

## **Chapter II**

### **Trade and Investment Insurance System of Canada**

#### **Export Development Corporation (E.D.C.)**

## **EDC HISTORY & OVERVIEW**

What is EDC?

- Canada's official ECA
- Financially self-sustaining Crown corporation that operates on commercial principles

EDC Mandate

- EDC offers a range of financial and risk management services, including export credit insurance, sales financing and guarantees.

History of EDC

- 1944 Export Credits Insurance Act established Canada's first export credit agency - Export Credits Insurance Corporation (ECIC)
- 1946 joined Berne Union (remains member to date)
- 1960 Act amended to provide long-term financing for sales of capital goods
- 1969 Act changed to Export Development Act
- 1972 began to conduct Treasury operations and by 1976 ceased to borrow from Government
- 1993 Ed Act modified to extend powers to allow
  - domestic insurance
  - equity
  - working capital guarantees

## **EDC Today**

Commercial Orientation

- self-sustaining (not reliant on Parliamentary appropriations)
- assess risk according to commercial principles (no subsidies or grants)
- operate on a user-pay basis
  - premiums and fees for insurance
  - all loans fully repayable with interest

- generates profit

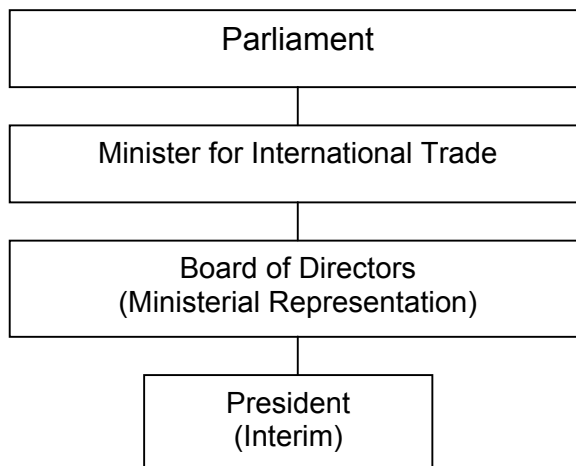
### Multiservice ECA

- Most official ECA's act solely as insurers/guarantors for their national government's account
- EDC is a multi-service ECS offering both insurer/guarantor and direct lending services under one roof

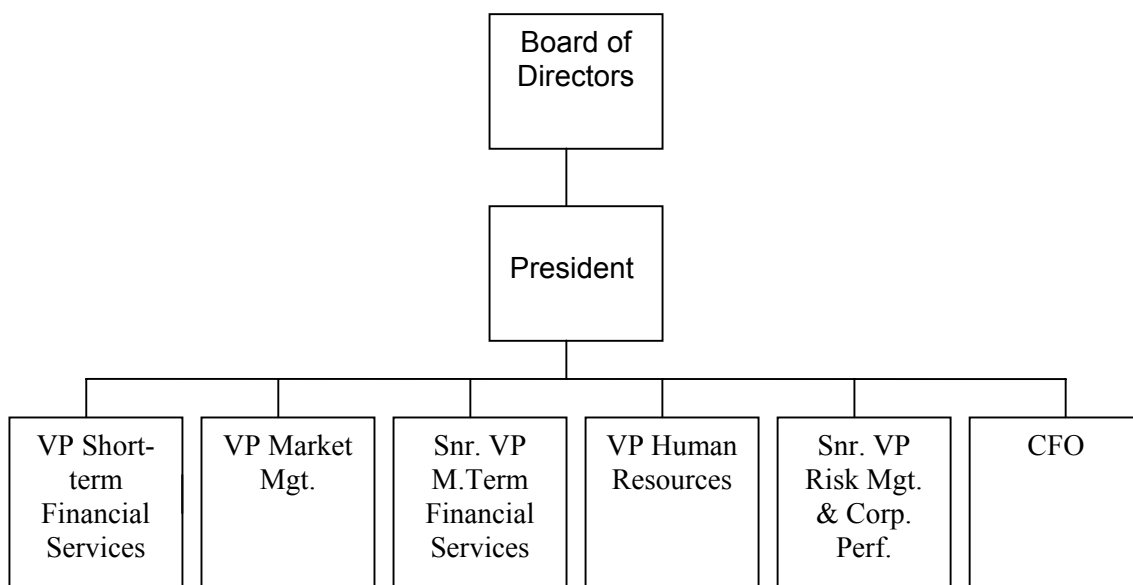
### International ECA Competition

	Canada	U.S.	Japan	Germany	U.K.	France	Italy	Italy
Official ECA	EDC	EXIM	EID/MIT	HERMES	ECGD	COFACE	COFAC	SACE
Other Gov't Institutions		OPIC CCC	JENM	KFW C&L	CDC		E	Medio-credito
Eca Programs			I					
Lending	√	√	x	√	x	x	x	X
Credit Insur.	√	√	√	x	√	x	√	√
FII	√	x	√	x	x	√	√	√
Guarantees	√	√	√	x	√	√	√	√
Relation to Gov't	Crowa Corp.	Gov't Agency	Gov't Depart.	Gov't Bank	Private -on behalf of Gov't	Gov't Depart.	Private-on behalf of Gov't	Gov't Agency
Source of Capital	In house Treasury Operations	Gov't Budget	Gov't Account	Borrows in Capital Markets	Gov't Account	Gov't Account	Gov't Account	Gov't Account
Commercial Orientation	√	x	x	√	x	x	x	x
Cashflow US\$m-1995	156.22	-145.20	574.77	0.21	34.9	337.70	-139.90	-
Cashflow US\$m-1996	273.76	-105.60	674.55	0.80	583.30	583.87	832.40	-508.74

