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Bureau d'assurance du Canada

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Diana Smallridge, President and CEO
International Financial Consulting Ltd
World Exchange Plaza, P.O. Box 81119
Ottawa, Ontario K1P 1B1

Dear Ms Smallridge,

Insurance Bureau of Canada (IBC) welcomes the opportunity to provide input for the upcoming legislative review of Export Development Canada (EDC).

The property and casualty insurance industry in Canada plays an important role in underwriting the economic and financial risks associated with starting and operating a business. Insurance is an enabling sector, which supports new ventures that contributes to Canada's economic prosperity. The industry understands the unique challenges that Canadian entrepreneurs and businesses face, and it endeavours to develop new insurance products that meet these customers' needs.

IBC has been working with insurers on examining the scope of EDC's mandate and activities, and has identified a number of areas where EDC's activities are hindering private sector participation in the credit insurance and surety markets.

IBC recommends that the federal government re-evaluate EDC's mandate, specifically in relation to the following areas:

- *The impact of EDC's activities on private-sector participants*
- *The necessity of EDC's domestic insurance powers*
- *The potential conflict of EDC's dual financing and insurance operations.*

Impact of EDC's Activities on the Private Sector

The Export Development Act sets out a mandate for EDC to support and develop Canadian producers' domestic and export trade capacity. The last legislative review of EDC was completed in 2009, in the midst of the worst financial crisis since the Great Depression. The outcome of that review broadened EDC's powers to help increase access to credit for Canadian companies by participating in domestic financing and insurance transactions with private-sector financial institutions, insurance providers and the surety industry.

Despite the recovery of the financial system, EDC still retains broad powers related to its insurance and surety functions that are now unwarranted.

One example of this is EDC's participation in the surety market. EDC has been monitoring the surety industry as it endeavours to have the public-private partnership (P3) performance bond gain wider acceptance in the lending community. However, there is an absence of a timeline for EDC's phasing out its offering of performance security guarantee (PSG) products for certain segments where the surety industry has developed P3 performance bonds that are being accepted by the lending and financial community as viable alternatives to EDC's product.

IBC recommends that EDC collaborate with the market in the short term on the offering of PSG products to help develop the private sector's capacity to take on risk. IBC proposes that EDC develop a timeline for phasing out PSG products when the market attains this capacity.

Similarly, the role of EDC in the short-term trade credit insurance market displaces and deters, rather than complements, private-sector activity. Today, EDC is a dominant provider of short-term trade credit insurance, competing directly with private-sector insurers in marketing its credit insurance products to Canadian companies.

Competing with a Crown corporation that has a considerable competitive advantage creates a significant disincentive for the private sector to participate in the market. EDC's advantages include the following:

- *EDC is not subject to insurance supervisory and regulatory requirements*
- *EDC is not required to pay premiums or income taxes*
- *EDC can borrow at the federal government's preferred rates*
- *EDC is not required to comply with federal regulations that obligate lending and insurance operations to take place with arms-length subsidiaries.*

These market advantages facilitate EDC's ability to dominate some markets, leaving little room for private-sector participants to develop their Canadian capacity and compete with EDC. EDC's participation in certain markets is often defended on the basis of a response to a market gap. If the argument can be made for granting EDC latitude to intervene quickly when evidence suggests that market gaps exist, the same logic should apply to EDC exiting a market when evidence suggests that the private sector is capable and willing to fill those gaps.

The existence of private-sector participation in markets dominated by EDC demonstrates the appetite of the private sector to assume these risks in Canada. IBC recommends that EDC's activities be re-examined to ensure they complement, rather than crowd out, those of the private sector. EDC fulfills a positive, complementary role with private sector insurers, for instance, in regard to its function as a reinsurer.

EDC's Domestic Insurance Powers

<u>Domestic Receivables Insurance</u>

Through a partnership with Compagnie française d'assurance pour le commerce extérieur (COFACE), EDC is offering domestic receivables insurance to joint EDC-COFACE policyholders, with EDC acting as an agent of COFACE. The agreement allows Canadian exporters who receive insurance for their export receivables from EDC to obtain coverage for their domestic receivables from COFACE. EDC's rationale for this is that it supports domestic credit insurance transactions and provides additional domestic credit capacity in Canada on a complementary and incremental basis.

Under the current arrangement with COFACE, EDC directs premiums to a single company rather than letting the market compete for the business. In doing so, EDC is selecting winners and losers. Not only is EDC's arrangement disadvantageous to other insurers in the private market who also offer this product, it also limits choice for consumers. The arrangement compels consumers to use EDC to insure through COFACE rather than find the best price in the market.

