Scotiabank's Submission

to the

2008 EDC Legislative Review

Scotiabank®

Table of Contents

1. Introduction

Scotiabank welcomes the opportunity to respond to the request for comments on the Export Development Canada (EDC) legislative review. As Canada's most international bank, Scotiabank Group and its affiliates have more than 60,000 employees serving approximately 12.5 million customers in some 50 countries around the world. We present our submission to the legislative review as a Canadian bank with over 175 years of serving the trade financing needs of Canadian exporters and companies operating in foreign markets.

As the Statement of Work notes, EDC's mandate is to support and develop, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade, and to respond to international business opportunities. This mandate is very closely aligned with our own approach to serving Canada's international business activity. While broad in scope, we believe this flexibility is appropriate in today's highly competitive global market for international business. Canada must have an export credit agency (ECA) that is competitive with the ECAs of other countries competing for international business and one that is a close working partner with the country's private sector trade financing institutions.

The legislative review is timely in this respect, as there is growing concern regarding Canada's international competitiveness, most recently expressed by the Competition Policy Review Panel. Scotiabank was pleased to see the emphasis in the panel's final report on international competitiveness, and we are very encouraged by the themes included in the Statement of Work for the EDC's legislative review that explicitly address global competition and the capacity of Canada's "trade finance system."

We want to highlight the importance of this perspective (Parts A and C of the Statement of Work). We fully agree with the need to address the overall capacity of the "trade finance system" which encompasses the EDC and private sector financial institutions, and the role of the EDC in working with these institutions as part of the system.

We believe the principal responsibility for meeting the financial and risk management needs of Canadian business should rest with the private sector. The competitive strength of Canada's trade finance system must primarily be its private sector markets. The EDC can best support and enhance the trade finance system by developing the capacity and eligibility of exporters and investors to gain private sector financing. Graduating clients into private sector financing should be a sign of success and a goal of the EDC, along with expanding the services available in the market through innovations and market practices.

At Scotiabank, we are committed to growing our trade finance operations and the overall support we provide to Canadian exporters and investors. We see the EDC as an effective and instrumental partner in this regard. Clearly, there is a role for the EDC to service the needs of Canadian business directly, particularly in mitigating risk not adequately covered by the market. However, the most important element of the Statement of Work is, in our view, the EDC's contribution to building private sector capacity (Part C):

> Review the performance of EDC's lines of business from the point of view of their contribution to building private-sector financial capacity in support of Canada's international commerce. Assess the potential for enhanced co-operation between EDC and the private sector

This submission focuses on this element of the legislative review, based on our view of the positive relationship we have enjoyed with EDC and our interest in building on this partnership to strengthen Canada's overall trade finance capability.

- First, we provide our thoughts on the new competitive landscape and the rise of new economic powers in the BRIC countries (Brazil, Russia, India and China).
- Second, we focus on how we are working to address the needs of Canadian business, based on our international experience.
- Third, we address the role EDC plays as a partner. We highlight areas where EDC´s participation has been beneficial, specifically in the areas of commercial and bank risk mitigation and guarantees for foreign medium-term credits. We explore the need for the EDC to have clear entrance and exit strategies, considering products, services and expertise that are accessible from the private sector.
- Finally, we offer our views on the place of EDC within government and its trade and investment strategy. We argue that the EDC should support the foreign economic policies of the federal government and its Global Commerce and Americas' Strategy.

Overall, we believe that EDC's mandate and legislative framework should be broad enough to allow the EDC the flexibility to adjust to the needs of Canadian business and to remain internationally competitive. The EDC, perhaps more than any other ECA, offers a comprehensive range of products, services and expertise to Canadian exporters and investors. Clearly the EDC needs to remain flexible and innovative to meet emerging needs amidst growing international competition for business and investment. We believe that the EDC should seek greater operating flexibility through continued expansion of some of its existing business lines.

