



March 10, 2009

Hon. Michael A. Meighen, Senator  
Chair, Standing Senate Committee on Banking, Trade and Commerce  
The Senate of Canada  
Ottawa, ON  
K1A 0A4

Dear Senator Meighen:

The Canadian Chamber of Commerce network is the largest business organization in Canada, with membership of 175,000 businesses. Our members include both large and small companies in all sectors of the economy and all regions of the country. We pride ourselves on being “The Voice of Canadian Business” and we work hard with governments of all political stripes to ensure that Canada’s business community is able to maximize its economic and social contribution to our national well-being.

The Canadian Chamber commends the Standing Senate Committee on Banking, Trade and Commerce for consulting on the issue of access to credit for businesses. Finance Minister Jim Flaherty has said on a number of occasions that access to credit is the No. 1 concern. If credit is overly constrained, it threatens the well-being of Canadians and Canadian businesses. Individuals may not be able to purchase big-ticket items, like homes and autos, and businesses may find it difficult to finance their day-to-day operations, or invest in machinery and equipment, inventories and/or exports. Business investment and consumer spending are the foundation to our economy.

Despite global economic and financial turbulence, credit conditions in Canada remain much healthier than in other major economies. Indeed, credit on an aggregate level is still growing in Canada but there are challenges. While Canadian banks continue to prop up credit growth, many other financing channels are contracting. Overall credit conditions have not returned to normal.

### **Availability of Credit**

Businesses’ (i.e. non-financial private corporations’) ability to tap the capital markets to raise funds has been severely impaired. According to Statistics Canada’s *Financial Flow Accounts*, in the final quarter of 2008 issuance of bonds, equity and

commercial paper contracted on a net basis by almost \$5.3 billion.<sup>1</sup> By comparison, in the final quarter of 2007, there was a net increase of \$9.3 billion. Moreover, it has become prohibitively costly to tap equity markets for financing.

Against this background of difficult market conditions, there was renewed robust growth in bank lending to businesses. Bank lending to non-financial private corporations increased by \$11.9 billion in the fourth quarter of 2008 and \$22.1 billion in 2008 as a whole – a record quarterly and annual flow.

In contrast, non-bank lending activity (by non-depository lending institutions) dropped sharply. Loans to businesses by non-bank finance companies fell by \$1.9 billion in the fourth quarter of 2008 and almost \$5 billion for all of 2008 – the largest annual contraction. Non-bank finance companies are large issuers of commercial paper. They raise funds for lending in the commercial paper markets. This market has seized up making it virtually impossible for these intermediaries to play their role in meeting the credit needs of business customers (for lending products, growth capital, revolving lines of credit, equipment leasing, cash flow and asset financing) as well as consumers (for auto loan or leasing, retail credit cards, and other sales financing). Some non-bank lenders have ceased operation.

While core financial institutions continue to prop up credit growth, credit conditions are not expected to return to normal until business financing from capital market sources – marketable debt (issuance of short-term paper and bonds) and equity issues – returns to normal. Moreover, while Statistics Canada's *Financial Flow Accounts* show that bank lending is up, it does not provide data on whether the increase in supply of funds has been adequate to meet the demand for funds by corporations. In other words, we do not have data on the demand for funds. We do know anecdotally and from independent surveys that many companies in a wide range of industries continue to face difficulty accessing credit. Additionally, companies may have seen their credit facility scaled back and/or cost of credit increased.

During previous recessionary periods, business credit growth fell to zero shortly after economic contractions. In the current recession, the real economy decline is taking place alongside a decline in prices, resulting in the nominal economy contracting – suggesting the risk is for an outright decline in business credit growth in the year ahead.

### **Cost of Credit**

According to the Bank of Canada's latest *Business Outlook Survey*, nearly two-thirds of firms reported tighter credit conditions in the fourth quarter of 2008

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<sup>1</sup> In the fourth quarter of 2008, net new commercial paper issuance fell by almost \$2.4 billion and net new bond issuance contracted by \$3.1 billion, the largest ever quarterly decline. Additionally, with equity markets in a slump, net share issuance slowed substantially in the quarter to its lowest level since 1971. Non-financial corporations issued a net \$213 million in shares in the fourth quarter of 2008 compared to \$8.4 billion in the final quarter of 2007.

relative to the previous three months. The majority of these firms characterized the change as being significant and felt that it was driven mainly by a market-wide adjustment in risk premiums. Most firms indicated that the tightening came in the form of higher borrowing costs. Deteriorated credit conditions were widespread across sectors.