In conversations with insurers, EDC has proposed altering the model to a panel of insurers in which COFACE would be the lead insurer writing business on behalf of other insurers. EDC has proposed another model, whereby EDC would write the risk, and private insurers would act as reinsurers.

Both of these alternative models interfere with competition and crowd private insurers out of the market. In the first model, COFACE would retain a competitive advantage over other legitimate market participants, and the rationale for this preferential treatment is unjustifiable and without merit. In the other model, with insurers acting as reinsurers, EDC would retain dominance over the market, which would provide little incentive or opportunity for private insurers to expand their capacity.

IBC believes that the government should promote a healthy, competitive domestic receivables insurance marketplace that ultimately benefits Canadian businesses with market-determined premiums.

IBC recommends that EDC discontinue this favouritism by exiting the domestic insurance market. If EDC does not exit the market, IBC recommends that EDC use broker channels to ensure that other insurers have the opportunity to bid on that portion of EDC's business and that EDC clients have access to the best rate(s) for domestic receivables insurance for their clients.

Other Domestic Insurance Powers

In 2014, the government enacted amendments to subsections 5(2) and 6(2) of the Export Development Canada Exercise of Certain Powers Regulations, specifying that EDC may provide domestic support (financing, guarantees and insurance) without obtaining ministerial authorization for transactions entered into with a company whose annual export transaction and foreign market business volume is at least 50% of its total annual business volume (otherwise, ministerial authorization is required). This provision potentially allows EDC to underwrite a wide range of insurance products, from auto insurance to liability insurance to windstorm insurance (see appendix).

The public policy rationale for EDC having such broad and overarching insurance powers is unclear. Given the capacity and appetite of the robust private insurance sector to participate in the market, insurers should have the opportunity to play a strong and active role in a healthy, competitive market to best serve consumer needs.

IBC recommends that the government re-examine the necessity of EDC's domestic insurance authority and amend the Export Development Act to reflect its precise mandate by repealing these broad powers over domestic insurance.

EDC's Financing and Insurance

EDC is not restricted by regulations in the way that Canadian banks are. Currently, EDC has the jurisdiction to offer financial and insurance products to support and develop Canada's export trade by helping Canadian companies respond to international business opportunities. This means that EDC offers companies export financing, trade credit insurance and bond solutions.

Unlike EDC, banks are subject to regulations under the Bank Act. Section 459.1 of the act makes it illegal for a bank to engage in the anti-competitive practice of coercive tied selling, whereby financial institutions make obtaining a product or service from them or their affiliates conditional on obtaining another product or service from them:

> *Restriction on tied selling*
>
> *459.1 (1) A bank shall not impose undue pressure on, or coerce, a person to obtain a service from a particular person, including the bank and any of its affiliates, as a condition for obtaining another product or service from the bank.*

This legally imposed separation of financing and insurance functions on the private sector exists to protect clients who might not want to deal with one financial institution for all of their business needs. However, this provision is not applicable to EDC. It is unclear why EDC is allowed to retain this dual function of both financing and insuring entities without concern that this, too, will lead to tied-selling practices. To protect clients, EDC's insurance functions should be separated from its other activities, as is required of other financial institutions. This would protect exporters from being compelled to use EDC for their insurance needs for fear of being denied access to trade financing, even if better terms for insurance products exist in the private market.

When EDC engages in financing functions, EDC operates and acts as a capacity provider, which is a complementary role to the banking sector. However, when EDC engages in insurance functions, it operates as in competition with private insurers and crowds out the market. EDC's relationship with banks should be replicated with insurers to allow for fairness among all private-sector participants. Furthermore, IBC recommends that EDC's insurance operations comply with the same federal regulatory standards for solvency that apply to every other insurance entity. EDC should also be appropriately licensed as all insurance entities are required to be. This will ensure greater transparency and fairness to all market participants and clients.

