expanded to better promote and support exports and investments by Canadian companies.
- EDC's bank guarantee arrangements have been enhanced across a range of products responding to a variety of needs by financial intermediaries and their customers.
- EDC's equity program has been broadened.
- Services in support of SMEs have been strengthened, including establishment of a dedicated SME business development team, new products, more online capability, simplified documentation and tools to help the banks market to SMEs.

These changes reflect EDC's recognition that as the world is driving Canadian companies to review their business model, it is driving EDC to do the same. Additional details on these changes are provided throughout this chapter. A short summary of how EDC has incorporated recommendations from the last Review can be found in Annex A.

## **4.2 EDC Within the Government of Canada's Trade Portfolio**

EDC plays a central role in creating prosperity through trade in Canada. Its public policy mandate drives it to take risks for the benefit of Canada, to support and inform small and medium-sized businesses and to identify Canadian procurement opportunities through foreign buyer relationships, thereby increasing Canada's share of global investment and direct investment abroad. In supporting the government's trade policy, EDC also partners with the private sector, maintains a high standard of corporate social responsibility and leads innovation in support of Canadian businesses engaged in global supply chains in areas such as risk management, financing, trade technology and development.

EDC is committed to working with the Department of Foreign Affairs and International Trade in implementing Canada's trade and investment agenda so that Canadian companies can more easily engage in global commerce in the new economy. In support of this, EDC's Business Strategy is anchored in three pillars: connecting with exporters and investors; facilitating integrative trade; and leveraging the organization.

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This Business Strategy is aligned with and supportive of Canada's Global Commerce Strategy, and with the expectations for EDC outlined by the Minister of International Trade in his statement of priorities and accountabilities provided to EDC.

The strategy outlines how EDC will respond to the needs of Canadian companies engaged in integrative trade, and in particular, in high-growth and emerging markets such as China, India and Brazil, in order to strengthen Canada's international competitiveness, promote commercial interests abroad and ensure that Canadian companies have access to global value chains. **EDC's role in this new trade paradigm is to anticipate the needs of Canadian companies of all sizes so that it can develop and deploy relevant solutions to assist exporters and investors to increase their business internationally.** And, it will do so working collaboratively and in partnership with the government, the Trade Commissioner Service, other financial intermediaries, the private and public sector as well as with other stakeholders.

### 4.3 EDC as an Export Credit Agency

While for many years EDC offered programs similar to other ECAs, **today EDC is viewed as a progressive ECA whose mandate and scope is broader than many others.** Unlike its counterparts, EDC employs a blended model that gives it flexibility to respond to the wide range of needs of companies operating in all parts of the world. EDC's commercial approach allows it to operate in both the commercial and Consensus markets and to be financially self-sustaining.

In the early 1990s, EDC perceived changes in the marketplace that would require a different operating approach for the organization. The expanded mandate in 1993, its customer focus and commitment to sound risk management and commercial financial practices enabled the Corporation to expand its product line and scope of activity, serve more customers and facilitate their export and investment business while continuing to deliver positive financial results.

This has made EDC unique. Other ECAs have adapted to the changing marketplace at different paces but most now recognize the need to adjust to market realities and adopt a more commercial orientation to stay relevant to their customers. Indeed, several ECAs in industrialized countries have seen their business volumes decline in recent years and are approaching their governments to expand their scope of activity. **EDC is ahead of some, but not as flexible as others whose countries have ensured they are viewed as an integral part of their country's overall strategy for growth and prosperity.**

### 4.4 EDC and International Agreements

Canada is party to many international agreements, and some of these govern the policies and practices of EDC as described below. EDC also adheres to other international agreements such as its decision in 2007 to become a signatory to the Equator Principles, an international financial industry benchmark for assessing and managing social and environmental risk in project financing.

- **The OECD Consensus Arrangement:** This informal agreement was first instituted in 1978 and strives to eliminate trade distortions among the world's most industrialized nations. The Arrangement's objective is to eliminate subsidies relating to the provision of export credits and trade-related aid. As Canada's ECA, EDC must abide by the terms of this agreement when providing Consensus-based export credits.
- **OECD Common Approaches on Environment and Officially Supported Export Credits:** The Common Approaches, originally adopted in 2001, is an agreement among OECD Member countries that provides guidelines for the environmental review of projects and transparency on official export credit support.
- **The WTO Agreement on Subsidies and Countervailing Measures (ASCM):** Some 150 nations are members of the WTO and are bound by the ASCM. The ASCM defines prohibited export subsidies subject to challenge and provides a defence for export subsidies if transactions comply with the interest rate provisions of the OECD Consensus. EDC's market-based approach in the consideration of customer transactions is consistent with and respectful of WTO obligations.
- **The Berne Union General Understanding:** Officially known as the International Union of Credit and Investment Insurers, the Berne Union is an association of government-owned as well as private insurance companies. Its purpose is to work for the international acceptance of sound principles of export credit and foreign investment insurance. Members have agreed to respect disciplines on export credit terms, which are documented in the Berne Union General Understanding.
- **The Anti-Corruption initiatives and legislation:** EDC is subject to international anti-corruption initiatives such as the Action Statement agreed by OECD ECAs and to Canada's anti-corruption legislation, the *Corruption of Foreign Public Officials Act*.
- **Anti-Terrorism legislation:** In response to its obligations under the United Nations Security Council Resolution against terrorism, Canada has enacted legislation that criminalizes the perpetration of terrorist acts as well as the provision of financial and related services to individuals or entities suspected of being involved in terrorist activity. EDC has implemented systems enhancements to ensure that it does not transact business with such individuals or entities that are identified pursuant to the legislation.

#### 4.5 Governance at EDC

Since its inception, EDC has been financed through the investment of \$983 million by the federal government. **Operating on a self-sustaining basis with no annual appropriations from Parliament, EDC is self-funding, and has an extensive Treasury function that raises funds required for EDC's activities by issuing debt in the public debt market, with the total borrowing amount limited both by statutory formulas and requirements for approval of its borrowing plans.** EDC has recorded profits in every year except one and has returned \$720 million in dividends. The shareholder's equity now stands at \$6 billion.

EDC is subject to a strong governance regime. Its activities are regulated by the *Financial Administration Act* in addition to the *Export Development Act*. EDC's financial statements are audited by the Auditor General of Canada who also conducts regular audits of EDC's environmental practices and periodic Special Examinations. Both are currently underway. In addition, the Auditor General makes an annual examination to ensure EDC's activities are within its mandate. EDC follows the governance requirements for action by Crown corporations set out by the Treasury Board Secretariat, including holding annual public meetings open to all.

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### *Role of Government of Canada*

The Government of Canada is the shareholder of EDC and remains at arm's length from the day-to-day operations. EDC reports to Parliament through the Minister of International Trade. The Governor in Council appoints the Chairperson of the Board, and the President, while the Minister appoints all other directors. The government has, by statute, retained certain other high-level roles with respect to all Crown corporations, including EDC: EDC's annual corporate plan, which outlines its business strategy for a five-year period, requires approval of the Minister as well as the Governor in Council, and the Corporation's budgets are to be approved annually by the Minister and by Treasury Board, while borrowing plans contained in EDC's corporate plan need to be approved by the Minister of Finance. The Minister of International Trade issues an annual statement to the Corporation outlining government priorities for the Corporation, and related accountabilities. EDC collaborates with the Department of Foreign Affairs and International Trade in order to provide a continuum of trade promotion, finance and risk management services to Canadian business.

### *Role of EDC's Board*

EDC's Board establishes a strategic direction to ensure that EDC meets its mandate in the most effective manner. This responsibility is primarily carried out by Board review and input into EDC's business strategy contained in the corporate plan, along with the Corporation's borrowing plan, both of which are finalized and adopted by the Board before being ultimately submitted for government approval. **The Board's oversight role ensures that the Corporation's strategies are aligned and consistent with high-level government objectives.** The Board also approves policies and frameworks for assessment and management of risk, and other strategic policies. The Board's approval is required for certain large or otherwise significant business transactions undertaken by EDC.

## **4.6 Evolution of the Mandate**

EDC was established as a federal Crown corporation by statute (the *Export Development Act*), "for the purposes of supporting and developing, directly or indirectly, Canadian export trade and Canadian capacity to engage in that trade and respond to international business opportunities." In support of this broad mandate, EDC is empowered to, among other things, "enter into any arrangement that has the effect of providing to any person, any insurance, reinsurance, indemnity or guarantee." (*Export Development Act*, s.10(1.1)(b)).

Since EDC was created, its mandate has expanded to reflect the changing nature of Canadian trade and international business. Annex B provides highlights of EDC's evolution. The *ED Act* was amended in 1993 to enhance the Corporation's ability to serve Canadian companies by, among other things: eliminating a number of restrictions and impediments; granting EDC new powers with respect to domestic credit insurance, domestic financing, equity and leasing; and, enhancing foreign investment insurance capacity. New regulations were also added.

**While the powers under EDC's current mandate are broad, the regulations are restrictive. It can be argued that the regulations were written to reflect the needs and concerns of the time, not to anticipate the evolution in global commerce that has occurred over the past 15 years.** The current rules, juxtaposed with the way trade is done today, require EDC to carefully weigh what it can and cannot do for exporters and investors.

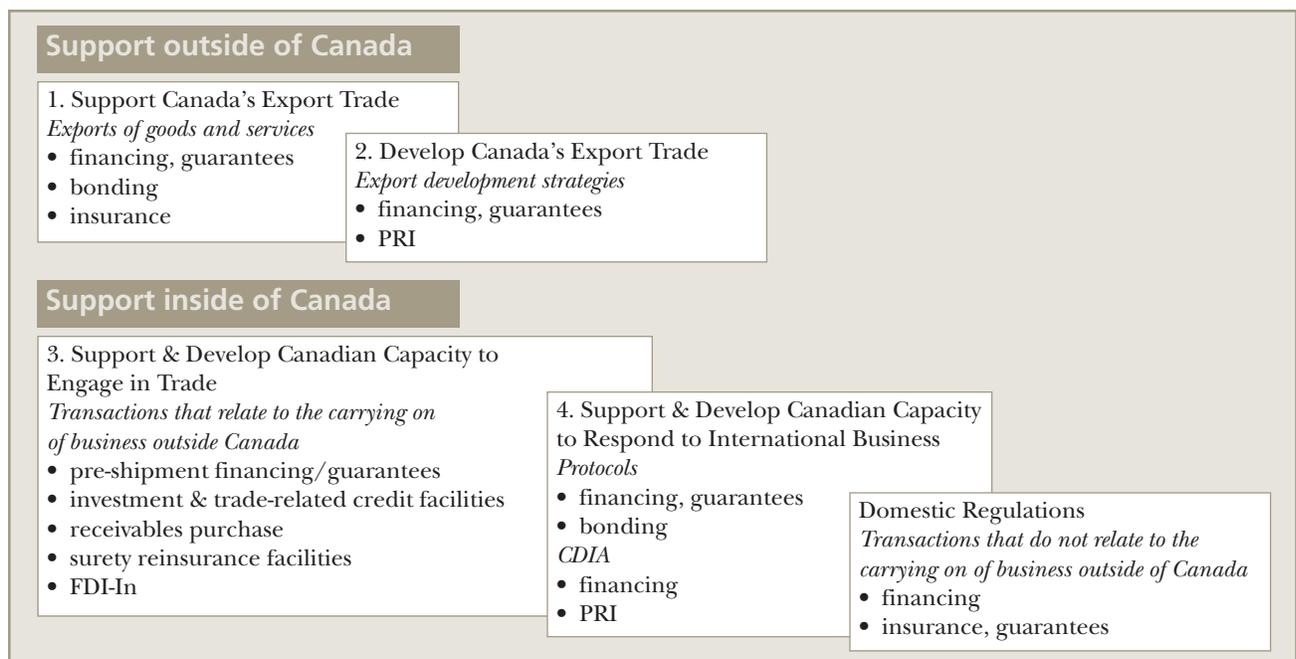
In practical terms, every transaction that EDC is asked to support must meet a two-pronged test: can EDC do the transaction under its mandate; and, should EDC do it? That requires the transaction to be measured against the mandate in a highly disciplined manner to ensure it is in accordance with EDC's legislation. Decisions often need to be made case-by-case, reflecting the current complexities of business and investment and what EDC must concern itself with in terms of the relation to exports, international business opportunities, Canadian ownership and Canadian content.