In our view, this legislative review offers the opportunity to consider the allocation of the EDC resources within its existing mandate. Given the wide range of its activities and some demand for it to expand further into new areas, we believe it is essential that the EDC has a clearly defined process for identifying business activities and markets where its entry is justified, as well as business activities and markets where to instead advance the development of private sector capacity. We believe that EDC's relationship with private sector financial institutions can be a real competitive advantage for Canadian exporters and investors and for the financial sector as a whole.

2. Changing global and competitive context

Ten years ago, when the last EDC mandate review took place, the Gowlings report highlighted several trends in international commerce that remain relevant today (e.g., the increasing importance of trade and foreign direct investment, supply chains). However, competition, globalization and scale have heightened. For a small, open market, such as Canada, it is more important than ever that the EDC collaborates with financial institutions to build private sector trade finance competitiveness.

As we stated in our recent submission to the Competition Policy Review Panel's consultation process, we believe the competitive challenges facing Canada are significant and that tackling these challenges should be a key priority of both government and business. Canada needs to orient a range of policies in trade and investment – in conjunction with market structure and competition – toward strategic sectors and the ability of firms to succeed as truly global competitors in international markets. At the same time, Canadian businesses need to be more aggressive in their pursuit of growth opportunities abroad. Too many corporations are overly focused on the domestic market. The U.S. is our most important trade partner, and it is an obvious focus of Canada's trade, investment and security policy. While there is still much to be done, particularly with respect to the border, we must exploit opportunities in other markets in which Canada has advantages related to geography, history, culture, industrial capabilities and expertise. The difference in perception that exists about Canada and the U.S. in some markets can be a significant advantage for Canada. For a small market economy such as Canada, advantages over larger, more powerful global players cannot be ignored.

Recent efforts by the Canadian government to increase the number of free trade agreements (with the European Free Trade Association, Peru, Colombia, the Dominican Republic and the CARICOM members) will open more opportunities for Canadian companies. In addition to traditional competitors, Canada is also facing competition for business from emerging economies, most notably the BRIC countries (Brazil, Russia, India and China). These countries are significant players in trade and investment, given their demand for development, infrastructure and commodities. As these countries also present significant business opportunities, Scotiabank has established an on-the-ground presence in each of the BRIC countries.

We are also witnessing consolidation of trade services providers. The resulting economies of scale allow these larger financial institutions to make new investments in technology and to develop the required compliance infrastructure needed to support global trade and supply chain finance models. Technology has been key in integrating production and supply chains, and Canadian companies need to have access to competitive financial support and new tools to be active and successful in foreign markets.

Trade finance is a vital component of international commerce. In light of the heightened competition from emerging countries, the higher number of preferential trade arrangements, the increased complexity of production and commercialization processes, and the importance of scale for trade service providers, there is a great need for EDC to work jointly with the Canadian private financial institutions in the provision of trade finance products to Canadian companies. EDC's risk mitigation functions are particularly important, especially in times of reduced credit availability such as the one we are going through now. In light of the proven value of the EDC's collaboration with private sector financial institutions and the scope to expand this relationship, we believe this should be a clear priority for the EDC.

3. Our efforts to meet the needs of Canadian business

In this section we summarize Scotiabank's trade-related operations and our relationship with EDC.

3.1 Background on Scotiabank's trade-related operations

Scotiabank has trade finance capabilities across its global network and more than 700 employees in our Global Transaction Banking (GTB) business line, who provide seamless trade services along with payments, cash management and foreign exchange solutions. We are the only Canadian bank to have on-the-ground presence in each of the BRIC countries, and *Global Finance* magazine recognized Scotiabank as the *Best Trade Finance Bank in Canada* for 2008. This is the second time Scotiabank has won this award (also 2006) for its wide range of trade-related services.

No other Canadian bank has such a broad geographical coverage in its trade finance network. In 2007, we had the leading dollar market share in export letters of credit. Based on our experience working with our international clients, we have found the need to offer various levels of electronic solutions. In fact, our clients' systems interact seamlessly and securely with the Bank's electronic financial products and services. We ensure our services adapt to many types of management systems around the world, in multiple languages and currencies.