### Corporate Reporting Structure



### Organizational Structure

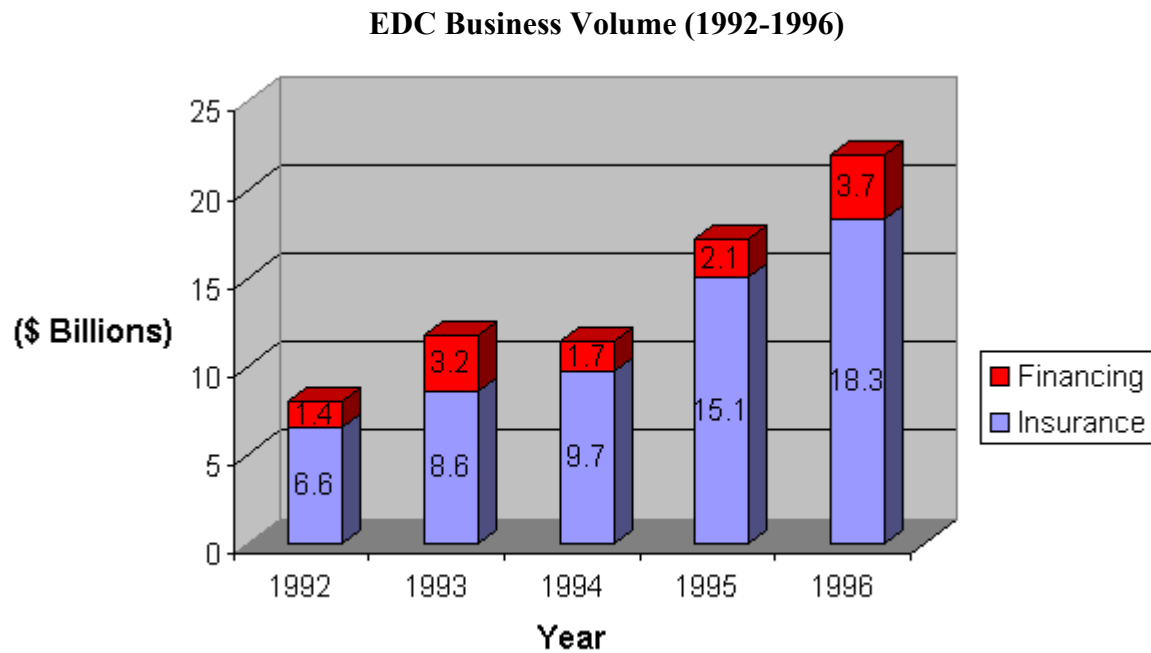


### Corporate vs. Canada Account

- Sect 10 (Corp.) vs. Sect 23 (Can.) of Export Development Act
- EDC as Canada Account agent for the Government (paid an admin. fee)
- Cabinet Authority (>\$50mn) vs Ministerial Approval

### Track Record

- Exports: EDC has supported more than \$100 billion since the start of 1996 (6% of Canada's total export volume)
- Every region of the globe (137 countries in 1996)
- Every region of Canada
- Every sector of the Economy