Once the mandate test is met, EDC also needs to satisfy itself that the transaction should be supported. In doing so, the Corporation must answer a number of questions. For example, it must determine if such support meets other EDC policies and practices, including the Canadian Benefits policy, the Environmental Review Directive for projects, credit risk policies and compliance with the WTO and OECD Arrangement. EDC must consider also whether it has the capacity to take on these risks and whether the transaction will impact the Corporation's reputation. Finally, it asks if the transaction would get done if EDC were not there and whether the private sector can play a partial role to increase capacity or share risk.

There is no doubt that EDC's products and services have evolved within the limits set out in its legislation, in step with the needs of international trade, as illustrated in the chart below. But it is also clear that EDC cannot fully meet the expectations of Canadian companies involved in global supply chains due to the definitions and restrictions in EDC's regulations that narrow today's understanding of how trade and investment occurs and why. **EDC's legal framework has prevented it from progressing in step with the pace of globalization.**

It is usually impossible for EDC to provide products and services to emerging exporters unless they have a firm export-related contract in place. For example, a company wanting to buy a fishing vessel cannot obtain EDC financing unless it has a firm contract in place with a fish processor even though 95% of the fish to be caught by the vessel are destined for export markets.

### EDC Mandate



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## 4.7 Canadian Benefits

All business facilitated by EDC is reviewed in the context of its Canadian Benefits Framework as part of its due diligence process. One of the principles of the Framework is to achieve a reasonable alignment between the level of support that EDC is contemplating and the economic benefits likely to be generated by the transaction.

**Every transaction undertaken by EDC must demonstrably benefit Canada.** In the days of traditional export trade, this came down to supporting Canadian export sales and ensuring that the products being exported were primarily produced in Canada with Canadian inputs. As the integrative trade paradigm began to emerge, companies began to incorporate higher percentages of imported content in their Canadian exports.

EDC has gradually modernized its interpretation of Canadian benefits to reflect the role of global supply chains, and a more modern appreciation of Canadian benefits beyond traditional Canadian content. The process has recently been enhanced to provide companies with greater predictability around EDC's capacity to facilitate their business and greater flexibility to tap this capacity.

Thus, the Canadian benefits framework that EDC employs today recognizes that there are a number of beneficial characteristics of transactions beyond the Canadian content of the export. These include R&D spending, the pursuit of global product mandates, entry into brand new emerging markets, the generation of above-average employment effects, the fact that the company is small, and so on.

A company's Canadian footprint – essentially, its contribution to jobs and economic growth through its wage and procurement bills – is used as a guide to determine the scale of EDC's participation in the company's global activities. EDC's overall objective, then, may be characterized as working to maintain or grow the company's contribution to GDP, or its footprint. Conceptually, this analysis obtains whether the company is legally Canadian, or is a foreign-owned company with a significant Canadian presence or footprint in Canada. The Canadian benefits policy at EDC has moved from one of ensuring that something is “made in Canada” to one in which something is “made by Canada”. Other ECAs are seeing a similar evolution.

The framework recognizes that investment in foreign economies may be essential for a Canadian company to grow its business and maintain or increase its Canadian employment level or footprint. With such future benefits clearly identified, EDC is in a position to facilitate such investments, either through financing or insurance products.

At the same time, Canadian companies are becoming part of foreign companies' global networks. They may still need access to the same level of support from EDC after being taken over, and such support would be appropriate if they still maintain a presence in Canada and generate benefits through wages, purchases and investment. In such cases, EDC may engage with the foreign owner and develop a protocol that makes clear EDC's role and mandate, and reinforces the fact that any support offered must generate Canadian benefits.

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EDC's Canadian Benefits policy is an important tool in measuring and demonstrating the value to the Canadian economy of the business facilitated by EDC. Its evolution from a highly prescriptive process requiring detailed review and extensive monitoring of Canadian content to a flexible and exporter-friendly Canadian benefits platform has mirrored the evolution of Canadian trade and the needs of Canadian exporters.

#### 4.8 Corporate Social Responsibility

A key area of attention since the last Review has been corporate social responsibility (CSR) – the policies and practices encompassing EDC's commitments to environmental review, transparency, business ethics, organizational climate and community investment. An operating principle for EDC for more than six years, CSR guides EDC's decisions and actions in support of Canadian business. In 2007, EDC benchmarked its CSR practices with a cross section of other export credit agencies and global banks. Specifically, this evaluation looked at performance against the five pillars of CSR at EDC: business ethics, environment, transparency, community investment and organizational climate. The evaluation determined EDC was well positioned with its peers on most initiatives, and identified areas where EDC will continue to lead, including environmental practices.

The Environmental Review Directive (ERD) in effect since 2001 sets out the processes, standards and accountabilities that accompany environmental review of projects. EDC remains the only export credit agency where reviewing the environmental impacts of the transactions that it considers is a legal obligation. The ERD also provides for an assessment of social and economic impacts related to projects, including resettlement, community engagement and impacts on indigenous peoples. The human rights assessment process reviews not only how the human rights situation in a given market can impact a project, but also analyzes how the project may impact local human rights.

EDC is committed to a regular review of its **human rights** processes and has an ongoing engagement with all of its stakeholders, including Canadian companies, business associations, the government and civil society. To broaden understanding of how countries and companies around the world assess and manage human rights issues in business, EDC participated in consultations convened by the United Nations' Special Representative on Business and Human Rights in both Zurich and Copenhagen and was one of a handful of export credit agencies to do so. In April 2008, after consultations with the CSR Advisory Council, EDC released a new Statement on Human Rights that presents the Corporation's position, values and commitment with respect to human rights, to ensure that business activities are conducted in a manner that is compatible with protection and promotion of human rights.

EDC is only the second ECA to adopt the Equator Principles – a set of voluntary guidelines for assessing and managing the environmental and social risks in project lending, which have become the standard for the world's leading private financial institutions.

The CSR commitment includes conducting business in an open and transparent manner. The Disclosure Policy, in place since 2001, governs the disclosure of information on transactions EDC facilitates and projects under consideration. This information is updated regularly at [www.edc.ca](http://www.edc.ca). The policy was recently revised to

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disclose more environmental information following a further update to the *OECD Common Approaches on Environment and Officially Supported Export Credit* which EDC follows. Recent coverage by the federal *Access to Information* legislation allows for the protection of commercially confidential information entrusted to EDC by its customers, while providing much greater access to information on general administration and operations.

Good CSR practices bring a competitive advantage to Canadian companies operating internationally, particularly in emerging markets. **EDC's continued commitment to CSR ensures the transactions it facilitates meet some of the highest standards applied by any ECA and some of the leading international banks.** In addition, EDC has taken the following steps.

- An umbrella Environmental Policy was developed to strengthen environmental review across all lines of business.
- EDC has launched an EnviroExport Initiative to support the exports of environmental technologies and services from water treatment technologies to solar energy systems.
- EDC is actively assessing and attempting to reduce the environmental footprint of its internal operations at the Ottawa headquarters.
- EDC has an independent Compliance Officer whose role is to enhance EDC's transparency and accountability with respect to the public disclosure of information, internal disclosure of wrongdoing, environmental reviews, human rights practices and business ethics.
- EDC has in place a Disclosure of Wrongdoings Policy and makes available the services of the Compliance Officer, an independent third party and a hot-line to receive reports of potential wrongdoing.
- A CSR Advisory Council, made up of eminent Canadians, was established in 2001 and meets semi-annually to advise EDC on how to strengthen its CSR practices and advance CSR practices among exporters and investors.
- EDC conducts multi-stakeholder roundtables, such as the 2007 roundtable on best CSR practices in the mining sector in the Democratic Republic of Congo. It also participated in the 2006 National Roundtables on the Extractive Industry.
- A Memorandum of Understanding to facilitate the sharing of human rights-related information has been in effect since 2002 with the Department of Foreign Affairs and International Trade. This information strengthens EDC's ability to assess any potential human rights issues in the transactions it has been asked to facilitate and provides a platform for regular dialogue between EDC and DFAIT.
- EDC's Code of Business Ethics and Code of Conduct reflect the Corporation's commitment to ethical conduct and require annual review and sign off by all employees. The members of the Board of Directors annually confirm their awareness and understanding of the obligations under the Code of Conduct and related procedures as well as their compliance with them.

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- In addition to regular diligence, EDC customers are asked to sign anti-corruption declarations. EDC reserves the right to terminate its support where there is credible evidence or reason to believe that bribery was involved in a transaction.
  - EDC supports active employee engagement in the community through a variety of activities such as charitable donations and paid time off for employee volunteerism and strong support for the United Way campaign.

## Chapter 5

### EDC TODAY: FACILITATING TRADE AND BUILDING CAPACITY

- EDC responds to Canadians with a customer-focused business strategy, new products and an expanded foreign network.
- EDC works in partnership with both the private and public sectors to increase capacity, lead innovation and develop trade.
- Customers are highly satisfied with EDC's products and services.
- EDC plays a strong public policy role in the credit insurance market by working with customers of all sizes and in all markets while remaining self-sustainable.

#### 5.0 Introduction

Previous chapters have described the current business and financial situation. This chapter will explore in depth how EDC responds to this environment through a customer-focused business strategy designed to meet the needs of global champions and SMEs alike, and the evolution of key products and services including the credit insurance program. It will also show where EDC is able to provide support and some areas where its operating regulations are in conflict with not only the mandate but also the needs of exporters and investors, particularly in financing some elements of a supply chain. Further, it will describe EDC's capacity-creating partnerships with the private and public sector and the Corporation's growing risk appetite.

#### 5.1 Focus on Customers

**EDC has a customer-centric focus that guides all aspects of the Corporation's business.** Connecting with Canadian exporters and investors is one of three pillars of the business strategy to reach out to Canadian companies to better understand their needs. EDC seeks to complement the resources available from the private and public sectors and in fact delivers a number of services in partnership, as is explained later in the chapter. Annual surveys confirm high levels of customer satisfaction with EDC and provide ongoing feedback highlighting areas for improvement. The chart shows overall satisfaction levels of EDC's customers for both SMEs and large customers over the past eight years. Scores are calculated on a scale of 10 to 100.