3.2 Relationship with EDC

Scotiabank has a successful, collaborative working relationship with the EDC. For many years, we have had very successful guarantee arrangements with EDC. Its *Export Guarantee, Financial Securities Guarantee and the Performance Security Guarantee* programs have been very effective risk-sharing tools that allow us to support our trade-focused customers. We recently established a Master Agreement with EDC for Grupo Scotiabank, Scotiabank's subsidiary in Mexico.

The Documentary Credits Insurance (DCI) Master Policy has also been a success story and we are currently seeking to expand our collaboration with EDC in this area for the benefit of Canadian businesses.

In addition to the Global Transaction Banking unit, Scotiabank's International Corporate and Commercial Banking Structured Finance Department (ICCB-SF) is responsible for assisting and overseeing commercial or corporate loans for Scotiabank's international customers that are risk-enhanced by guarantees or insurance policies provided by export credit agencies or private insurance companies. There is continuous and close interaction between ICCB-SF and EDC. The two programs that are used the most are: 1) the EDC Bank Guarantee Program that provides guarantees to term loans provided by the Bank to foreign buyers of Canadian goods; and 2) the Political Risk Insurance (PRI) policy, when the ultimate risk for the Bank in a particular transaction is a sovereign entity.

EDC is a frequent participant in loan syndications, including several where Scotia Capital is the agent/arranger. EDC has participated in 22 syndicated deals in North America since January 1, 2006. Scotia Capital is in eight of the same deals and was the arranger/is the agent on two.

In 2006, EDC established the Canadian Financial Intermediaries Group to actively manage its relationship with the financial services sector. The new group has proven helpful in our interactions with the EDC. For instance, last year, Scotiabank and EDC worked together to deliver a workshop on EDC products and programs to our staff across Canada.

3.3 Towards a stronger partnership with EDC

Canada has a well-developed financial system to support Canadian companies. Canadian banks (which are characterized by high standards of operation, credit assessment and compliance, in addition to good risk appetite) provide a wide range of trade finance instruments. However, there are always transactions that carry greater risk than that accepted by the private sector, be it for less creditworthy companies, projects in geographic regions considered of high risk and specific financing products. In this regard, EDC has played an important role complementing private sector financing supply.

When EDC is compared with other G-7 export credit agencies, EDC is more likely than its peers to behave like a private player, actively looking for business opportunities[1]. This has posed mixed challenges on the private sector. On the one hand, the EDC has undeniably enhanced the private sector's products and has also made financing available to high-risk firms, projects and markets. The wider range of products and services it provides, relative to other G-7 ECAs, allows for greater flexibility for Canadian companies. On the other hand, the EDC sometimes competes directly with the private sector, in some cases delaying the development of market-based capacity. Other G-7 ECAs have made a clear demarcation of activities between services provided by them and those better met by the private sector.

We see a role for EDC as an organization within the marketplace. EDC is a partner, promoter and facilitator of trade. We believe EDC should continue to focus on high-risk segments that are not being served well by the private sector, and it should charge the

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[1] Ex-Im Bank's Competitiveness Report: 2006

corresponding premium when pricing its services. The EDC should also complement or enhance already-existing offerings by the private sector, as opposed to duplicating them. We are pleased with the products that EDC has introduced in the market, as most have complemented our international operations. At the same time, more should be done through increased operating flexibility to enhance the Canadian private sector's financial capacity for trade and risk management.

4. Canadian private sector financial capacity for trade and risk management: Scotiabank's interaction with EDC

In this section we will refer to specific areas in which EDC´s participation has been beneficial and will also suggest areas where we see room for EDC's further engagement, as well as others where co-ordination with the private sector could be explored, particularly given the current economic cycle. In addition, we will mention other activities, such as lending, where we think a more optimal apportioning of responsibilities could be defined between EDC and private sector players. Lastly, we will talk about considerations for EDC's market presence.