Recommendations

1. *EDC should collaborate with the private sector in the short-term offering of PSG products to help develop and expand private-sector risk capacity. Additionally, EDC should develop a timeline for phasing out the offering of PSG products as the private market has the capacity to take on such risk.*
2. *The government should re-examine EDC's mandate to ensure that it is clearly articulated, concise and not over-reaching. The government should rein in those EDC activities that crowd out, rather than complement, private-sector appetite and capacity.*
3. *The government should examine the arrangement between EDC and COFACE, as it currently displaces private-market participation. EDC should use broker channels to ensure that private-sector insurers have an opportunity to bid on that portion of EDC's business, and that EDC clients have access to competitive, market-determined premiums.*
4. *The government should repeal EDC's domestic insurance authority in the regulations of the Export Development Act.*
5. *To protect clients from tied-selling practices, EDC should separate its insurance operations from its other endeavours related to financing.*
6. *EDC's insurance operations should comply with the same federal regulatory standards for solvency that apply to every other insurance entity. EDC should also be appropriately licensed as*

all insurance entities are required to be. This will ensure greater transparency and fairness to all market participants and clients.

Canada's long-term economic prosperity depends on creating an environment where competitive markets thrive. The private sector is capable and willing to participate in markets that EDC currently dominates. A review and clarification of EDC's mandate will directly benefit entrepreneurs and businesses by expanding private insurer capacity, resulting in consumers having more choice.

Thank you for the opportunity to provide our comments at this time. We look forward to submitting additional comments as the consultation process advances.

Sincerely,

David McGown
Senior Vice-President, Strategic Initiatives

Appendix

Export Development Act, RSC 1985, c. E-20

Purpose

10 (1) The Corporation is established for the purposes of supporting and developing, directly or indirectly,

(a) [Repealed, 2009, c. 2, s. 263]

(b) Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities.

Powers

10 (1.1) Subject to any regulations that may be made under subsection (6), in carrying out its purposes under subsection (1), the Corporation may

(b) enter into any arrangement that has the effect of providing, to any person, any insurance, reinsurance, indemnity or guarantee;

Regulations

(6) The Governor in Council may, on the recommendation of the Minister and the Minister of Finance, make regulations governing

(b) the entering into by the Corporation of arrangements that

(i) have the effect of

(A) providing, to any person, any insurance, reinsurance, indemnity or guarantee,

(d) the entering into by the Corporation of arrangements that have the effect of providing to a person any insurance, indemnity or guarantee, in respect of the financing, by that person, of an acquisition by another person of any interest, other than a security interest, in any entity;

Export Development Canada Exercise of Certain Powers Regulations SOR/94-410

Interpretation

2 In these Regulations,

"domestic insurance transaction" means any arrangement entered into by the Corporation whereby the Corporation provides any insurance, reinsurance, indemnity or guarantee with respect to a transaction entered into by another person and that does not relate, directly or indirectly, to the carrying on of business or other activities outside Canada;

Circumstances Under Which the Corporation May Exercise Certain Powers

4.1 The Corporation must ensure that domestic financial transactions and domestic insurance transactions complement the products and services available from commercial financial institutions, commercial insurance providers and the Business Development Bank of Canada.

6 (1) Subject to subsections (2) and (3), the Corporation may enter into a domestic insurance transaction.

(2) A domestic insurance transaction to be entered into by the Corporation requires the approval of the Minister and the Minister of Finance if it is entered into with or in respect of a person whose annual export transaction and foreign market business volume, at the time of the person's request for insurance, reinsurance, indemnity or guarantee to the Corporation, is less than 50 per cent of that person's total annual business volume.

(2.1) Despite subsection (2), the approval of the Minister and the Minister of Finance is not required if, within 48 months before the person's request for insurance, reinsurance, indemnity or guarantee, the Ministers approved a domestic insurance transaction entered into by the Corporation with or in respect of that person.

(3) A domestic insurance transaction to be entered into by the Corporation requires the approval of the Minister and the Minister of Finance where the domestic insurance transaction is an insurance arrangement that is of a class defined in the schedule to the Insurance Companies Act and that is set out in column II of an item of the schedule to these Regulations.

Schedule:

1 accident and sickness insurance
2 accident insurance
3 aircraft insurance
4 automobile insurance
5 boiler and machinery insurance
6 boiler insurance
7 earthquake insurance
8 employers liability insurance
9 explosion insurance
10 falling aircraft insurance
11 fidelity insurance
12 fire insurance
13 forgery insurance
14 hail insurance
15 impact by vehicles insurance
16 inland transportation insurance
17 legal expense insurance
18 liability insurance
19 life insurance
20 limited hail insurance
21 limited or inherent explosion insurance
22 livestock insurance
23 machinery insurance
24 marine insurance
25 personal accident insurance
26 personal property insurance
27 plate glass insurance
28 property insurance
29 public liability insurance
30 real property insurance
31 sickness insurance
32 sprinkler leakage insurance
33 theft insurance
34 title insurance
35 water damage insurance
36 weather insurance
37 windstorm insurance