Over the past few years, EDC has restructured its front line operations to align with Canada's key export sectors and their related supply chains to



Canada's specialty crops sector has been a traditional user of EDC's credit insurance. Now companies in the sector seek a full range of products as they establish operations in foreign markets and require customized financing solutions. For example, many use EDC performance security guarantees to free up working capital when they post grain bonds required by the Canadian Grain Commission, using a customized EDC solution for the sector.

better understand what customers face. Sector-focused business development teams include senior account executives who work closely with larger, strategic customers such as global champions. In fact, EDC has dedicated account managers working with all but the smallest exporters. A specialized business development team was also established with the goal of reaching out to more SME exporters and developing simplified products and streamlined processes appropriate to their trade needs. Getting closer to customers means EDC can propose other products that offer solutions to customers' needs well beyond credit insurance, for example. This approach is proving successful as evidenced by the number of customers who have become users of more than one product line. There were 513 multi-program users in 2007, representing a 22% increase over 2006.

EDC is placing more underwriters and other professionals in offices across Canada and abroad to work more closely with customers and their buyers. Annex C shows the locations of EDC offices and representatives in 2008.

In addition, process improvements are enabling EDC to enhance the customer experience. In 2007, EDC applied Lean methodology to various stages of its loan underwriting and post-signing administration. The goal is to deliver financial solutions faster and more predictably while liberating human resources to focus on identifying customer needs. Significant reductions in "cycle time" have already been achieved. A major initiative is also underway to develop a Customer Relationship Management (CRM) system and supporting technology. Among the goals of this investment are improved customer service and higher customer satisfaction.

EDC's sector teams have identified areas where EDC is well positioned to support mid-market Canadian companies. This segment of the customer population has been highlighted as a growth priority for EDC, which recognizes that the needs of companies in this segment may be more varied and complex. Accordingly, the identification of ways in which the Corporation can both tailor and target its solutions to respond to company needs is a major component of business development planning in 2008 and beyond.

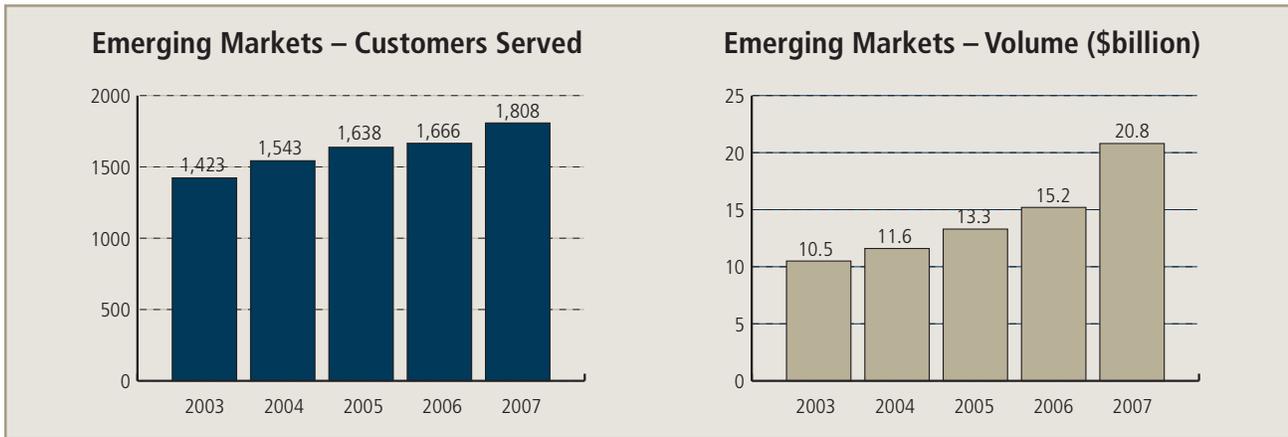
## 5.2 EDC Around the World

Global representation has grown considerably with 13 representatives now in important markets worldwide. Working with Canada's Trade Commissioner Service, these representatives play a catalytic role by identifying new foreign opportunities and establishing loan facilities for strategic foreign borrowers like the Reliance and Tata Groups in India, effectively leading Canadian companies to important new opportunities and facilitating procurement from Canada. EDC has assigned account managers to develop relationships with 55 of the most important

EDC's collaboration with MABE, Mexico's largest household appliances manufacturer, illustrates the value of EDC's foreign buyer relationships. In 2005, EDC took a USD 22.5 million position in a new USD 400 million syndicated credit facility for MABE. This facility allowed MABE to procure even more Canadian goods, equipment and raw materials for the fabrication of its products. MABE ultimately bought out General Electric Co. to become owner of Camco Inc., a Mississauga-based manufacturer of dishwashers and clothes dryers. This strategic alliance has ensured Camco maintains its position as the No. 1 manufacturer of clothes dryers in Canada and the U.S. and now supplies the Mexican and Latin American market from its plant in Montreal. MABE does not produce dishwashers or clothes dryers at its other plants in Latin America.

buyers around the world, foreign companies that have the most significant involvement in, and impact on, the trends in key markets and industry sectors. In 2007, EDC undertook \$3.6 billion in financing to encourage procurement from Canadian sources, and confirmed \$1.2 billion in new sales from 287 Canadian exporters on those projects.

**EDC places representatives in markets that are priorities for Canadian business because of their growth rates, importance to global supply chains and alignment with Canadian strengths.** Such investments are paying off. EDC business volumes in Brazil, Russia, India, China and Mexico totalled more than \$7.4 billion in 2007, up from \$6.8 billion in 2006. In India alone, \$1.2 billion was facilitated in 2007, which is triple the level of support in 2005 when EDC's first foreign representation was established in that country.



Accordingly, EDC is aggressively expanding its global network of representations to deepen its long-term relationships with local buyers and borrowers in opportunity-rich markets. EDC plans to expand its foreign representations to 20 by 2010. This expansion is consistent with the goals of the government's Global Commerce Strategy.

Unlike Canadian Commercial Corporation, EDC does not have the clear legislative authority to establish its own stand-alone foreign offices. Rather, EDC representatives are restricted to locations where space is available in Canadian diplomatic premises. While this works well in many locations, there may be markets where it is beneficial for EDC to locate outside an embassy for commercial, location or space reasons. Having the ability to complement the government's network would also extend Canada's overall reach.

### 5.3 Focus on SMEs

SMEs have been a priority customer segment for many years at EDC. **As part of its public policy role, EDC has long focused on SMEs through dedicated teams offering advice, financial products and assistance in accessing other government and private sector programs and resources.** EDC provides a spectrum of products and services that help smaller businesses expand and compete in the global marketplace. Their needs are addressed through direct lending and insurance programs as well as through partnerships with BDC, banks and private sector insurers. The growth of small companies into larger firms with a global reach will be a major driver of Canada's economic development in the 21st century.

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For many SMEs, their introduction to EDC is through the credit insurance program. In 2007, 84% of EDC customers were SMEs. There are a multitude of other products available to support the working capital needs of SMEs, and many are delivered in partnership with the private sector. Overall, the portion of EDC's business volume generated by SMEs in 2007 grew to a record \$18.8 billion, a 22% increase over 2006.

Single Buyer Insurance helped a small Quebec-based manufacturer that had a large contract with a new and unknown U.S. buyer. Knowing it could be a one-time sale, the manufacturer secured a \$100,000 insurance policy easily and efficiently.

Along with new partnerships and business development activities, several new products have contributed to the increase. Single Buyer Insurance was designed to provide a quick and easy solution for exporters with infrequent credit insurance needs or for companies entering new foreign markets. The Export Express Credit program is a micro-financing solution for first-time exporters, which can be used to cover a specific export contract's costs, fund a marketing initiative or buy equipment necessary to make the export product. This partnership between EDC and Mercantile Bank is currently being enhanced to provide more financing for market development activities.

The Export Guarantee Program provides a guarantee for up to 75% (to be increased up to 90% as announced in the 2008 federal budget) of a loan made by a SME's financial institution to fund costs for a specific export contract, multiple contracts, operating facility or the acquisition of term assets used in the production process, as well as to finance the production of components in a Canadian supply chain for a product that is ultimately exported.

EDC also offers online business products that are accessible and efficient as well as online information on markets, the economy and other research.

## 5.4 Evolution of Products and Services

While traditional products – credit insurance, buyer financing and bonding support – remain as important as ever, today's competitive environment requires new products and approaches. EDC's business has evolved to meet changing customer needs and has a much more extensive offering of services for Canadian companies.

EDC offers a range of products and services aimed directly at small and medium-sized companies, helps finance Canadian Direct Investment Abroad (CDIA) and provides bonding services. Many of these products are offered both directly or through guarantee structures arranged with commercial financial institutions. EDC also works with major foreign buyers directly, putting financing in place in advance of export sales and doing matchmaking in order to generate new business for Canada. Annex D provides an overview of EDC's main products and services.

For example, EDC has:

- placed a priority on facilitating exports and investments to **emerging markets** – today, this business accounts for 27% of the Corporation's total business volume even though it represents only 9% of Canadian trade;
- introduced a strategy to facilitate **CDIA**, which includes support for all aspects of a foreign affiliate's business, generally in proportion to the percentage of ownership by the Canadian parent. CDIA support includes Political Risk Insurance (PRI) for equity investments in, and export

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finance to, emerging markets. EDC facilitated \$9.6 billion of CDIA in 2007, a 49% increase over 2006;

- supported many aspects of the supply chain, for example, in meeting the short-term financing needs of parts manufacturers and toolers in the automotive sector and providing credit insurance to Natexport in support of its new Supplier Payment Program to support import supply for Canadian exporters;
- financed export-enabling infrastructure in Canada (within the limitations of its domestic financing and insurance regulations and normally in partnership with banks);
- responded to market demands for new financing approaches such as lease financing, local currency support and Islamic financing structures; and
- established a Global Trade Management Innovation Centre within the Corporation to conduct research on global supply chains and the use of electronic payment platforms, and to consider what role EDC could play alongside its banking partners.<sup>24</sup>

In addition to the existing investments to meet changing market needs, EDC also recognizes that agility in solution enhancement and continued investment in innovation across a wide range of solution requirements (financing, risk management, technology and trade development) are required to support Canadian companies operating in global supply chains. Participation in global supply chains imposes new (and less understood) requirements and risks on Canadian companies.

Potential areas for innovation include protection to Canadian companies against failure of their suppliers or supply chain due to financial or quality issues and delays in shipment outside the control of Canadian company; supporting the development of a technology infrastructure that assists Canadian companies integrate with their business partners and financial services providers more effectively; and certification of both buyers and suppliers to lower overall transaction risk in supply chain relationships. These comprise just a few areas where EDC and its partners can collaborate to deliver competitive advantages to Canadian enterprises.

**EDC's Equity program fills a market need for venture and expansion capital by adding capacity to Canada's private equity market and building relationships.** EDC supports entrepreneurial growth and export-oriented companies with high potential for global success by supplementing the availability of private equity and value adding with its core intellectual property. Internationally, EDC builds and develops networks and opportunities by investing in foreign private equity funds which serves to facilitate opportunities for Canadian supply, partnerships and investments within the global marketplace. Since its inception in 1997, EDC's Equity program has supported directly and indirectly about 150 Canadian companies which have generated approximately \$3 billion in exports and investments. EDC expects the Equity program could grow to \$1.2 billion by 2012.

EDC's Equity program helps high-growth SMEs grow internationally. Sometimes this is done through a direct investment, sometimes through a partnership with an existing equity fund. In the case of Redlen Technologies it was both. Redlen is a high-tech SME exporter which produces advanced materials for thin-film solar cells and imaging in medical applications. When they needed start-up capital, they approached Yaletown Ventures who was able to address their need, facilitated in part through EDC's investment in Yaletown's venture capital fund. Later on, Redlen needed additional capital for international growth; this time EDC invested directly in Redlen, alongside Yaletown.