4.1 Commercial and bank risk mitigation

EDC provides a number of risk mitigation products that Scotiabank uses to support the trade and export needs of its clients. These include Documentary Credits Insurance (DCI), the Export Guarantee Program, Foreign Bank Obligation Guarantees, Performance Security Guarantees, Accounts Receivable Insurance and Political Risk Insurance. We believe EDC could further develop Canada's trade capacity if it expanded the scope and application of some of these products.

For instance, EDC's Accounts Receivable Insurance currently covers short-term, but not medium-term (1-3 years) receivables. We would like to see EDC expand this program to medium-term insurance receivables to support medium-term credit to foreign purchasers of Canadian exports. With longer-term coverage, we would be able to increase financing for this market under our International Vendor Program.

We recognize that regulatory hurdles can make it very difficult for EDC to offer this insurance in certain foreign markets, but we believe that EDC should explore opportunities to insure account receivable credits in specific markets, especially in the emerging markets in Europe.

EDC recently expanded its DCI program to cover letters of credit (LCs) received by Canadian banks for cross-border transactions that do not have a direct Canadian connection. The banks' involvement in these transactions is considered to be important Canadian Direct Investment Abroad (CDIA) with direct economic benefits to Canada. The evolution of this program is part of the new strategic focus taken by EDC in 2005, whereby it began providing greater support for CDIA in recognition of its role in enhancing the competitiveness of Canadian companies and trade capacity. We at Scotiabank are very pleased to see EDC expand this program, and consider it a model for future products. We encourage EDC to further expand the DCI program to provide coverage for letters of credit of longer terms, between three to five years.

4.2 Guarantees for foreign medium-term credits

Scotiabank values that EDC is now willing to guarantee foreign medium-term buyer credits. Our Medium-Term Foreign Buyer Financing provides customized financing to foreign companies buying Canadian goods. Scotiabank is interested in growing this business. In addition, Scotiabank and EDC have a Master Guarantee Agreement in place for Grupo Scotiabank in Mexico, whereby EDC guarantees the credits that our Mexican subsidiary issues to its local customers. In most of these transactions, our customers are either buying goods from a Canadian company or they are the subsidiary of a Canadian company.

We would like to see EDC extend our Master Guarantee Agreement in Mexico to our subsidiaries in other markets, possibly under a similar arrangement. We would also like EDC to waive the requirement for these transactions to have a direct Canadian export connection, given the involvement of Scotiabank's subsidiary. As with the DCI arrangement, EDC could provide guarantees up to an agreed percentage of Scotiabank's Canadian content portfolio.

We believe such a move is in line with EDC's strategy of facilitating CDIA and its focus on developing and delivering services for foreign affiliates of Canadian companies. As EDC has noted, Canadian foreign investments have economic benefits and generate spin-off procurement and supplier opportunities. Under its Canadian Benefits Policy, EDC has identified many benefits of supporting CDIA, such as future trade creation, R&D investment and employment in Canada.[2]

For medium-term buyer credit of more than US$ 5 million in value, Scotiabank has found EDC's Bank Guarantee Program very helpful, as well as the insurance policy for sovereign products (PRI). We would greatly benefit if EDC expanded its guarantee program to include project finance deals and leases.

An area in which EDC could have a large positive impact on further developing Canada's trade finance system is related to the implementation of Basel II. The move to Basel II will trigger additional capital allocation requirements for the banks for foreign credits – even if they are covered by credit insurance. However, we can reduce our capital requirements if our credit insurance is converted to credit guarantees, which provide superior risk mitigation. Private sector insurers are already addressing this issue, and EDC needs to review its portfolio of products in light of the new regulation. We would be happy to jointly work with EDC to explore solutions to this new challenge.

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[2] Canada's State of Trade: 2007.