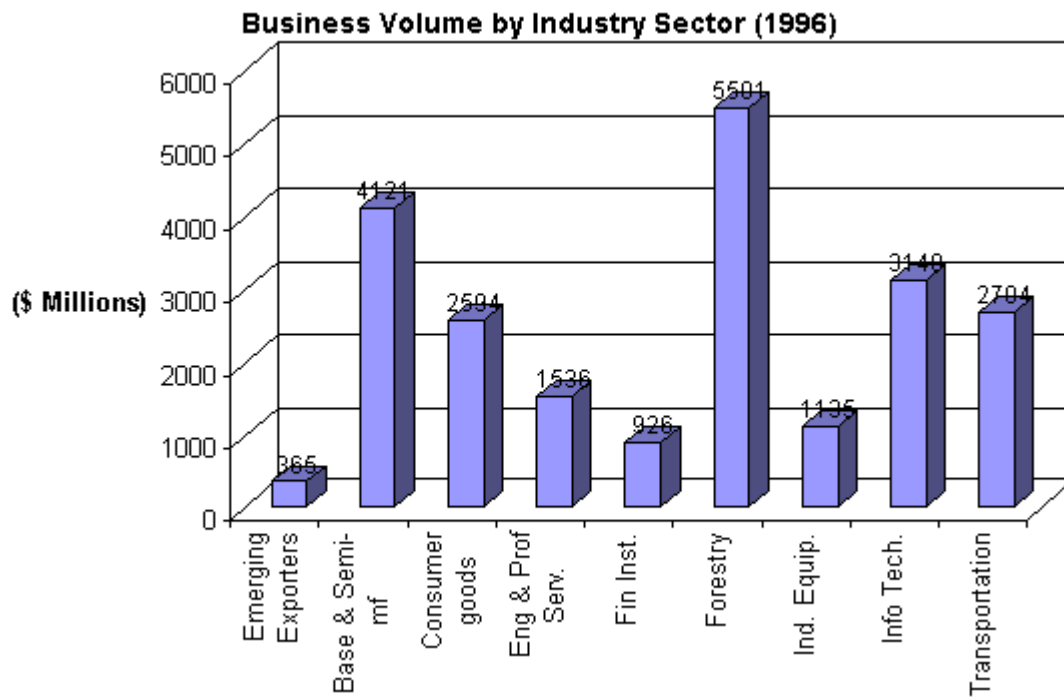


### Where We Do Our Business

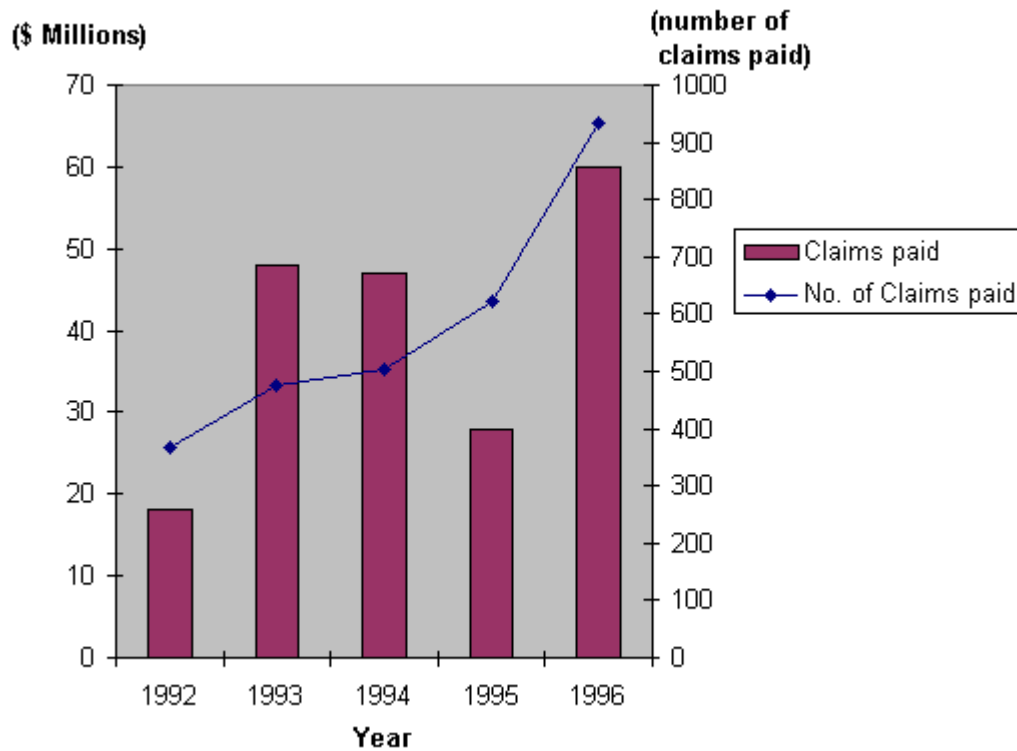
(Diagram EDC Volume by Geographic Market (1996))

(Diagram EDC Volume as % of Cdn. Export (1995))

## Business Volume by Industry Sector (1996)

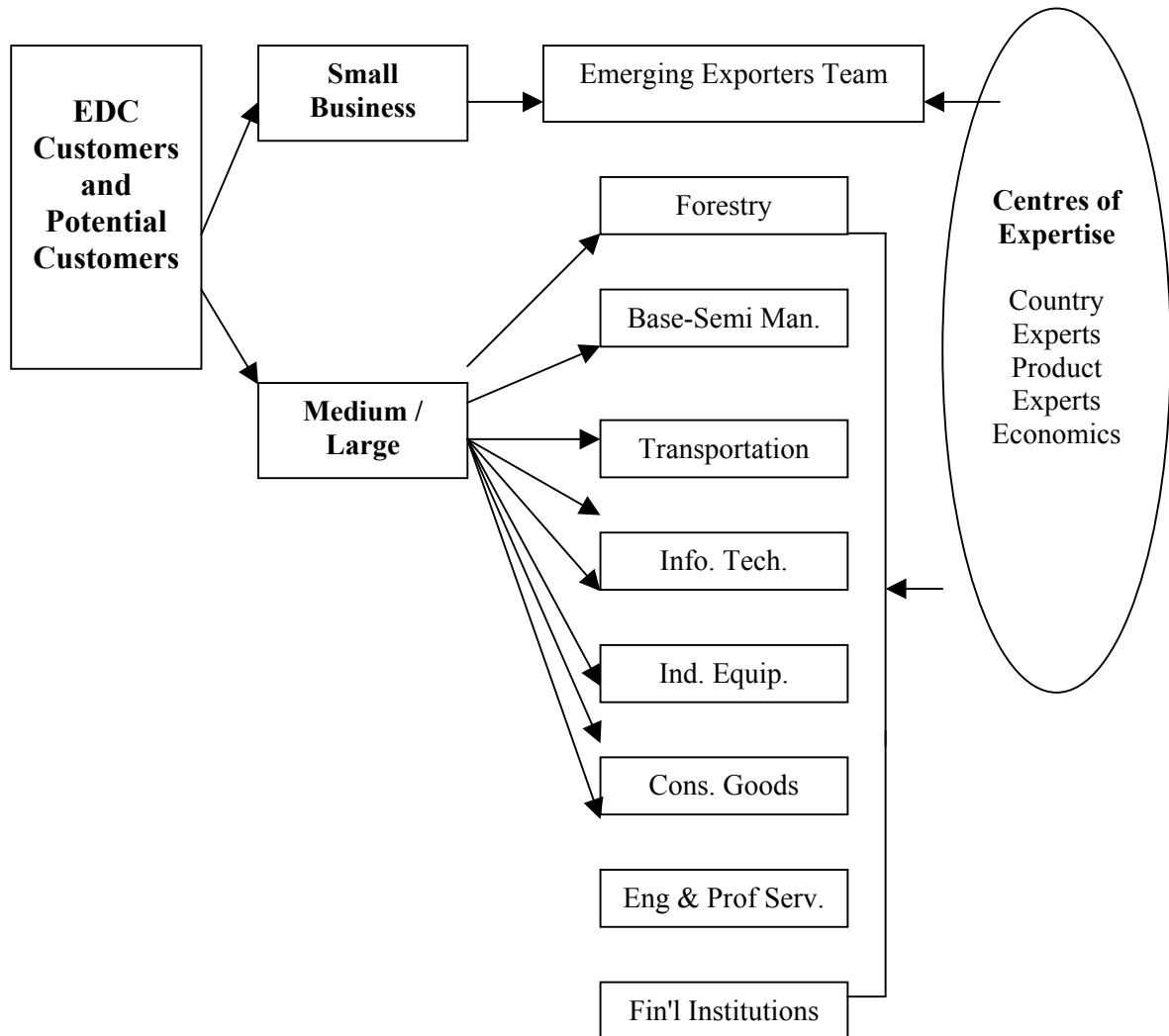


## Claims Paid



## EDC's New Structure

### Customer Focused Teams



### EDC - Overview of Financial Services

#### Financial Services

(1996 - \$Billions)

- Credit Insurance                      \$15.8
- Financing                                \$3.7
- Foreign Investment Insurance      \$1.5
- Performance Security                \$1.0

### Coverage for Letters of Guarantee

- 90% coverage to the exporter for:
  - Wrongful call of a letter of guarantee; and
  - Rightful call outside exporter's control
- 100% coverage to the bank for:
  - Any call of a letter of guarantee
  - EDC requires recourse to the exporter
- Used to free up working capital funds

### Coverage for Surety Bonds

- Surety Bond Insurance
  - Up to 85% coverage to surety company against exporter's non-performance
  - Proof of default required before payment, hence reduces risk for exporter
  - Typical in North America
  - Flexibility for non-traditional industries and markets
- EDC Surety Bonds
  - Applicable where current programs do not suit transaction
  - Primarily with sovereign buyers