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<sup>24</sup> GTM refers to the synchronization of the physical, informational and financial value chains attached to global trade. By effectively leveraging people, process and technologies at all stages of a transaction, companies are able to maximize productivity and enhance competitiveness.

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## 5.5 EDC's Credit Insurance Program

Canada's credit insurance market is largely composed of accounts receivable insurance (ARI). At the most basic level, ARI is purchased by exporters to make sure they get paid. An exporter buys insurance coverage, pays the premium and collects 90% of the balance owing if the buyer does not pay for the goods or services provided. Because of its immediate value, ARI is often the first product that exporters use and often complements their relationship with their banking partner. Banks treat insured receivables as collateral and are usually willing to extend more working capital to help exporters grow. As they do, they often turn to EDC for other products and services beyond credit insurance that can enhance their growth strategy and make them more successful.

**In 2007, EDC's credit insurance program served more than 5,800 EDC customers and insured \$51 billion of exports. Further, \$8.3 billion of the program's supported volume was in emerging markets. Eighty-five per cent of its customers served were SMEs.**

Over the years, EDC has adapted its practices and developed new products to remain relevant to Canadian exporters. In addition, EDC has engaged in numerous agreements and arrangements with various partners to grow the Canadian credit insurance market for the benefit of Canadian exporters. EDC's domestic partnership with COFACE, its reinsurance agreements with the private sector insurers, and its banking and factoring policies are all examples of this partnering effort.

EDC operates its export credit insurance business in a manner that is self sustainable over the long run in order to fulfill its international obligations and its commitment to its shareholder.

EDC's customers, whether through their brokers or directly, indicate high levels of satisfaction with EDC's service and credit insurance offering. This is corroborated by the high customer value index scores and feedback indicating that the credit insurance program delivers what is valued by Canadian exporters: superior risk appetite, credit stability and reliable claims payment.<sup>25</sup>

In keeping with its public policy mandate, EDC offers the following:

**Enhanced SME coverage:** EDC operates in all segments of the market but places special focus on small exporters, unlike the private sector players. SMEs are not viewed as an attractive market segment for the private insurers due to their size, experience and risk profile, although one private insurer has recently introduced a product for smaller exporters. It remains EDC's expectation that half of its current customers could not obtain coverage by the private sector because they could not meet the requirements for annual minimum premiums necessary to be a customer. Professor Ragan concludes that **if EDC were to withdraw from the market, "the smallest and riskiest exporters would be left un-served, at least until the private insurers increased their willingness to serve high-risk exporters."**<sup>26</sup>

Farmer Direct Co-operative Ltd. is an organic farmers' co-operative involving 70 family farms and exporting 99% of its sales, primarily to the U.S. and Europe. Noting that the biggest risk in the grain trade is not getting paid, Farmer Direct knew it needed a good risk management strategy. The Saskatchewan Trade and Export Partnership (STEP) put them in touch with EDC, and they took out an Accounts Receivable Insurance Policy. This has enabled the co-op to grow and ensure they get paid.

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<sup>25</sup> Customer feedback also indicates that EDC's pricing is higher than that of the private sector, typically in the range of 20% to 30% higher. This feedback was confirmed through a 2007 qualitative survey and focus groups with 21 credit insurance brokers that are familiar with the offerings of both EDC and the private sector.

<sup>26</sup> Ragan, p. 5.

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In the past 10 years, EDC's credit insurance has helped more than 1,000 small businesses develop into medium and large businesses. The SME sales force spends considerable time and effort providing the service that emerging and new exporters need. This is a key part of EDC's public policy mandate and supports EDC's continued role in providing credit insurance.

**Superior risk appetite and credit stability:** This is especially important during downturns in the credit cycle or when a particular buyer or industry's credit risk increases. In these circumstances, private sector credit limits may be rationed to ensure sufficient capacity for the largest companies, which are not necessarily Canadian. EDC has extended and sustained coverage in markets and sectors with higher risks, including the automotive, forestry and seafood sectors. Such coverage was instrumental in supporting Canadian exporters through difficult times. When GM experienced difficult times two years ago and demanded longer payment terms from suppliers, EDC extended capacity to Canadian exporters to allow them to obtain financing from their banks to keep shipping products and avoid bankruptcy.

**Access to an array of solutions:** EDC has the dedicated resources available to help customers develop exporting expertise and offers them a suite of trade finance and credit insurance tools tailored to the specific needs of Canadian companies and sectors.

Providing an insurance program available to exporters of all sizes in up to 200 markets requires ongoing investments in technology and underwriting expertise. By making such investments and by participating in all segments of the credit insurance market worldwide, EDC has the scale required to tolerate higher risk and serve market segments such as SMEs, yet maintain financial sustainability, even in economic downturns. **Changing the current model could lead to the so-called unraveling of the business created by losing capacity and expertise gained by serving customers of all sizes and in all markets.**<sup>27</sup>

EDC intends to remain relevant to Canadians and act in the best interests of Canada by continuing as a direct insurer and upholding the following principles:

- Ensure the evolving needs of Canadian exporters of all sizes are met.
- Operate the credit insurance program at no cost to the taxpayer.
- Grow the Canadian credit insurance market and ensure a stable supply of credit capacity by leveraging strategic partnerships wherever possible with banks, brokers and private insurers. EDC is willing to build capacity with the private sector by sharing its credit capacity for the benefit of customers; by increasing awareness of credit insurance in an effort to build the market; and by leveraging various distribution channels.

## 5.6 EDC's Growing Risk Appetite

Exporters look to EDC to take on risks that go beyond what they or their banks are willing to take. Through sound financial management, EDC has an adequate capital base to fulfill the mandate now and in the future. This gives the Corporation

In 1999, Enbridge established Canada's first internet-based crude-oil exchange through a subsidiary called NetThruPut Inc. There was no form of credit insurance available on the market at the time to cover its unique risk. EDC worked with NetThruPut to enhance its standard insurance policy to meet these new needs.

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<sup>27</sup> Malcolm Stephens, Short-term Export Credit Insurance, June 2007. Raoul Ascari, Is ECA a Misnomer? The ECA Response to a Changing World, 2007, p. 5. U.S. Eximbank, Report to the U.S. Congress on Export Credit Competition and the Export-Import Bank of the United States, 2006, p. 85–86.

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the capacity to prudently manage greater risks related to new and/or small exporters, emerging markets, high-risk buyers and high-risk industry sectors. EDC is also able to adjust its deal structures to the needs of different markets, for example, providing unsecured financing for smaller equipment sales to India – a market where it is difficult to take security.

EDC's willingness to take on more risk to support trade development is best illustrated by the profile of business concluded in the past two years. In 2006, the risk profile of new signings under the financing program reflected a 55:45 split between investment and non-investment grade borrowers. In 2007, the ratio was practically reversed, with non-investment-grade financing volume increased to 52%. EDC expects riskier transactions to reach 60% of the Corporation's financing activity. A more dramatic shift has occurred in the credit insurance program. In 2007, the risk profile of foreign buyer credit limits increased to 56% higher risk compared with 38% the year before.

The expansion of EDC's risk appetite is further internally supported by allocating additional, self-generated capital to support higher-risk business opportunities, which are believed to be fundamentally sound but could not meet the normal risk criteria of EDC. In 2007, EDC facilitated \$2.4 billion in higher-risk business across financing and insurance lines. Such business included providing a guarantee to a sub-sovereign financial institution in support of the sale of agricultural equipment to buyers in an emerging country; financing to a high-risk "C"-rated borrower for its purchase of aerospace equipment; and unsecured limited recourse financing for the acquisition, development and exploration initiatives of a Canadian oil exploration company in two emerging countries, among many others.

Canadian Bank Note Company, Limited (CBN) supplies security printed products and control systems for identification, payment and lottery systems to more than 40 countries, including high-risk markets in the Americas and West Africa. CBN uses credit insurance for all its foreign transactions as well as political risk insurance for long-term contracts where it assumes responsibility for operating results. Rounding out its support, EDC supplies CBN with contract insurance when CBN is required to post a performance bond on a large international contract. This product is provided in partnership with CBN's Canadian bank which posts the bond – EDC's guarantee ensures that CBN has continued access to sufficient working capital to manage and grow its business.

There are many other examples of transactions that have required EDC to consider risks beyond what the private sector would normally accept. These include long-term financing to Vietnam just after this market opened up in the early 1990s; credit insurance for a young digital animation company on its first international production; and contract frustration insurance on a consulting contract with the Rwandan government. Such transactions illustrate why EDC was created and demonstrate the Corporation's continuing public policy role as an agent charged with expanding Canada's exports of goods and services.

## **5.7 EDC and Financing the Supply Chain**

### *Foreign Affiliates*

EDC already provides extensive support for CDIA, including for the foreign affiliates of Canadian-owned companies, through political risk coverage, financial support and, where legally possible, inclusion of foreign affiliate cover in ARI

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policies. **As foreign affiliates become an extension of their parent, they need the same level and type of support that is available to the Canadian parent. EDC's customers do not always make a distinction between their parent and subsidiary financing or insurance needs, but rather seek support for a complete package.**

In considering medium and long term support to foreign affiliates, EDC as a general rule applies a proportionality test based on the amount of Canadian ownership to ensure compliance with the mandate which requires a clear link to exports, building export capacity or enabling the Canadian company to respond to an international business opportunity. Requests for support that fall outside the test can only be considered on a case-by-case basis.

**Therefore, EDC's mandate requirements and the application of a proportionality test can be seen as creating obstacles for some customers with foreign affiliates. Satisfying these requirements can compromise the flexibility, predictability or timeliness that customers are seeking as they build trade links.**

### *Financing*

The following section outlines where exporters need specific types of domestic financing and guarantees to participate in global supply chains or to enhance their ability to export and where EDC can facilitate such support.

#### **Pre-Shipment Financing Needs:**

SMEs in particular require pre-shipment financing support to help finance the pre-shipment costs associated with an export contract. While such support was originally envisioned as being of particular benefit to the high-tech sector, it has proven beneficial to Canadian companies across various sectors of the economy, and notably for the automotive sector. Under EDC's Export Guarantee Program (EGP), EDC has been able to increase the amount of pre-shipment financing available to SMEs by providing guarantees to the bank to extend incremental financing in support of requirements associated with a specific export contract. The EGP can be used to effectively increase the size of bank operating lines.

#### **Supply Chain Financing Needs:**

An often underserved group of companies are upstream suppliers that are directly or indirectly linked through an export value chain to an export contract. Most of these firms are smaller companies working at a second- or third-tier level of a supply chain. For a number of years, EDC has successfully worked with various banks to bolster financing available to small and mid-market automotive parts suppliers. However, EDC can provide such support in other sectors only if it can tangibly link such support to export contracts. EDC also provides financial guarantees to banks in support of the extension of general operating lines providing working capital.

#### **General-Purpose Corporate Facilities for Larger Canadian Companies:**

Increasingly, larger Canadian companies are using general purpose corporate facilities as their preferred means for raising capital to fund expansion of their export capacity, invest in foreign operations and fund foreign subsidiaries, joint ventures and other affiliates. Such facilities often do not differentiate between foreign and domestic requirements. As well, these facilities are more likely to be of

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a revolving nature with ongoing draw downs and repayments over the term of the facility. When EDC participates in such facilities, it generally does so as a lender alongside other financial institutions and typically provides not more than 10% to 15% of the required amount of financing.