4.3 Other activities

Given EDC's mandate (to support and develop Canada's export trade and Canadian capacity to engage in trade and to respond to international business opportunities), we understand EDC is interested in further developing its ability to support trade in times of tight credit markets and throughout various economic cycles. Given Scotiabank's extensive experience and expertise in this area, we welcome the opportunity to work with EDC to support Canadian companies in this ever-changing business environment with relevant products and services. We feel it is premature to determine whether EDC should play a greater role during these cycles (when the banks face higher levels of risk) -- to provide guarantees, enhance capacity and/or help soften the impact of bad debt. As we have detailed in this submission, we are supportive of increased operating flexibility for EDC insofar as it expands existing limits on its credit insurance and guarantee programs.

4.4 Lending activities

EDC is now a significant source of trade financing for Canadian exporters and foreign buyers of Canadian goods and services. We believe that more companies could benefit if EDC made available loans that are not currently being offered by the private sector.

In addition, we believe there is ample competition and financial players in commercial financing in the areas identified for possible EDC expansion:

- General working capital financing for start-up and emerging exporters;
- General purpose corporate facilities for Canadian companies;
- Financing for production projects and infrastructure projects; and
- Domestic mergers and acquisitions.

On the other hand, there is real value in the EDC providing direct financing to high-risk industries and companies to which the private sector is not willing or able to offer credit. EDC could increase its role as a business facilitator if it extended its insurance and/or guarantees for export financing to help commercial banks to increase the number of credits that would otherwise be too risky to offer.

As part of EDC's mandate to support and develop Canadian capacity to engage in international trade, the organization should foster competition and transparency among Canadian companies. An example is the interaction that exists between EDC and Northstar. Perhaps a case can be made where further competition is possible. We would be interested in an opportunity to be able to bid on this business. We are keen to compete in all financing opportunities and encourage clearer guidelines to bid for projects. Guidelines could be established by EDC to assure that a level playing field exists for all potential participants.

4.5 Market presence for EDC

The EDC is mandated to minimize its market overlap with the private sector. Thus, any services that the private sector can adequately provide should not be provided by the EDC in order to ensure market efficiency. This should be a key consideration for EDC to enter the market. As we argued earlier, EDC should enhance and complement already existing financing products. Guarantees and insurance products have proven to be beneficial. EDC should provide financing to companies that otherwise would not be able to get this financing. EDC should have established and clear exit criteria, so that when the private sector can offer accessible products to firms, the EDC either withdraws from this business or complements it.

With respect to EDC exit strategies, the first consideration is that there is considerable evidence that for a number of product lines, the private-sector institutions may not be prepared to fully take and hold on to higher-risk clients and projects, particularly during difficult financial times. Thus, the recent trend that shows private insurers as more willing to insure small, risky Canadian exporters may not necessarily hold true in the future, given an unstable economic climate. It is important that any EDC exit does not take place until a compelling case can be made that some future economic downturn will not present a case for its return.[3] In order to establish an exit strategy, it is important to know whether the EDC's activities are self-sustaining. One option, which we would support exploring, is the one put forth by McGill University's Christopher Ragan.

In summary, we feel it is important for the EDC to have empirical evidence to justify entry into underserved segments of the market. Further to the Statement of Work, we believe that the EDC should pursue a public analysis of the benefits and risks inherent in EDC entering or exiting a specific business line. In this spirit, we argue that the EDC should have a defined entrance, transition and exit strategies to either complement private sector products, services and expertise or withdraw them when the private sector has the capacity to offer them to companies.

5. EDC's place within government

EDC is a crown corporation in Canada and is a significant instrument in the trade and investment strategy of the country. In this regard it is essential that the work of the EDC align and advance the objectives of the Government's Global Commerce Strategy.

We further support strengthening the work of EDC as a loud voice for Canadian trade and investment overseas as part of this strategy. This should be both an inbound and an outbound responsibility. EDC should promote Canadian business abroad and highlight Canadian successes at home for decision makers and the broader public. The combination of these activities can support the growth and profile of global corporate champions such as Scotiabank and its clients.