### Foreign Investment Insurance

<b>90% coverage against political risks</b>	<b>Period of coverage:</b>	<b>Types of investment &amp; coverage:</b>
Expropriation	Up to 15 years	Equity: Capital & retained earnings
Transfer of funds		Loan: Principal & interest
War, Revolution, Insurrection		



## Financing Eligibility Criteria

- Exporter
  - Business operating in Canada
  - Technically & Financially capable of completing transactions
  - Benefits to Canada requires 50% Canadian content minimum - If less than 50%, will look into other factors, such as if create more jobs, etc.
- Buyer/Borrower
  - Creditworthy
  - Acceptable country
    - No Iraq, Libya
- Project
  - Technical & commercial viability

## Financing Services

Types of Services:

- Direct Buyer Loans
- Lines of Credit
- Note Purchase

### Direct Buyer Loans

- Tailored to commercial contract
- EDC disburses funds on behalf of the borrower
- Meets the credit needs of foreign buyers
- Competitive interest rates & fees

### Lines of Credit

- EDC pre-negotiated terms with foreign institution
- We disburse funds on behalf of the borrower
- Fast turnaround
- Over 40 lines around the world
- Ideal for small to medium-sized transactions

## Note Purchase

- We buy promissory notes issued by the buyer
- Available for sales in commercial markets
- For small to medium-sized supplier credit transactions

## Emerging Exporter Team

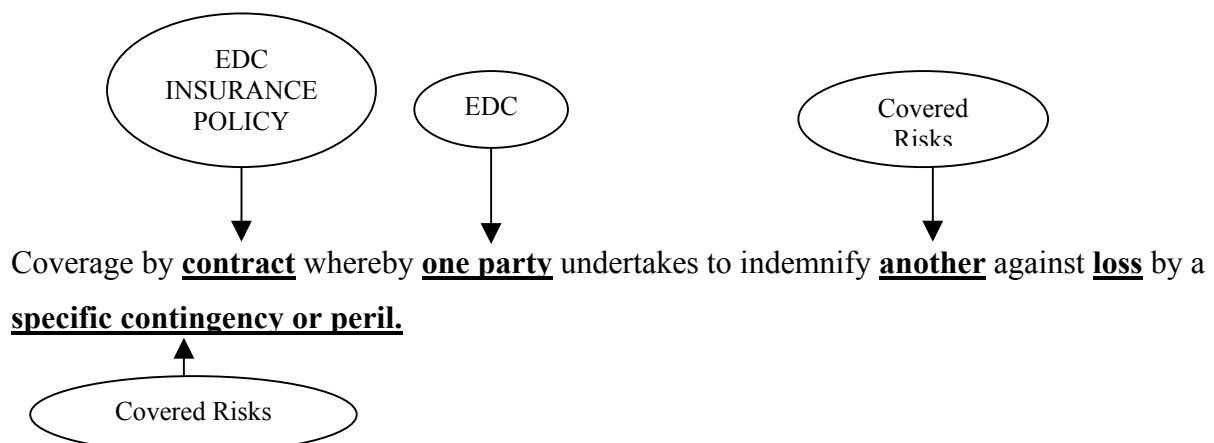
- SME Need
  - ✓ Responds to need for quick turnaround, standardised product and account management
- EDC Role
  - ✓ Provide a centralized, automatic and rapid client service
- Benefits
  - ✓ Higher customer satisfaction
  - ✓ Dedicated attention to the client base
  - ✓ Targeted marketing
  - ✓ Lower overhead
- Status
  - ✓ Launched March 27, 1995

## Responding to Customer Concerns

- More than 62% of credit approvals done within 24 hrs
- Short-term policies for SME's issued over the phone
- Toll-free number to reach underwriters directly

## Short-Term Insurance

### What is Insurance & Who are the Parties?



### **What is Short-Term Insurance?**

Short-term insurance covers exporters against non-payment of their short-term export receivables through the issuance of whole turnover credit insurance policies

- Covers all (most) credit sales - allows some selections if exporters have reasonable spread of buyers
- Standard cover rate 90%
- 1 or 2-year term (1-2 years policy /duration of policy)
- pay-as-you-go - non-refundable
  - monthly declaration or quarterly, pay at time of declaration - be flexible

### **Short-Term Insurance Policies**

- Comprehensive Insurance
  - -Global Comprehensive Insurance Policy (or Export Credits Insurance Policy for smaller exporter) - 90-95% of EDC business
  - -Shipments or Contracts - EXPR can choose either one
  - -Services
- Political Risk Only Insurance
  - -Global or Selective
- Documentary Credits Insurance

### **What Losses do we Protect Against?**

The majority of EDC's policies protect our clients against losses that can occur when they extend credit to their buyers.

- Insurance is purchased to protect against a loss resulting from an event occurring at a future date, which is unforeseen, unexpected and beyond the insured's control
- We generally cover 90% of the loss incurred
- By indemnify we mean that we put the exporter back in the same position as he was before the loss. The insured can not be put back into a better position after the loss

## **Risks Covered - Credit Insurance**

### **Commercial Risks**

Buyer insolvency

Default (non-payment)

Repudiation of goods by buyer (non-acceptance)

Contract cancellation by buyer

### **Political Risks**

Conversion & transfer difficulties

War & related disturbances

Cancellation of import/export permit

Moratorium on country's external debt

What Must the Insured do to be Protected?

- **In order to be protected our clients must have:**
  - an insurable interest (either a contract or a receivable)
  - complied with the terms & conditions of their policy (including paying premium)
  - acted in good faith

Why Credit Insurance?