### **Export-Enabling Infrastructure and Capacity Expansion:**

Canadian and international companies continue to invest in projects in Canada, which expand Canadian export production capacity. For example, this could be for the construction of a manufacturing plant, with the ultimate goal of exporting its production, or it could be related to the refurbishment of power generation facilities. Investment is occurring in various resource and manufacturing sectors and significantly in the extractive sector where the capital requirements are tremendous, and some large projects exceed the appetite of the domestic banking sector. EDC's international lending experience coupled with the size and nature of the debt requirements for these projects, makes EDC's participation attractive to Canadian project sponsors and the banks arranging the required financing.

## **5.8 Limits on Domestic Financing and Guarantees**

As noted, there are restrictions on what EDC can do in terms of providing domestic financing. **EDC can participate in financing transactions with Canadian companies in Canada only to the extent that it complies with both its legal mandate and the regulations that govern its domestic financing and guarantee activities.**

These restrictions present an interesting dilemma for Canada. Financial institutions are seen as sources of large pools of capital to permit infrastructure development and mergers and acquisitions that will make Canada more competitive internationally. They in turn look to financial partners such as EDC with expertise in credit analysis, structuring capability, risk mitigation and financial capacity. EDC is an obvious domestic partner by virtue of the fact that it is providing these services with international partners in projects and business around the globe. But unless it is tangibly linked to exports, EDC cannot do inside the country what it can do outside.

EDC may enter into a financing transaction not linked to an export-related transaction only after obtaining the approval of the ministers of International Trade and Finance. The regulations have different provisions depending on whether the domestic financing support is in the form of a financial guarantee to a bank, which is providing a loan to a Canadian company, or in the form of a direct loan to the company.

In the case of financial guarantees, EDC follows the requirements set out under the domestic insurance section of the regulations as this section also applies to other contingent liabilities such as guarantees. For financial guarantee transactions, there is no need to seek ministerial authorizations if: (1) the provision of the financial guarantee can be tangibly linked to exports; or (2) the annual export business volume of the Canadian company is greater than 15% of its total business volume or greater than \$5 million.<sup>28</sup>

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<sup>28</sup> Under the domestic insurance section of the regulation, EDC may provide support without ministerial authorization if the transaction is with a Canadian company whose annual export business is greater than 15% of total annual business or greater than \$5 million.

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In the case of a direct loan, the domestic financing section of the regulations applies. Similar to the domestic insurance regulations, there is no need to seek ministerial authorizations if the financing can be tangibly linked to exports. Unlike the domestic insurance regulations, the domestic financing regulations do not set out an objective test nor provide other clear guidance.

In cases where it is difficult to attribute the use of funds between domestic- and export-related activities, such as a general corporate facility, EDC has established and follows a rule to determine if it can meet the requirements of the regulations. This rule requires that the borrower's total annual export business volume must be at least 80% of the borrower's annual business, and in the case of a revolving facility, the availability period must be no more than two years. This rule allows EDC to meet the test for some of the transactions it is asked to support but is inefficient, time consuming and cumbersome for both the borrower and EDC to document and administer. Where the rule is not met, EDC turns down the transaction.

Infrastructure and domestic mergers and acquisitions also present difficulties due to the specific wording of the regulations. Stronger infrastructure not only helps Canadian companies get their goods and services quickly and efficiently onto world markets, it also makes Canada a more attractive destination for trade. While EDC has the financial capacity and expertise to participate in such financing in partnership with the private and public sector, EDC's domestic regulations do not permit this type of financial assistance unless there is a clear link to exports. 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.

#### **Examples of business EDC could not facilitate due to limitations of the mandate and regulations**

**Domestic financing – new SME exporters:** A start-up company ready to launch its product into the market after several years of R&D needed operating and term financing. Successful commercialization of the product was dependent on export sales. The company's Canadian bank was willing to provide the necessary financing support with a partial guarantee from EDC. As the company did not have actual export sales at the time of application, it did not meet the definition of exporter under the domestic insurance regulations that apply to financial guarantees.

**Domestic financing – capacity building:** Several years ago when the U.S. housing sector was booming, EDC was asked to provide financing to a company with plans but no contract to export housing construction products to the U.S. The transaction would have required ministerial authorization as, without binding contracts, the financing would not relate to the carrying on of business outside Canada.

**Domestic financing – mergers and acquisitions:** During the recent consolidation of the extractive sector, two Canadian mid-size gold companies merged and EDC was approached to participate in the related financing syndication. The merger would benefit Canada by strengthening the competitiveness of its gold mining sector, and was clearly linked to international activities since most of the gold assets of the two companies were in emerging markets. However, EDC was unable to participate (without ministerial approval) in this or other similar Canadian mergers because of the limitations of its financing regulations.

Chapter 6 will outline how EDC could do more, in partnership with banks, to meet more of the current domestic financing needs of exporters if the regulations were modified.

EDC customer satisfaction surveys with its banking partners in 2008 showed an overall satisfaction level of 8.17 (on a scale of one to ten), with many noting improvement since EDC established a dedicated financial institutions team. The banks value EDC's risk mitigation and foreign market expertise, and note a desire for greater collaboration and more flexibility in what EDC can and will provide.

ArtFX makes display showcases for retail kiosks and exports 70% of its sales. It saw an opportunity to grow through sales to U.S. shopping centres, but the sheer size and competitiveness of the U.S. market was a big challenge to a company of only 35 employees. When the company won a large contract with Westfield Corporation, the largest retail developer in the world, it needed access to more working capital to complete the order. EDC worked with the company's bank to provide support under the Export Guarantee Program, with the bank providing a loan to ArtFX and EDC providing a guarantee to the bank. This partnership ensured that ArtFX had access to the necessary financing for this and other major contracts.

## 5.9 Enhancing Capacity Through Partnerships

Over the years, EDC has built extensive relationships with other financial institutions, often delivering products and services through these intermediaries with which customers have a primary relationship. These partnerships are built with a multitude of players, either at the initiative of EDC, at the request of the partner or in response to a particular customer need. In 2006, EDC established a Canadian Financial Intermediaries Group to enhance its relationship with financial institutions by better understanding how they serve the needs of their customers and what role EDC can play to complement their offerings.

EDC's involvement with financial institutions takes many forms, but such activities can be grouped under two themes: "stretching" capacity and sharing risk. All activities have one common objective: to ensure that the customer's needs for financial intermediation are fully met.

EDC provides insurance and guarantees to financial institutions in order to stretch their capacity to serve the working capital, bonding and export and investment financing needs of Canadian companies. **EDC's risk-sharing products enable the private sector to extend support to a Canadian company that it would not provide fully on its own for a variety of reasons:** the company is small and needs additional working capital or a bonding product to sell more goods and services; the sector in which the company operates is experiencing a slowdown or a credit crunch; the foreign buyer or the foreign market where the company does business is viewed as too risky.

For example, EDC has recently concluded a joint financing agreement with HSBC Bank Canada to help Canadian exporters of all sizes capitalize on trade opportunities. Under this arrangement, an exporter can increase working capital by converting open account receivables insured by EDC into cash through a discounting arrangement with the bank.

EDC also has a new risk-sharing guarantee program with Scotiabank Inverlat in Mexico which, when launched, will support Mexican buyers of Canadian goods and services and provide support to Canadian affiliates in that market.

In 2007, financial institutions provided \$11.7 billion of financial support to Canadian companies with the backing of an EDC insurance or guarantee facility. Companies of all sizes benefit from these arrangements, but small companies benefit the most since they often find it more difficult to access the capital they need to do business internationally. Indeed, several of EDC's risk-sharing products are designed specifically to meet the needs of SMEs and to facilitate smaller-sized transactions.

EDC also works alongside banks and insurers where each party brings its financial capacity to the table and assumes the risk under its own account. This is a common practice under the financing and political risk insurance programs.

### *Partnering with Canadian Banks*

EDC's relationship with the Canadian banking sector is **multifaceted**. EDC is a customer of the banks through its Treasury operation, where funds are borrowed to finance business activities. Canadian banks are customers of EDC through various risk-sharing products to assist Canadian companies in their export and investment activities. Banks are also exporters and use EDC products and services

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to protect their investments abroad. Finally and most importantly, EDC and the banks join forces as partners to provide the financing needed by Canadian companies.

### **2007 Bank Partnerships with EDC**

EDC partnered directly with commercial financial intermediaries in about 15% of its business volume in 2007. This amounted to \$11.7 billion facilitated through EDC insurance or guarantees. More than 60% of EDC's business volume is facilitated indirectly in partnership with commercial institutions. The difference is attributable to the volume of EDC credit insurance that is used as security for bank financing activity.

### ***Banks as Customers of EDC***

EDC offers various forms of **guarantees** to banks to help them stretch their capacity for the benefit of Canadian companies and also insurance products to support their international activity.

A partnership-based business model has been the key to the success of EDC's bonding program by leveraging customers' existing financial networks (e.g. banks, brokers and surety companies). Under this program, EDC provides guarantees and reinsurance to the customer's financial institution to free up working capital and general corporate capacity. In 2002, EDC's volume for its bonding program was \$3.4 billion, supporting the issuance of more than 800 bonding instruments. In 2007, EDC support to customers and their financial partners increased to over \$6.2 billion, relating to more than 2,700 bonding instruments.

Under its financing program, EDC offers various types of guarantees to banks that totalled \$1.2 billion in 2007. Several of EDC's bank guarantee products are designed to assist small exporters or support small transactions. The Export Guarantee Program, a program highly valued by banks and customers alike, supports transactions under \$10 million, primarily to extend working capital or term financing to exporters. Since the program's inception, guarantees have been provided to some 30 financial institutions in Canada. In 2007, more than 200 transactions were guaranteed under this program and approximately half were under \$0.5 million.

EDC also saw activity under its Bank Guarantee Program in 2007, with transactions valued at \$126 million concluded during the year.<sup>29</sup> This program was revamped in 2005 following the last Legislative Review, which concluded that greater participation by the banks in trade finance could be of benefit to exporters. The program provides Canadian exporters with incremental financing for their buyers in emerging markets.

Also in response to feedback from the banks, EDC introduced Non-honouring Sovereign (NHS) insurance in 2005 as an alternative to the Bank Guarantee Program and aimed at banks making loans to sovereign or state-owned borrowers. This product protects the bank against the risk that the foreign government refuses or is unable to make a loan payment.

Aecomtric Corporation designs and manufactures custom burners and controls for heavy industry. From an initial focus on the U.S. market, the company has grown through exports to emerging markets and establishment of a production facility in China to serve the Asian market. Throughout its growth, the company has relied on the support of its banker and EDC together. EDC has provided bonding support and pre-shipment guarantees which ensured Aecomtric had ongoing access to working capital. Today, the company has sales of over \$20 million and is recognized among Canadian SMEs as an innovator.

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<sup>29</sup> Only seven transactions have been concluded under the Bank Guarantee Program since its inception in 2005. This level of usage reflects the general global decline in OECD Consensus business which the program was designed to support.

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EDC recently expanded the coverage provided to Canadian banks under the Documentary Credits Insurance (DCI) program, to accommodate trade transactions where the exporter is domiciled outside Canada. This coverage of third-country trade transactions allows Canadian banks to expand the provision of trade finance services internationally through their foreign branches, foreign subsidiaries and other international delivery channels. EDC's support for these transactions is based on the premise that the international trade finance activities of Canadian banks are exports of financial services and as such qualify for EDC services under the mandate.

Two of Canada's top domestic banks used EDC products to protect their investments in foreign markets in 2007.