Senior Loan Officers reported the tightening applied to both pricing and non-pricing aspects of business-lending conditions. The pricing responses reflect the efforts of financial institutions to pass on to borrowers the increase in their own borrowing costs relative to risk-free rates. The non-pricing responses indicate a tightening in the terms and standards for loans and/or limits on the funds allocated to some sectors.<sup>2</sup>

The cost of prime based borrowing is largely determined by the policy rate (set by the Bank of Canada), term premium (in general, the greater the time to maturity, the higher the premium) and credit premium (or risk premium, which reflects the likelihood of default). The Bank of Canada has reduced its key policy rate – the target for the overnight rate – by a cumulative 400 basis points since December 2007, to 0.50 percent at present, to lower borrowing costs and stimulate demand for credit. When the Bank of Canada reduces the policy rate, it affects mostly the cost of shorter-maturity loans because the term premiums are the smallest. It also influences Government of Canada yields, for example government bonds and treasury bills, because term and credit premiums are relatively small.

The Bank of Canada has taken additional steps to provide liquidity to key market participants through purchase and resale agreements.

- The Term Purchase and Resale Agreement (Term PRA) Facility allows primary dealers and large financial institutions to raise funds via repurchase agreements<sup>3</sup> of eligible securities for terms of up to three months. The Bank has widened the range of assets that it will accept in these operations as collateral and has extended the range of counterparties with whom it will transact. The value of PRAs is currently about \$35 billion.
- The Term Loan Facility (TLF) allows large financial institutions to use their non-mortgage loan portfolios as collateral for funds for one month.
- The Term PRA Facility for Private Sector Instruments allows primary dealers on a direct basis and other money market participants on an indirect basis<sup>4</sup> to also raise funds via repurchase agreements of eligible securities (Bankers’

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<sup>2</sup> Bank of Canada. “Senior Loan Officer Survey on Business-Lending Practices in Canada.” January 12, 2009. The Senior Loan Officer Survey collects information on the business-lending practices of major Canadian financial institutions.

<sup>3</sup> A transaction in which a party sells a security and simultaneously agrees to repurchase it at a given price after a specified time.

<sup>4</sup> Eligible indirect bidders consist of institutions that can demonstrate significant activity in the Canadian dollar wholesale money markets and are subject to Federal or Provincial regulation.

acceptances and promissory notes, commercial paper, asset-backed commercial paper, and now corporate bonds) for terms of up to three months.

These liquidity operations, along with monetary easing by the Bank of Canada, have resulted in a significant reduction in short-term lending rates. Indeed, credit spreads (as measured by the difference between short-term lending rates and the expected overnight rate) at a term of three months have reverted to September 2008 levels significantly below the all time highs experienced in October and November. However, to this day they remain materially higher than pre-August 2007 levels. Longer-term credit spreads remain higher than normal, especially for lower-quality borrowers.

Given the low level of the target for the overnight rate and limited room for further reductions<sup>5</sup>, the Bank of Canada stated that it is prepared to take a more innovative approach to further ease financial conditions beyond what can be attained by reducing short-term interest rates. It has referred to this strategy as credit and quantitative easing. For example, the Bank could buy assets directly in the market, like corporate bonds, where issuance has been under severe stress and credit spreads remain wide – a move the Canadian Chamber of Commerce would fully support. By doing so, the Bank will aim to influence term and credit premiums directly while ensuring that lenders have sufficient liquidity and capital. Details will be provided in the Bank's April 23<sup>rd</sup> *Monetary Policy Report*.

The Canadian Chamber also recommends that the Bank of Canada consider converting the short-term liquidity facilities it operates to longer-term facilities. This will enable lenders to get access to assured funding over longer time frames, thereby increasing the likelihood that they will boost availability of credit, and provide loans over a longer-term and at more attractive spreads.