- risk management
- cost effective provisioning
- bank financing
  - credit quality enhancement
- competition
  - level the playing field
  - competitive advantage

Underwriting - Premium Rates

- Basic Premium Rates
  - Based on Matrix which takes into account
    - Commodity Classification
    - Country Risk
    - Terms of Payment
    - Volume

- Other Underwriting Factors
  - Spread of Commercial/Political Risk
  - Severity of Risk - Individual Credit Limits
  - Historical Incidence of Loss - Industry and Exporter
  - Exporter Risk
  
- Contracts Policies - Pre-Shipment Cover Rates
  - Length of Pre-Shipment Period
  - Salvage Value

#### Underwriting - Other Issues

- Discretionary Limits
- Use of Deductibles
  - First Loss Deductible
  - Per Buyer Deductible
  - Non-Qualifying Losses
- Setting the Maximum Liability

#### Sources of Credit & Financial Information

##### Traditional

- credit agency report
- specific industry agency report
- bank report
- trade references
- SEC (10Q & 10K)
- annual reports
- investment brokers

##### Not so Traditional

- Investment Brokers, Vulture Funds
- Bond & Credit Rating Agencies (e.g.S&P, Moody's, DBRS)
- Electronic Media (e.g.Bloomberg, Lexis Nexis,Reuters)

- Financial databases on CD-ROM (e.g. Amadeus - Europe, FAME - UK, PC-Plus - USA/Canada, DIANE - France, JADE -Japan, Worldscope - Europe, Moody's USA & Int'l)
- Industry specialists and trade supplier group associations
- Country specialists

## **Product Development, Promotion and Marketing**

### **Product Development**

#### Products vs Solutions

- EDC transition from a product-driven company to a solution-driven company
- Multiplicity of products = confusion?

#### Flexibility with Existing Product Range - Examples

- Coverage of domestic and international sales
- Large buyers only policy
- Multi-country policy

#### Separate Products vs Separate Delivery Example of SME's

- EDC's Research on SME's concluded:
  - No patience for "red tape"
  - High priority on fast service
  - Lower priority on individualized underwriter relationship

#### Product Differences

- Claim waiting period in case of default (4 vs 6 months)

#### Delivery and Administration Differences

- One underwriting team (not industry sector specific)
- Underwriting Team vs individual underwriter
- Product delivery over the phone (1-800 numbers)

- Coast-to-coast coverage during business hours
- No monthly declaration if no insured sales

#### Recent New "Products"

- Master Accounts Receivable Guarantee (MARG) --for small exporters, provides BANKS with guarantee on loans against receivables
- Grow Export Program--joint working capital guarantee program with Canadian Imperial Bank of Commerce for small high-tech companies
- Northstar Trade Finance--short-term policy tailored to cover medium-term credits (up to 5 years)
- Medium-Term Documentary Credits Policy--broadened short-term DC policy to cover medium-term LC's (up to 5 years)
- Bank Aval Policy--policy in development to cover Canadian banks on foreign bank avals rather than Letters of Credit

### **Promotion and Marketing**

#### Selling Features of Credit Insurance

- Asset protection
- Enhanced access to bank operating lines
- Increased sales
  - Alternative to more secure terms (ILC or payment in advance)
  - Longer terms
  - Increasing buyer limit
  - New market penetration

#### Direct Selling vs Selling Through Brokers

- Cost effectiveness
- Product understanding
- Relationship with customers
- Access to certain (larger)potential customers

## EDC Marketing Force

- 8 offices across Canada
- Approximately 30 Business Development Managers

## Promotional Tools

- Sales Collaterals (Brochures)
- Advertising
- Direct Mailing
- Workshops
- Word of Mouth

## **Commercial Risk Management**

### Short-Term Commercial Risk

Commercial risk is defined as non-payment (financial distress or unwillingness to pay) by a buyer of its obligation to a company supported through EDC's short-term credit insurance program.

Emphasis:

Maximizing automation

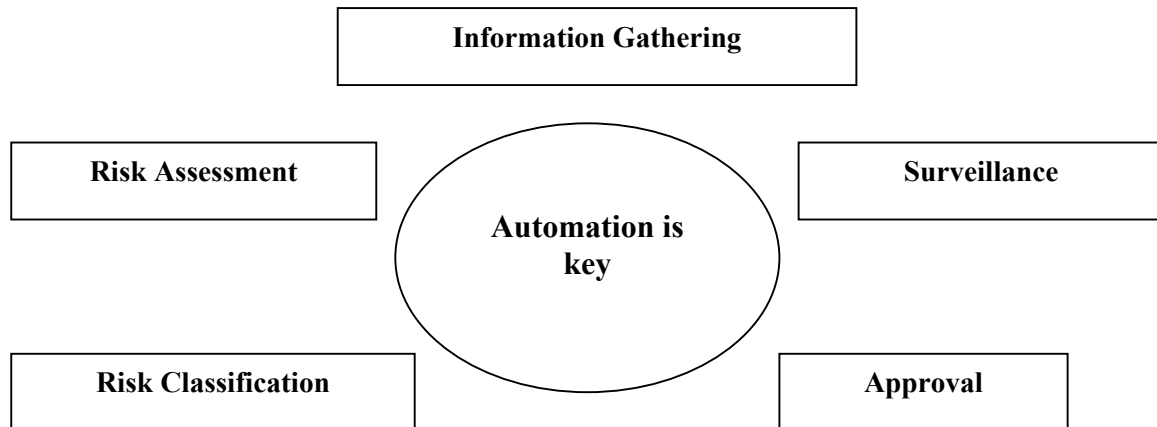
- Decision models & limits
- Automatic surveillance & support
- Mainframe-to-mainframe

### Management Unit - Organization

- Credit Surveillance and Analysis Department - reports to V.P., Short-Term Financial Services
- Services all Short-Term Insurance Business Teams
- Staff of 40
  - Buyer High Risk Unit (17)
  - Automated Credit Facilities Unit (6)
  - Client Credit Processing/General Admin./Buyer Low Risk (15)
  - Director of Credit and Assistant (2)