### *Banks and EDC Supporting Trade Together*

A major Canadian mining company that uses EDC financing for global expansion says EDC plays an important role in its syndicated loans to develop new mines around the world. It views EDC as a marquee lender on mining projects that carry high levels of political risk by providing comfort to other private sector lenders that are more risk averse.

More than half of EDC's financing business was concluded alongside banks in 2007 where each institution brought its financial capacity to the table to meet the needs of the customer. Canadian companies and foreign buyers fund themselves very differently today than they did 10 years ago. Many of them, including buyers in emerging markets, raise their capital requirements through the syndicated loan market as opposed to funding individual export or investment transactions. EDC has invested considerable resources over the past few years to form good relationships with loan syndication desks of Canadian and international banks as well as with foreign buyers in sectors where the potential for Canadian supply is high.

**EDC brings more than its financing capacity to the table. Customers value the knowledge and expertise in risk management, market intelligence and association with Canada that EDC brings.** EDC's involvement can attract other global financial institutions to a transaction. Participation in a foreign buyer's syndicated facility can also influence the procurement decisions of that buyer to create incremental sales for Canadian companies.

### *Partnering with Private Insurers*

In the last few years, EDC has steadily increased the level of partnership with private sector insurers in Canada. Most importantly, EDC has vacated the field of domestic credit insurance and entered into a strategic relationship with the private sector to provide such coverage for EDC customers, while still meeting customer demand for one-stop shopping. It has signed ad hoc reinsurance arrangements with some of the major private credit insurers operating in Canada, and has also purchased reinsurance from the private sector to protect against catastrophic loss. Such arrangements enable EDC to provide risk appetite for certain buyers, which benefits both the exporter and the industry. On the political risk side, it is common for EDC to seek reinsurance on large emerging market exposures, thereby freeing up capacity to take on new risks on behalf of Canadian companies.

EDC has arguably been the most active export credit agency in cooperating with private insurers, especially in the political risk insurance and investment insurance areas. Zurich, for example, has stated that it does more business with EDC than with all the other ECAs combined. Furthermore, EDC actively pursues partnership opportunities with the private sector through such initiatives as excess loss cover in the auto industry, joint policies and trade fairs.

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EDC has made significant efforts to partner with various insurance partners and will strive to further leverage and deepen these relationships in the future through more systematic use of the private reinsurance market and sharing of capacity on large limits.

### *Partnering Within the Public Sector*

**EDC works closely with its public sector partners, in particular the Department of Foreign Affairs and International Trade, to leverage resources and align business strategies to support Canadian interests.** EDC's foreign representatives engage daily with Canada's Trade Commissioner Service in support of market and business development strategies worldwide. Working-level cooperation between DFAIT and EDC is ongoing with current activity focused on research to support the Canada–EU trade discussions, training, a joint secondment program and trade missions. In addition, EDC is a partner in the online Virtual Trade Commissioner.

EDC collaborates with other Crown corporations that assist exporters, including Business Development Bank of Canada (BDC), Farm Credit Corporation (FCC) and Canadian Commercial Corporation (CCC). EDC and BDC met on frequent occasions over the past year at the senior management level to explore potential collaboration opportunities. The two organizations are currently assessing various options to complement their respective offerings and possibly leverage their core competencies for the benefit of more Canadian companies. Examples include: leveraging EDC's relationships with large foreign buyers to benefit BDC's customer base; ensuring that Canadian exporters and investors are aware of and have access to the products and services of both EDC and BDC; leveraging BDC Consulting network to support Canadian exporters; and collaboration in specific sectors such as automotive and information communication and technology sectors. Both organizations will have further discussions to assess whether the scope of these initiatives warrants a formal framework arrangement between BDC and EDC.

EDC executives meet regularly with their counterparts at CCC and DFAIT to discuss business development strategies, and EDC and CCC have collaborated on a specific tool to support business development activities. EDC also partners with the Bank of Canada in developing leadership programs.

While a significant amount of information and support is available to Canadian business through government departments and other Crown corporations, the myriad of trade support programs can be tricky to navigate. EDC is working with its government partners to enhance the online resources available to companies as well as to sponsor business development events.

EDC also partners with the Saskatchewan Trade and Export Partnership and the Atlantic Canada Opportunities Agency as well as other provincial bodies to provide more unified solutions to support exporters entering into new markets or expanding activity in existing markets.

### *Other Partnerships*

EDC works with other partners to build capacity and help Canadian companies. As noted elsewhere, EDC products and expertise serve a catalytic role in enabling

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A small manufacturing company had a potential sale to a buyer in Mexico, but the buyer needed a loan to close the deal. The manufacturer turned to NORTHSTAR Trade Finance Inc. which provided buyer financing, with a guarantee from EDC. NORTHSTAR specializes in financing higher risk transactions in support of SME transactions, typically in the range of \$100,000 to \$10 million.

pension funds to invest in more markets. NORTHSTAR Trade Finance Inc. provides buyer financing in support of SME exports, through a partnership with EDC, various banks and provincial governments. As caisses populaires, credit unions, venture capitalists and factoring companies enter the market, EDC has developed relationships with them. Collaboration among export credit agencies has also increased; today, EDC uses reinsurance and co-financing arrangements with all of the G-7 export credit agencies to meet the needs of global companies with operations bridging multiple jurisdictions.

## 5.10 Looking Ahead

Companies in Canada require consistent and predictable access to financial intermediation and exporting intelligence. **EDC ensures that companies of all sizes, in all sectors of the economy, have the support they need, through all phases of the economic cycle.** EDC continues to play an important public policy role as a direct insurer. EDC must remain in the market and work with private sector partners to grow the Canadian credit insurance market and ensure a stable supply of credit capacity, and must do so at no cost to the taxpayer.

EDC must continue to evolve. This means more customer-focused initiatives and support for integrative trade, including the foreign investment activities of Canadian companies. It means being a good corporate citizen, improving service offerings to all customers and perhaps most significant, being where companies are, and where they are going.

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## Chapter 6

### EDC AND THE FUTURE OF CANADIAN TRADE

- The public policy rationale for EDC's current model and product lines remains strong.
- Clarity and flexibility are needed in the mandate and regulations to respond to customers' evolving supply chain needs, including treatment of imports, foreign offices and domestic financing in partnership with the banks.
- EDC will continue to work with financial partners, including the private insurers, to overcome the current gaps in the market to the benefit of exporters and investors.
- EDC is part of the solution to make Canadians more successful traders and create prosperity for Canada.

#### 6.0 Introduction

As previous chapters have illustrated, Canada has more international opportunities than ever before, but global competition is intensifying. Canadian exporters and the standard of living they generate for the country require all the capacity for trade financing and trade services that the public and private sectors together can provide.

In the beginning, EDC was created to compensate for perceived gaps in Canada's international trade finance market. As has been shown, gaps still occur – some have widened and some have narrowed. Gaps are not consistent – they depend on the credit cycle, sometimes the nature of the transaction itself or the market. Trade is not static. What is important is that EDC's products and services are there when gaps appear, disappear or reappear. Few anticipated the scale of the current credit crunch, yet business must proceed and ride out the market shortcomings. 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 has become more compelling over time, rather than less. 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.

Since the last Review, integrative trade has changed the patterns of trade worldwide. While presenting tremendous opportunities, the new paradigm poses new competitive challenges and requirements for Canadian business. Their needs for financial intermediation have become more sophisticated, and require market players with specialized risk management expertise. A good way to meet that need is through greater collaboration among private and public sector players to ensure that Canadian companies have access to the best possible expertise and support to compete.

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EDC exists for the sole purpose of supporting Canadian trade. Every transaction that EDC supports generates tangible economic benefits for Canada. In 2007, Canada experienced strong growth in some commodity-driven industries and declines in others that were adversely impacted by the value of the Canadian dollar. EDC's business volume increased by 17.5% overall to a record \$77.7 billion of Canadian exports and investments abroad, with growth experienced in nearly all programs. This occurred while overall growth in Canadian exports slowed.

Statistics show that Canada is falling behind in its share of global investment, both inbound and outbound. In such an environment, the least that EDC can do is to make sure that the absence of comprehensive international financial intermediation is not a contributing factor to this shortfall.

**EDC must be positioned to respond effectively to the changing needs of Canadian exporters and investors.** To that end, this submission has described how EDC has proactively established a presence in foreign markets, developed new products, supported foreign investment, partnered with the public sector, and restructured itself in a customer-centric manner. Of particular note is the growing importance of partnerships between EDC and the private sector.

EDC's new as well as traditional financial and risk management services will be as critical as ever in providing Canadian companies and their employees with a solid financial platform from which to expand and access new opportunities. However, there are some areas where the mandate and the regulations limit EDC's ability to respond to some needs of its customers and requests from EDC's financial partners. Some small adjustments to the mandate or regulations to reflect the world of supply chains could provide more clarity, flexibility and certainty for customers and partners. This in turn would equip them with the tools they need to sustain the growth of jobs and wealth that Canada depends upon.

**The onus is on the current Review to look well beyond today in making recommendations that will position EDC to respond successfully to the needs identified but not met currently as well as those that have yet to be seen or imagined.**

## 6.1 Maintaining the Current Model

There remains a strong rationale for the existence of EDC as a specialized financial intermediary serving Canadian interests and offering the products and services available to their international competitors. At this time, the private sector alone does not appear to have the risk appetite that Canadian exporters and investors need in all of the markets where they are active. But, with more than 60% of EDC's business today being conducted in partnership with commercial institutions, whether direct or indirect, it is evident that EDC is enhancing the capacity of the market, not displacing it.

Validation of the current model would serve the public interest by positioning EDC in a flexible and adaptable way.<sup>30</sup> That requires self-sustainability, and operating on commercial principles as do other Crown corporations and many ECAs. By doing so, EDC can continue to offer support to SMEs and global champions, promote the development of trade in emerging markets and continue to increase Canada's share of trade and direct investment abroad.

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<sup>30</sup> For an elaboration, see Stephen S. Poloz, *Why Does EDC Exist?*, February 2007.

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EDC's products and services are needed at all stages of the supply chain, in all sectors and in all markets. It is therefore essential that EDC's current model remain intact. More can also be done in partnership with the banks and there is confidence on both sides that the successes of the past few years will continue to grow.

Private sector market gaps exist today in Canada and would continue if EDC were no longer offering credit insurance. That is the conclusion of McGill's Professor Ragan whose report states: "Evidence from Canada's insurance brokers confirms that EDC's behavior in the market for export-credit insurance is notably different from that of the private sector insurers, and is consistent with enhancing market efficiency."<sup>31</sup>

As stated earlier, EDC believes there could be more partnering opportunities with the private credit insurance sector and is prepared to continue engagement on the subject. EDC intends to remain relevant to Canadians and act in the best interests of Canada by continuing as a direct insurer and upholding the following principles:

- Ensure the evolving needs of Canadian exporters of all sizes are met.
- Operate the credit insurance program at no cost to the taxpayer.
- Grow the Canadian credit insurance market and ensure a stable supply of credit capacity by leveraging strategic partnerships wherever possible with banks, brokers and private insurers. EDC is willing to build capacity with the private sector by sharing its credit capacity for the benefit of customers; by increasing awareness of credit insurance in an effort to build the market; and by leveraging various distribution channels.