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[3] Ragan, Christopher. 2008. "Filling a Shrinking Gap: EDC's Changing Role in the Market for Export-Credit Insurance." McGill. http://people.mcgill.ca/files/christopher.ragan/EDC.pdf

5.1 EDC needs to reflect Canada’s foreign economic priorities

We believe that the EDC should support the foreign economic policies of the federal government. In the current context, this means contributing to the government’s Americas Strategy. Scotiabank has been an early supporter of the federal government’s efforts in the Americas. From the Security and Prosperity Partnership’s North American Competitiveness Council to the current Americas Strategy, we have long championed the need for engagement in hemispheric trade and development.

As our century-old presence demonstrates, we believe in the long-term prospects of the region. More recently, we are encouraged by the wave of democratization and economic liberalization that is setting the stage for economic prosperity across the Americas. We share the minister’s stated hope “that Canadian companies will take a leading role.” As the minister outlined to the Canadian Council of the Americas in Vancouver, nowhere are the benefits of trade clearer that in Mexico, Chile and Peru. Not surprisingly, these are also key markets where Scotiabank is present and investing in future growth. The EDC can be a critical component in the development of trade relations by supporting higher-risk private investment. We recommend that EDC direct a higher proportion of its spending and programs to areas that are aligned with the government foreign economic policy and priorities, namely the Americas.

5.2 EDC and investment promotion

We believe that the federal government needs to commit to and increase the resources dedicated to branding Canada as a preferred destination for investment and a trading partner of choice. Globalization and the acceleration of dissemination of information and trends have made countries more aware of its image and reputation - its "national brand." Today, small, open trading economies, such as Canada, need to attract investment, and influencing foreign public opinion is crucial to our economic prosperity. The federal government can and should use a wide array of public diplomacy instruments such as international education, international broadcasting, trade and investment promotion to brand Canada's status as a trading nation.

6. Conclusion

EDC has proven to be a valuable partner in supporting our international trade and banking activities. We support increased operational flexibility for EDC to allow it to adjust quickly to changing business conditions and better support global trade for Canadian manufacturers and service providers.

We believe that there is room for EDC to further increase its portfolio of risk mitigation products. Recent introduction of EDC’s insurance and guarantees programs have been important business instruments for Scotiabank that have allowed us to increase our business volumes. Specifically, we would like to encourage EDC to expand the following programs:

- Accounts Receivable Insurance program to cover medium-term insurance receivables to support medium-term credit to foreign purchasers of Canadian exports. EDC should explore opportunities to insure A/R credits in specific markets, especially in the emerging markets in Europe.
- Documentary Credits Insurance program to provide coverage for letters of credit of longer terms, between three to five years.
- Our Master Guarantee Agreement, currently available in Mexico, could be implemented in our subsidiaries in other markets. We would also like EDC to waive the requirement for these transactions to have a direct Canadian export connection, given the involvement of Scotiabank's subsidiaries.
- For medium-term loans that are greater than US$ 5 million in value, EDC could expand its Bank Guarantee program to include project finance deals and leases.

We encourage EDC to adopt policies that facilitate banks to comply with additional capital requirements established by Basel II by allowing banks to convert credit insurance to credit guarantees.

We also encourage EDC to establish clearer guidelines that confirm the organization's transparency practices toward all its partners, particularly in terms of business referrals.

For trade-related financing, the EDC should complement rather than compete with the private sector. We encourage EDC to remain focused on being an international business facilitator, as opposed to duplicating existing offerings in the market, particularly in relation to lending. EDC should continue providing loans in cases where no option is made available by financial sector participants.

EDC should establish clear entry, transition and exit criteria, so that when companies become eligible to access products offered by the private sector, the EDC either withdraws from this business or complements it.

We look forward to continuing to develop and strengthen our relationship with EDC and making it possible for Canadian companies to increase their footprint in markets abroad. Scotiabank intends to continue to work with agencies such as EDC to expand opportunities for international economic growth, which we believe is truly critical for Canada's prosperity. In fact, this was a central element in our submission to the Competition Policy Review Panel, where we argued that Canada should aggressively advance the trade agenda by pursuing new bilateral and regional agreements in markets in where we have comparative advantage.