## Commercial Risk Management - Approval Process

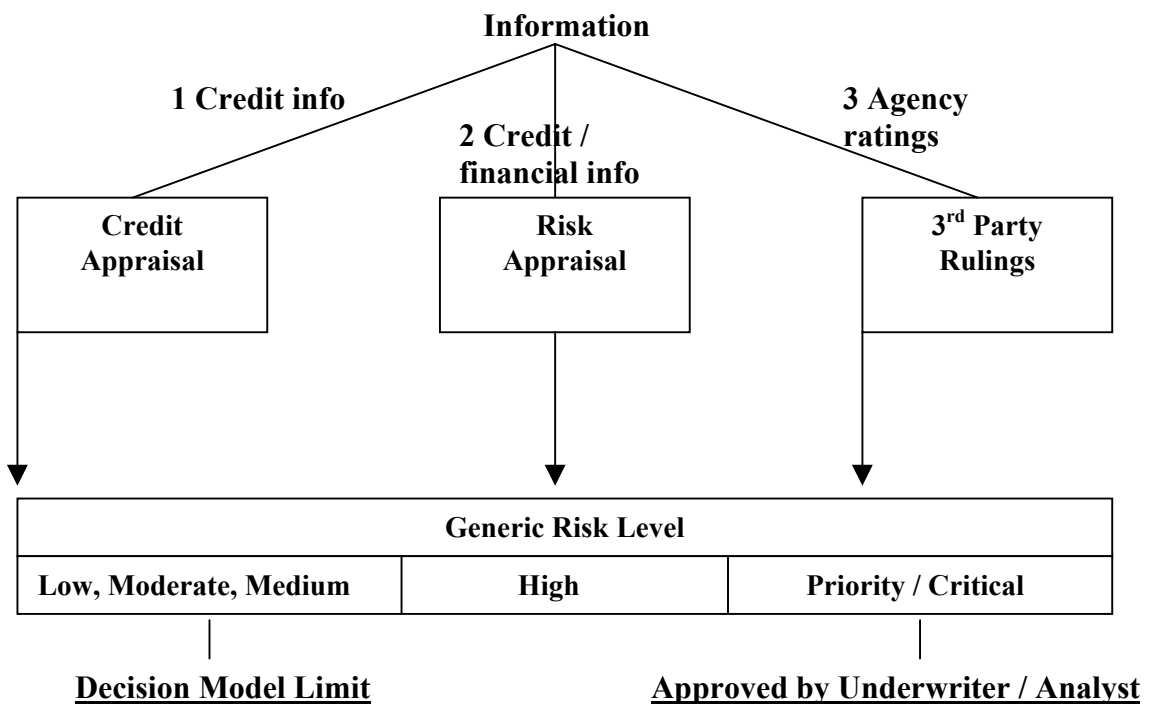


### Approval Process - Information

#### Means of data collection

- Mainframe-to-mainframe links
- On-line access to news services
- Credit & Financial databases on CD-ROM
- Credit agency reports via fax
- EDC Client/Buyer

### EDC Risk Assessment



## Credit Appraisal Focus & Model

- Years in business
- Business Reputation
- Management Quality
- Banking Experience
- Trade & Payment Data
- Third Party Credit/Financial Ratings
- Credit Appraisal

Plus

- Financial Appraisal Focus/Ratios
  - Liquidity
  - Leverage
  - Coverage
  - Operating
  - Financial Condition

## Rating (Third Party) Models

**Agencies who assess the credit & financial health of a company to perform as a going concern.**

Examples:

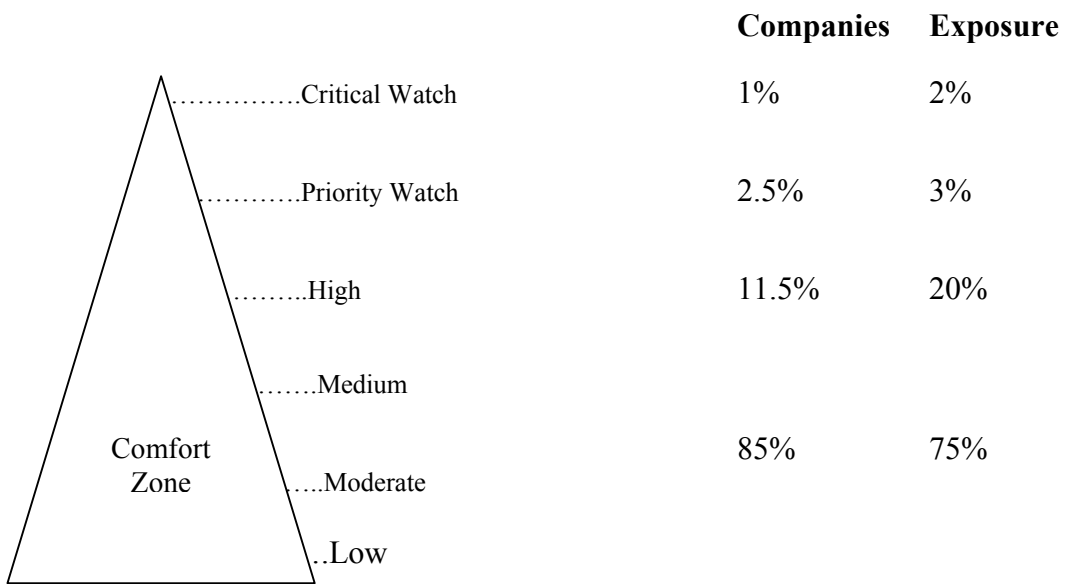
Bond Rating Agencies:

- Moody's Investors Service Inc.
- Standard & Poor's Corporation

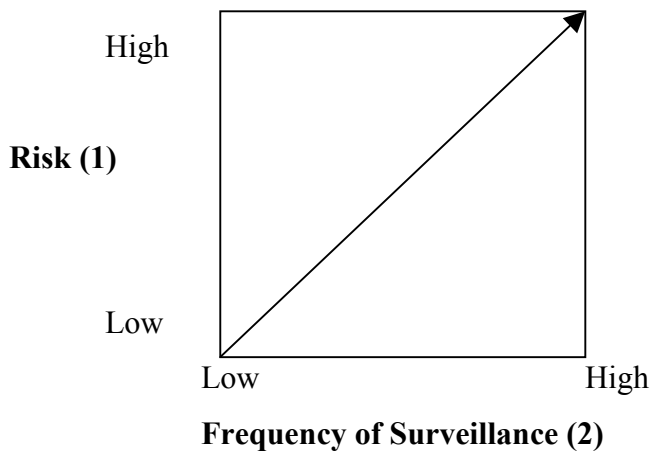
Credit Rating Agencies:

- Dun & Bradstreet (Int'l)
- Lumbermens (USA)
- Japanese Credit Agency (Japan)
- Novcredit (Italy)