## 6.2 Creating Flexibility, Providing Clarity

EDC's legislative and regulatory framework was designed with a good deal of flexibility embedded. As has been shown in previous chapters, EDC's interpretation of its mandate and of what lies in the national interest has evolved to reflect the shifting trade paradigm, and it has enhanced its product offering accordingly. However, the challenge remains to ensure EDC can continue to evolve and offer the kinds of products and services unforeseen today but likely critical in the not-so-distant future. Following are areas of changes proposed to provide the necessary clarity and flexibility.

### *Changes to the Regulations and Mandate*

For its part, EDC intends to remain relevant to Canadian companies and their employees and to enhance its ability to nimbly and fully respond to the ever-growing demands of a highly competitive global economy. With this goal in mind, there are a number of key areas where EDC's customers and partners would benefit from increased clarity and greater flexibility than is currently provided for in the existing mandate, powers and regulations. **Put simply, EDC's mandate provides for more powers than EDC can exercise due to the constraining effect of the current regulations. That means its ability to respond fully to the particular needs of Canadian companies has been restricted. Specifically, it may be time for a**

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<sup>31</sup> Ragan, p. 5.

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**re-examination of notions of capacity, domestic finance, exports, development of trade and proportionality.**

*Domestic Financing in Partnership with the Banks*

Domestic financing is allowed under the mandate but curtailed by the regulations. As shown in Chapter 5, EDC is unable to offer support in the following areas without ministerial authorization:

- general working capital financing for start-up and emerging exporters;
- 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.

Some would say that EDC's regulations are clearly at odds with the intentions of the mandate to support and develop export trade and Canadian capacity to engage in trade and respond to international business opportunities. That mandate gives EDC a role in domestic finance, a role that is recognized by some of the banks seeking capacity through partnerships. Such activities would benefit Canada and ultimately enhance Canada's trade capacity by making it more competitive. But without changes to the regulations or without taking each transaction through the lengthy process for ministerial authorization, banks will have to seek other partners if the projects are to be built or companies are to expand. The question of who EDC can support and under what circumstances needs to be addressed in the Review.

**At the same time, EDC is not seeking a carte blanche on domestic financing.**

Historically, when EDC has been able to do such financing it has always taken care to ensure its financing is linked to trade and it is providing additional capacity to the banks. Also it responds to customers' expressed needs; it is not seeking new customers on the basis of domestic opportunities. Going forward, EDC intends to apply the same general principles as it has in the past: it will look to the banks to maximize their capacity before calling on EDC; it will urge customers to seek bank support first; and it will participate in the same capacity as the banks.

*Providing Clarity and Flexibility for Customers*

In order to respond to customer needs and work with financial partners in a fast-paced global environment, EDC needs to respond quickly with innovative customer-focused solutions. It is impossible to predict what other needs might arise in future, but when they do, EDC needs the flexibility to respond within the customer's required time frame. However, the need to obtain certain additional information, clarifications and verifications to demonstrate mandate and regulatory compliance adds additional time and resources as well as uncertainty to deal completion.

Changes in a number of small areas to provide clarity and flexibility would allow EDC to provide new solutions, alone or through partnering with private sector

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banks and insurers, to companies operating in the integrative trade world. For example, **the government may wish to examine whether the term “export trade” is still relevant in today’s world of supply chains or whether it should simply be replaced with “trade” to capture more fully the realities of business in a borderless world.** The following are some examples that may be worthy of consideration:

- Lending to Canadians (including guarantees to banks) to support *capacity to engage in export trade* may be limited by regulations, particularly where the EDC support does not expressly link to *the carrying on of business or other activities outside Canada*.
- Support for emerging exporters who lack sufficient historical exports or a link to an export contract may be limited due to the lack of an express power.
- The inability or lengthy time required by the machinery of government to obtain ministerial approval for *classes* of domestic financing or domestic insurance transactions limits EDC’s ability to support program-type, rather than individual, initiatives.
- Support for foreign direct investment into Canada can be difficult due to the need to demonstrate that the use of funds relates to the carrying on of business outside Canada.

There may also be instances where EDC would benefit from greater flexibility in the management of its portfolio of signed loans. The ability to buy and sell assets, swap loans or use credit derivatives to manage credit exposures is an important part of any risk mitigation strategy, yet EDC must demonstrate that these portfolio management activities relate to its mandate of supporting and developing trade. Greater flexibility in this regard would help EDC manage its assets, ultimately benefiting the customer by positioning EDC to take more risk.

#### ***Ministerial Authorization***

In the case of domestic financing requests, even when they are considered mandate compliant, the time required for ministerial approval under the regulations may preclude EDC from supporting the company in the time frame required. **It may be time to consider whether certain approval processes could be streamlined** to allow more timely responses from EDC to customers seeking assistance, particularly for defined classes of transactions.

Streamlining the process for seeking ministerial authorization under the domestic finance regulations and providing EDC with the ability to respond to broader, program-type structures or classes of transactions rather than on a case-by-case basis would be advantageous.

#### ***Board of Directors and the Mandate***

As has been noted, the Governor in Council appoints the Chair and the President and CEO while the Minister of International Trade appoints the individual directors. Since the implementation of the government’s *Federal Accountability Act*, the governance structures of Crown corporations and their Boards have been further regulated and strengthened. **Given the significant changes to the trade environment expected between formal reviews, more**

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**authority and responsibility could be delegated to the Board of Directors on behalf of the government.**

For example, in the area of domestic finance, the government may choose to allow EDC to follow a mandate test based on a directive issued and updated as needed by EDC's Board of Directors, in lieu of the existing domestic financing regulations. This would allow EDC to respond to unforeseen global trade trends impacting customers prior to the outcome of the next Legislative Review, which will not begin until 2018. This would be preferable to increased or different regulation that could seem to solve a 2008 problem but inadvertently cause problems later as the trade world continues to evolve. Giving more delegated powers to the Board and greater accountability would answer potential partners that want to take advantage of EDC's mandate and capacity but also want assurance that their role in the market is unchanged.

Such a directive could be styled after the Environment Review Directive of 2001 where the government amended the *ED Act* to require the Board to issue a directive requiring EDC to determine whether a project would have adverse environmental effects despite mitigation efforts and if so, whether EDC should be justified in entering into such a transaction. The ERD is a policy approved by the Board and handed down to EDC by the Board for implementation. The Board closely monitors activities covered by the Directive through regular reports and periodic updates.

***Financing Imports***

EDC can finance imports, but such imports must be directly linked to an export contract or export activities, a requirement that can be difficult to establish in complex supply chains. Several banks have already approached EDC to support new forms of supplier payment programs. However, often the link to exports is not as clear or as strong as required by the current regulations on domestic guarantees that EDC must follow. Therefore, EDC is limited in its ability to support these programs.

The Conference Board of Canada has made a number of recommendations to encourage Canada to become more strategic about international trade and related investment. One recommendation highlighted the importance of financing imports.

*“Specifically Export Development Canada should have the legislative capacity to ensure that exporters can finance or insure key production imports on competitive terms. This could be an important success factor for some firms in an integrated manufacturing world where the foreign (or imported) content of exports exceeds 40 per cent, or even 50 per cent, in many manufacturing sectors.”<sup>32</sup>*

In April 2007, the House of Commons Standing Committee on International Trade recommended that EDC's legislation be amended to give EDC the direct mandate to finance imports.

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<sup>32</sup> The Conference Board of Canada, *Mission Possible: Stellar Canadian Performance in the Global Economy*, January 2007, vol. 1, ch. 7, p. 92.

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### *Foreign Offices*

A relatively minor change to the *ED Act* could be made to give EDC the explicit authority to establish foreign offices, like that given to Canadian Commercial Corporation. Allowing EDC more flexibility would result in an expansion of the government's international network, which is an important consideration when resources and physical space in embassies are constrained. Having the mandate to open foreign offices would not mean that EDC would locate all its operations outside of the government's consulates and embassies. Co-location may continue to be preferred in some markets. EDC would continue to consult with the Department of Foreign Affairs and International Trade as it expands the foreign representation network to ensure alignment.

### *Support for Global Supply Chain Financing Infrastructure*

As physical supply chain costs are minimized, best-in-class companies are exploring opportunities to reduce the financial costs associated with the supply chain. Facilitating the financial dimension of integrative trade may be crucial to a domestic company's competitiveness. A foreign company with the same technology and the same global supply chain but a more flexible bank providing access to a modern Global Trade Management (GTM) platform could be more competitive than a domestic company with a less flexible financial partner.

Some global banks are developing GTM platforms to help members of supply chains operate more efficiently. However, the availability in Canada of similar solutions, especially for SMEs, is limited. Canadian companies may therefore be disadvantaged by a lack of access to electronic trade platforms which allow them to process trade documents and payments online. EDC could play a role and has been in discussions with banks in this regard. However, such platforms need to be accessible to both domestic and international traders.

The potential involvement of EDC in this area would open new doors to the support, with financial partners, of non-traditional trade, and provides one more example of where EDC needs greater flexibility in its mandate to support burgeoning supply chain needs. A mandate built on trade rather than exports alone would allow EDC to play a greater role in an area that is particularly beneficial to SMEs, which are forced to rely on inefficient paper processes that are time consuming and negatively affect cash flow.

## **6.3 EDC as Canada's Export Credit Agency Going Forward**

Levelling the playing field among export credit agencies is taking on new meaning. Traditional and progressive ECAs alike must compete with ECAs and ECA-like institutions from emerging markets that have much broader mandates to operate in areas that strengthen their country's economy. Often, they are viewed as an integral part of their country's overall strategy for growth and prosperity.

**This leaves little doubt that a country such as Canada that is so reliant on trade for its prosperity needs an effective ECA whose mandate and orientation allow it to provide competitive solutions to its national companies to help them succeed globally.** This has been the *raison d'être* of EDC since 1944. The ability to adapt has been key to its recognized success in facilitating more exports and investment business year over year and, more importantly, in contributing to the success of its

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customers from SMEs to global champions. The end result – the contribution to Canada’s prosperity – has been significant.

#### 6.4 Conclusion

While EDC’s mandate has provided it with the flexibility and scope required in the past, the accelerating pace of globalization and increased complexity of trade and investment are challenging EDC’s ability to meet some customers’ needs. Unless these needs are met, Canada’s overall relevance could diminish as the global marketplace becomes increasingly competitive. This is unacceptable. Canada depends on the jobs and wages generated by trade to support the standard of living Canadians have come to expect.

**EDC is seeking some changes that would allow it to do more for Canadian business both as exporters and investors because they need more in terms of financial intermediation, foreign market expertise and trade development.** It wants to do more in partnership with the private sector, both banks and the private credit insurers. The current economic conditions and short-term export forecast underscore the need for partnerships to build and leverage capacity to make Canadians more competitive.

The current Legislative Review of the *Export Development Act* occurs at a timely juncture for Canadians as well as for EDC in its support of the government’s trade agenda. It is not enough to look at the current state of trade. Clear-eyed perception is needed to anticipate what trade will look like at least 10 years from now. Weighing the evidence and adjusting the course where necessary will ensure Canadians have the tools they need – including those offered by EDC – to preserve and expand Canada’s role in international trade.