### **Role of the Federal Government in Ensuring Access to Credit**

While the Bank of Canada's liquidity operations are focused on short-term financing, the federal government has introduced measures aimed at supporting long-term financing for businesses and consumers. As part of its Extraordinary Financing Framework, the Government will:<sup>6</sup>

- Purchase up to \$50 billion of insured mortgage pools from banks in the first half of fiscal 2009-10 under the Insured Mortgage Purchase Program, in addition to the up to \$75 billion of purchases authorized in November 2008. This will provide Canadian institutions with longer-term stable funding to help them continue lending to Canadian consumers and businesses.

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<sup>5</sup> We expect that the Bank of Canada will reduce its key policy rate one last time on April 21<sup>st</sup> (the next scheduled date for announcing the overnight rate target) by 25 basis points to 0.25 percent.

<sup>6</sup> Department of Finance Canada. *Canada's Economic Action Plan: Budget 2009*. January 27, 2009.

- Enhance the resources and scope of action available to the financial Crown corporations, and will provide \$13 billion in incremental financing. This will allow Export Development Canada and the Business Development Bank of Canada to extend additional financing to Canadian businesses, and the Canada Mortgage and Housing Corporation to support low-cost loans to municipalities.
- Increase the maximum eligible loan amount a small business can access under the Canada Small Business Financing Program from \$250,000 to \$350,000 and to \$500,000. These changes could increase lending under the program by some \$300 million per year.
- Allocate up to \$12 billion to a new Canadian Secured Credit Facility to purchase term asset-backed securities backed by loans and leases on vehicles and equipment. This new facility will help consumers and businesses access financing for these products.
- Extend the period for issuing guaranteed instruments under the Canadian Lenders Assurance Facility (CLAF) from April 30, 2009 to December 31, 2009. The CLAF will allow Canada's deposit-taking financial institutions to access competitive global credit markets by providing a guarantee on their term debt similar to those offered to banks in other countries.
- Create the Canadian Life Insurers Assurance Facility to guarantee wholesale term borrowings for life insurers. This will ensure they are not put at a competitive disadvantage relative to foreign insurers that benefit from guarantee programs provided by their home governments.
- In the fall of 2008, the Canada Mortgage and Housing Corporation launched a new quarterly 10-year Canada Mortgage Bond maturity. Over the year, the new maturity is expected to raise up to \$10 billion in supplementary funding for financial institutions.

Going forward, the federal government should stand ready to provide additional support for Canadian credit markets, as needs arise, by utilizing all tools at its disposal. The Canadian Chamber of Commerce recommends that the Government consider creating a commercial paper funding facility to purchase directly from eligible investment grade issuers both unsecured and asset-backed commercial paper. The purpose of this facility is to provide temporary support to a segment of the Canadian money market that has been significantly destabilized and to improve the flow of liquidity to a wide range of market funded Canadian businesses and non-bank lenders. As a direct provider of liquidity to the commercial paper market, the presence of the Bank of Canada would encourage institutional investors to reengage as buyers and to extend the tenor of their investments, thus reducing refinancing risk for issuers. The provision of liquidity could be structured in a manner that supports both issuers in the primary market and investors in the

secondary market. These actions would significantly alleviate the largest credit creation impediment in Canada resulting from the global financial crisis.

### **Conclusion**

The Canadian Chamber of Commerce is encouraged by the unprecedented actions taken by the Bank of Canada to ensure liquidity and the affordability of credit for Canadian businesses and consumers. The federal government has also taken bold and innovative action to provide additional support for Canadian credit markets.

Both should stand ready to do everything possible, and for as long as necessary, to further ease financial conditions and support economic recovery in Canada. While domestic response is crucial, the problem in funding markets is global in nature and will require global solutions. The Canadian Chamber urges the federal government and the Bank of Canada to continue to work collaboratively with our international colleagues to help stabilize the financial system and restore investor confidence. Eventually, conditions in the global credit market will stabilize and improve, but the process will not be quick. In the meantime, we should take some comfort in the fact that Canada's banking system entered the current market crisis in a stronger financial position than many of its international counterparts.

The Canadian Chamber of Commerce appreciates the opportunity to provide input to the Standing Senate Committee on Banking, Trade and Finance. We wish you every success as you consult on the issue of access to credit for businesses and we look forward to your report.

Sincerely,

A handwritten signature in cursive script that reads "Perrin Beatty".

Perrin Beatty

cc: Dr. Line Gravel, Clerk, Standing Senate Committee on Banking, Trade and Commerce