**Portfolio Risk Level**



**Automated Surveillance Matrix & Workflow Management**



- (1) Influenced by exposure, industry sector and country risk
- (2) Reflects type & frequency of surveillance as well as level of effort and expense

### Surveillance Risk Focus

	<b>Companies</b>	<b>Exposure</b>
Tier 1 <i>Higher Risk</i> Intense Effort	5%	10%
Tier 2 <i>Large Exposures</i> Moderate Effort	10%	70%
Tier 3 <i>Comfortable Risk</i> Low Effort	85%	20%

Higher Risks Require:

- Detailed financial analysis
- Industry risk considerations
- Country risk considerations

Through:

- Company visits
- Electronic news media
- EDC's automated risk assessment tools
- Credit and trade groups
- Industry specialists
- Country specialists

Problem Accounts Require

- Fast experienced attention
- In-depth financial analysis
- Visits
- Negotiations

- Credit considerations on future supply
- Third party discussions
  - Trade suppliers
  - Banks/Insurers/Factors
  - Landlords

#### Buyer High Risk Unit Supports Business Teams

- Dedicated portfolio managers
  - Commercial high risk expertise
  - Industry high risk expertise
  - Country high risk expertise
- Provides risk assessment & acceptance support on additional high risk exposure
- Handles problem accounts - working out rescheduling & credit needs
- Monitors high risk/large dollar exposures

#### Automated Credit Facilities Unit

- Establishes credit & surveillance standards
- Enhances decision models and provides validation (discriminate analysis, etc.)
- Group risk management
- Reports on Short-Term Insurance operational performance
- Controls automated appraisals & model limits

#### Benefits to Automated Commercial Risk Management

Since 1990:

- Credit application response time
  - (2 days vs. 12 days)
  - 65% processed within 24 hours vs. 20%
- Consistency
  - The rate of approvals on initial requests for credit increased by 22%
  - The rate of revolving approvals (vs. specific) on initial requests for credit improved by 8%
- Greater business volume

-As at July 31, 1997, insured volume is expected to exceed \$20 b vs. \$3.3 b in 1990.

- Greater risk appetite
  - Decision models accommodate the majority of comfortable risks thus allowing more time to address higher risk credits
- Improved net commercial claims
  - Significant improvement to gross and net claims since the introduction of automation

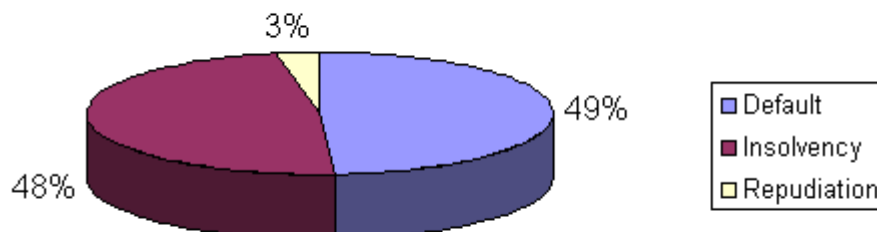
### **Claims & Recoveries at EDC**

#### **Presentation Overview**

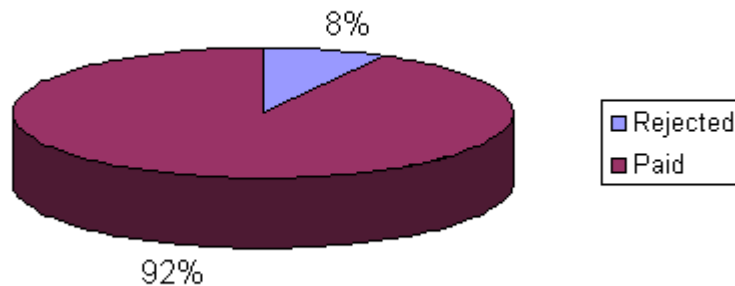
- Scope of claims work
- Mandate & Structure
- Loss Mitigation
- Claim Review & Payment
- Recovery

#### **Claims by Risks Incurred**

**As a percentage of all commercial risks**



## Claims Rejected



### Organizational Structure of CARD

- Department reports to Vice President and Controller of Finance
- Ten Claim Services Managers (CSM) reporting to a Team Leader
- CSM responsible for claim processing AND debt recovery
- CSM aligned to Business Teams

### Mandate of Claims Department

- Loss Mitigation - assisting clients
- Payment of all reasonable claims quickly
- Recovery of indemnities paid

### Loss Mitigation

- Clients must report overdues to EDC at 90 days OD (Global Comp policies)
- EDC will assist clients prior to Admissibility - Without Prejudice basis
- Failure to mitigate Loss could result in denial of liability by EDC (Exclusion under the policy)

### Claim Submission by Client

- Completion of Declaration of Loss on one page Claim Payment Application form.
- Application form combined with detailed instructions for each data field
- Documentation is to be attached

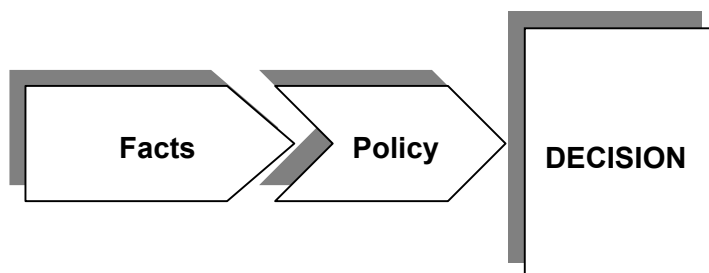
- Upon receipt at EDC, claim submission entered on database; all claim processing is done on- line
- Data links to upstream systems for control & validation

**Claim Review – Documentation**

<u>Customer Supplied</u>	<u>EDC Supplied</u>
<ul style="list-style-type: none"> <li>▪ Proof of Debt</li> <li>▪ Credit Requirements</li> <li>▪ Other</li> </ul>	<ul style="list-style-type: none"> <li>▪ Policy Coverage</li> <li>▪ Credit Approval (if applicable)</li> </ul>

**Claim Review - Interpretation**

- Linkage of underwriting intent with the facts of a loss
- Policy, endorsements, EDC credit approvals reviewed
- EDC relies on that which can be demonstrated