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# ANNEXES

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AT A GLANCE: EDC'S RESPONSE TO THE LAST REVIEW

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KEY MILESTONES IN THE EVOLUTION OF EDC

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EDC INTERNATIONAL REPRESENTATIONS

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EDC'S FINANCING AND INSURANCE SOLUTIONS

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## ANNEX A

### AT A GLANCE: EDC'S RESPONSE TO THE LAST REVIEW

During the last review of the *Export Development Act*, Canadian companies, parliamentarians and the Government of Canada highlighted a number of areas for EDC to review. Since then, EDC has taken a number of steps to respond to these views and strengthen how it serves exporters and investors on behalf of Canadians, including in the following areas:

#### Corporate Social Responsibility

- In addition to the legislated Environmental Review Directive embedded in the Act, an umbrella Environmental Policy has been developed to strengthen environmental review at EDC.
- The Corporation is only the second ECA to sign on to the Equator Principles – a set of voluntary guidelines for assessing and managing the environmental and social risks in project lending, which have become the standard for the world's leading private financial institutions.
- A public Disclosure Policy has been developed, under which information on EDC activities is proactively released on EDC's website. EDC has also been made subject to the federal *Access to Information Act*.
- A CSR Advisory Council, made up of eminent Canadians, was established to advise EDC on how to strengthen its CSR practices in order to position EDC to play a leading role in advancing CSR in the exporting community.
- An MOU to facilitate the sharing of human rights-related information has been signed with DFAIT, strengthening EDC's ability to assess any potential human rights issues in the transactions it has been asked to facilitate.

#### Partnering with Private Sector

- A partnership agreement has been signed with COFACE to provide Canadian companies with domestic credits insurance, while EDC has been working with the private sector to better promote the use of export credit insurance among Canadian companies.
- Further to a review by EDC's Board of Directors, DFAIT and Finance, the bank guarantee program has been enhanced to promote greater private sector participation in trade finance. In addition, a Canadian Financial Intermediaries Group has been established to coordinate and strengthen EDC's activities with Canadian banks.
- EDC has been working with private sector financial intermediaries to facilitate their own international business activities.
- Amendments to EDC's equity program were made in 2003 and 2008 in response to the views expressed by exporters and investors.

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## **Serving Canadian SMEs**

- Solutions have been developed directly (including on-line) and in partnership with the private sector to respond to the unique financing and insurance needs of SMEs.
- A range of information about trade and doing business in foreign markets has been made available to SMEs through publications, the EDC website, and information sessions and roundtables held across Canada.
- Collaboration between EDC and BDC has been strengthened to ensure that SMEs better understand the two organizations' respective services, and to explore the basis for synergies in supporting Canadian business currently or potentially engaged in export and trade.

## ANNEX B

### KEY MILESTONES IN THE EVOLUTION OF EDC

1944 to 1969	1969 to 1983	1983 to 1993
<p>Creation of Export Credit Insurance Corporation (ECIC) (1944)</p> <p>ECIC offers short and medium-term insurance (1944)</p> <p>First regional office established in Montreal (1946)</p> <p>ECIC becomes a member of the Berne Union (1947)</p> <p>Lending authority established (1961)</p>	<p>ECIC becomes Export Development Corporation (EDC) and the <i>Export Development Act</i> is proclaimed (1969)</p> <p>EDC begins treasury operations (1972)</p> <p>New products introduced:</p> <ul style="list-style-type: none"> <li>• Small Business Policy (1977)</li> <li>• Surety (1978)</li> <li>• Note purchase arrangements (1980)</li> <li>• Political Risk Insurance (1981)</li> </ul> <p>Regional underwriting capability established (1977)</p>	<p>Exposure Fee introduced (1983)</p> <p>Customer Satisfaction initiative launched (1990)</p> <p>EDC structured on product and country lines (1990)</p> <p>New products introduced:</p> <ul style="list-style-type: none"> <li>• Medium-Term Agriculture Credits Insurance (1986)</li> <li>• Documentary Credits Insurance (1989)</li> </ul>
<p>1969 Volume: \$341 million 869 policies</p>	<p>1983 Volume: \$4.8 billion 1,031 policies</p>	<p>1993 Volume: \$13 billion 2,057 customers</p>

1993 to 1997	1997 to 2001	2001 to Present
<p><i>ED Act</i> amended to include domestic financing/insurance, leasing and equity (1993)</p> <p>Customer Satisfaction survey launched (1993)</p> <p>First dividend to government (1993)</p> <p>Re-engineering initiative leads to new sector teams, International Marketing Group and dedicated SME team (1995)</p> <p>EDC launched a homepage on the World Wide Web (1995)</p> <p>Project Finance capability developed (1995)</p>	<p>First foreign representative posted to Beijing (1998)</p> <p>Support for CDIA (1999)</p> <p>First review of <i>ED Act</i> – leads to creation of Environmental Review Directive and new name Export Development Canada (2001)</p> <p>CSR initiatives launched:</p> <ul style="list-style-type: none"> <li>• Enhanced Code of Conduct/Business Ethics (1998)</li> <li>• Disclosure Policy (2001)</li> <li>• CSR Advisory Council (2001)</li> </ul> <p>First domestic insurance partnership with St. Paul's Guarantee (2000)</p>	<p>EXPORTCheck and EXPORTProtect, among EDC's online products and services (2002)</p> <p>EDC partners with COFACE for domestic insurance (2005)</p> <p>Integration initiative leads to new Business Development and sector focus (2005)</p> <p>First EDC Stakeholder Panel (2006)</p> <p>EDC becomes subject to <i>Access to Information</i> (2007)</p>
<p>1997 Volume: \$29 billion 3,711 customers</p>	<p>2001 Volume: \$44 billion 6,355 customers</p>	<p>2007 Volume: \$77.7 billion 6,963 customers</p>

## ANNEX C

### EDC REGIONAL OFFICES



### EDC INTERNATIONAL REPRESENTATIONS



## ANNEX D

### EDC'S FINANCING AND INSURANCE SOLUTIONS

<b>INSURANCE</b> Protects policyholder against various types of risks.	
<b>PRODUCTS</b>	<b>CUSTOMER APPLICATIONS</b>
Accounts Receivable Insurance	Protects policyholders against commercial credit risk such as non-payment by their buyers, whether due to insolvency, default, repudiation of goods or termination of contracts, as well as against political risks such as difficulty in converting or transferring currency, cancellation of export or import permits, and war-related risks. Coverage is available for companies of all sizes, and some products have been streamlined to meet the needs of SMEs.
Export <i>Protect</i>	See Online Products & Tools.
Documentary Credits Insurance	Protects banks in Canada confirming or negotiating irrevocable letters of credit (ILCs) issued by foreign banks to exporters of Canadian goods and services. The policy provides insurance against the risk that the foreign bank may fail to pay the insured bank for payments due to the exporter under the ILC. This enables the exporter to look to a bank in Canada for payment rather than the buyer's bank abroad.
Contract Frustration Insurance	Tailored coverage used for one-off goods, services and project contracts.
Political Risk Insurance	Protects Canadian companies with investments in foreign countries and/or lenders that finance investments pursued by Canadian companies abroad. Traditional policies cover investors or lenders against currency conversion and/or transfer difficulties, expropriation by the host government, and political violence. Availability of political risk insurance can also allow companies to leverage additional financing for projects. The political risk insurance program includes the non-honouring of a sovereign payment obligation to a lender; the non-payment to an investor of an arbitral award against a sovereign entity; and coverage of the rights associated with mobile assets. In addition, EDC has made a number of changes to the program to accommodate small business transactions.

## BONDING

Contract bonds assist Canadian companies to post or secure surety, guaranteeing their bid, performance and certain other obligations related to an export trade. They are issued in the form of a letter of guarantee by banks or as surety bonds by licensed sureties.

PRODUCTS	CUSTOMER APPLICATIONS
Performance Security Guarantee	Provides banks with a guarantee against any calls pursuant to the guarantees issued by the bank on an exporter's behalf and frees up working capital for the exporter.
Performance Security Insurance	Protects exporters from wrongful calls made on their bank letters of guarantee and is also available online under the Wrongful Call Program.
Foreign Exchange Facility Guarantee	Provides a second demand guarantee to the financial institution (FI) for 100% of the collateral provided to the FI with respect to the exporter's forward contracts facility, in the event that the exporter does not close the forward contract on the "settlement date."
Financial Security Guarantee	Provides the bank with a second demand guarantee to secure exporters' obligations in respect of suppliers and offshore working capital facilities.
Surety Risk Sharing	When an exporter, with existing but limited surety lines, is required to post surety bonds instead of bank letters of guarantee, EDC offers surety capacity in the form of Surety Re-Insurance to licensed sureties to increase capacity to facilitate the issuance of such bonds.
Surety Fronting Services	Available to exporters when financial profiles or volume of business does not meet normal surety underwriting guidelines. Surety bonds are thus issued by licensed sureties with the full support of EDC. This allows smaller exporters to access a surety market that is not typically available to them.

## FINANCING

Enables Canadian companies to provide their customers with flexible, medium- or long-term financing. EDC offers a variety of structures that can be tailored to meet today's evolving market conditions the world over.

PRODUCTS	CUSTOMER APPLICATIONS
Lines of Credit	Provides a fast and inexpensive means by which exporters can promote sales via pre-arranged financing facilities between EDC and foreign banks or corporations. That is, EDC may lend to a foreign bank for on-lending to buyers of Canadian exports, or EDC can establish a line with a major foreign corporation which is purchasing from one or more Canadian exporters.
Loans	<p>Loans between EDC and a buyer/borrower can be arranged for any export transaction. Two basic types of loans are available:</p> <ul style="list-style-type: none"> <li>• Buyer Credit involves a financing arrangement between EDC and the buyer (or a separate borrower on behalf of the buyer) to finance Canadian exports generally related to a specific export contract.</li> <li>• Supplier Credit transactions are structured to provide the exporter (supplier) with the ability to provide its buyer with extended payment terms. EDC can also provide pre-shipment financing to exporters, in conjunction with their bank, to finance costs directly related to an export contract.</li> </ul> <p>EDC may also provide financing to Canadian companies to support their export business or their foreign investments.</p>
Project Finance	Provides limited recourse financing to fund the construction of industrial and infrastructure projects across various sectors in support of Canadian exports to, or Canadian sponsor investment in, such projects. Project sponsors can additionally benefit from EDC's considerable expertise in arranging project finance transactions in cooperation with other lenders.
Guarantees	EDC may issue a guarantee to a financial institution to cover loans to foreign borrowers for the purchase of Canadian exports, or to exporters to provide financing to support their export business or foreign investments.
Equity and other Forms of Related Investments	EDC may provide equity and/or other forms of related investments (including fund investments) in support of next-generation Canadian exporters and to facilitate globalization of existing Canadian companies. This allows EDC to offer broader support to Canadian firms, leverage additional sources of financing, foster cooperation among Canadian firms and their partners, and assist Canadians to compete globally.

## ONLINE PRODUCTS & TOOLS

Provides another channel to inform, contact, transact with and serve Canadian companies.

PRODUCTS	CUSTOMER APPLICATIONS
EXPORT <i>Protect</i>	Provides online single transaction insurance coverage on a foreign buyer.
EXPORT <i>Check</i>	Provides a credit profile of a foreign buyer and/or a Dun & Bradstreet business information report.
EXPORT <i>AbLe?</i>	Helps potential exporters assess their company's overall readiness to export.
EXPORT <i>FinanceGuide</i>	Centralizes information about the wide range of solutions for an exporter's financing needs based on their location in the transaction cycle.
Country Information	Provides comprehensive market intelligence on a variety of regions and countries, enabling the user to assess business opportunities outside of Canada.
Online Solutions Advisor	A diagnostic tool that helps to identify the appropriate EDC product or service based on the exporter's need(s).
Currency Converter	Provides conversions into and from a variety of world currencies, for both current day and past dates (provided by the Bank of Canada).