**Calculating the Loss**

- Calculation of Loss can vary with risk
- Limitations on insured Loss does occur
- Consistency in underwriting practice very important

<u>Sample Calculation</u>	
Invoice total	\$1,000
Overshipment	<u>250</u>
	Net loss
Admissible	750
Deductible	<u>100</u>
Shared Loss	650
<u>EDC@90%</u>	<u>\$580</u>

**Recovery of Indemnities**

- Policy requires customer to take all reasonable measures
- Working with EDC, customer should have recovery under way prior to admissibility of loss
- Cost-Effectiveness is the Key



- All costs shared "pro rate" after approval by EDC
- Recoveries shared "pro rate" with the insured loss being in priority to non-insured loss

### **Tools of Recovery**

- Standard (Commercial) risks:
  - Under \$1,000,000 - to a collection agency
  - Over \$1,000,000 - legal action
- EDC takes assignments of all debts under \$50,000 & directs to an agency
- Direct involvement by EDC when viewed as "value added"
- All actions must be approved by EDC

### **Summary**

- Strong support of customers, even before admissibility judged
- Customer is serviced by one CSM to promote industry knowledge and customer specific knowledge
- All claim decisions are fact-based
- Recovery decisions are always based in cost-effectiveness
- Customer Satisfaction Index for claim service is high

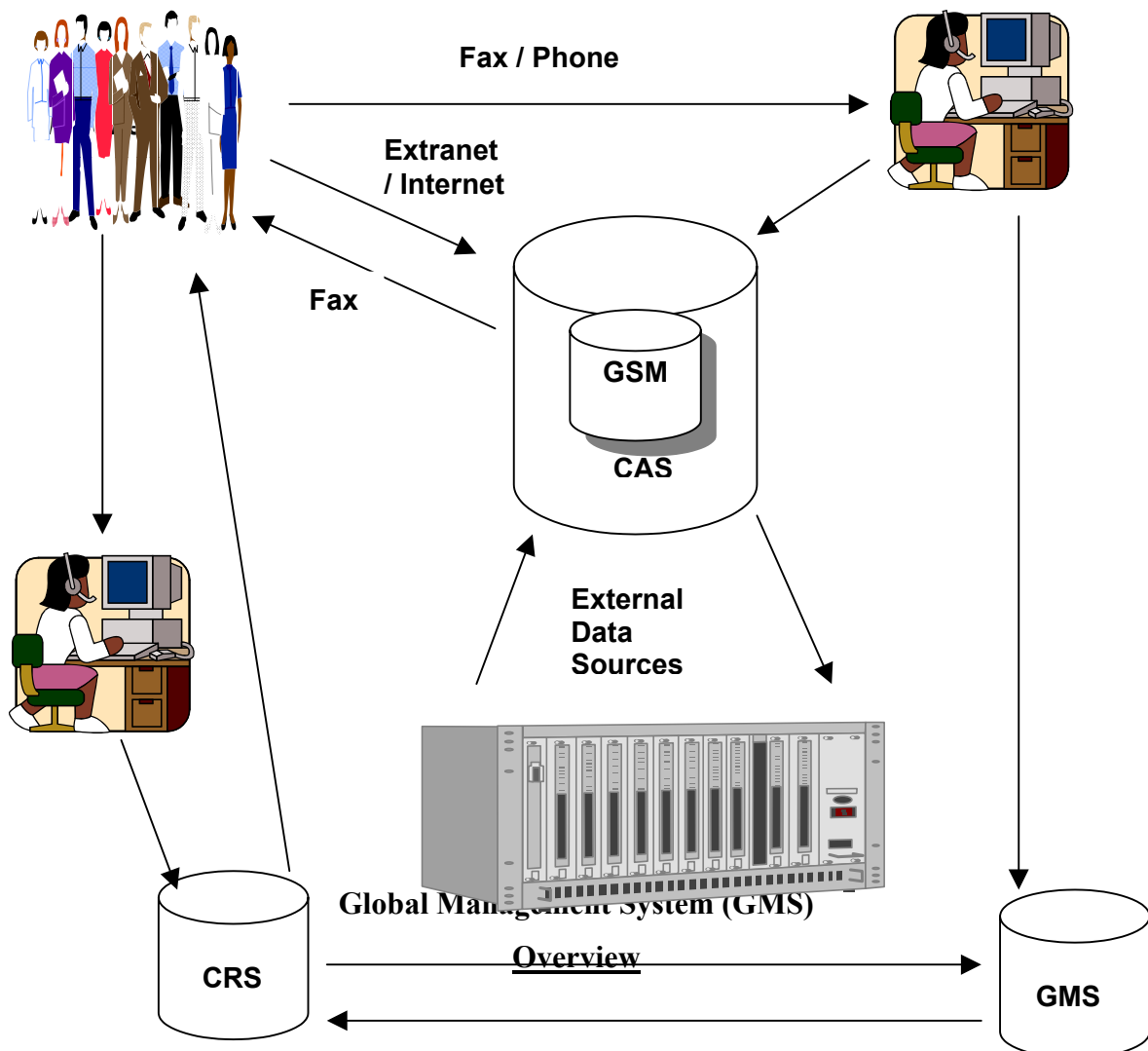
## **Credits Insurance Support Systems**

### **Overview**

**EDC uses several key systems to support the delivery and management of Credits Insurance.**

- The Global Management System (GMS) is used to underwrite and administer Credits Insurance.
- The Credit Administration System (CAS), with the integrated Decision Support Model (DSM) is used to manage EDC's short-term credit portfolio.
- EDC Direct provides customers with a PC-based interface to CAS.
- The Claims & Recoveries System (CRS) is used to process claims and recoveries.

Used in concert, these systems enable EDC to serve its customers with greater efficiency and effectiveness



The Global Management System (GMS) was originally introduced in 1984 with a view to meet the following business objectives:

- Provide an integrated support system to deliver and manage Credits Insurance.
- Support the Credits Insurance workflow in an efficient and effective manner.
- Standardize the rate calculation process used to underwrite Credits Insurance.
- Enhance customer services using automated facilities.
- Provide timely billings to customers.
- Provide consistent and reliable data to meet the reporting needs of the Corporation.
- Provide underwriters with user-friendly access to policy information.

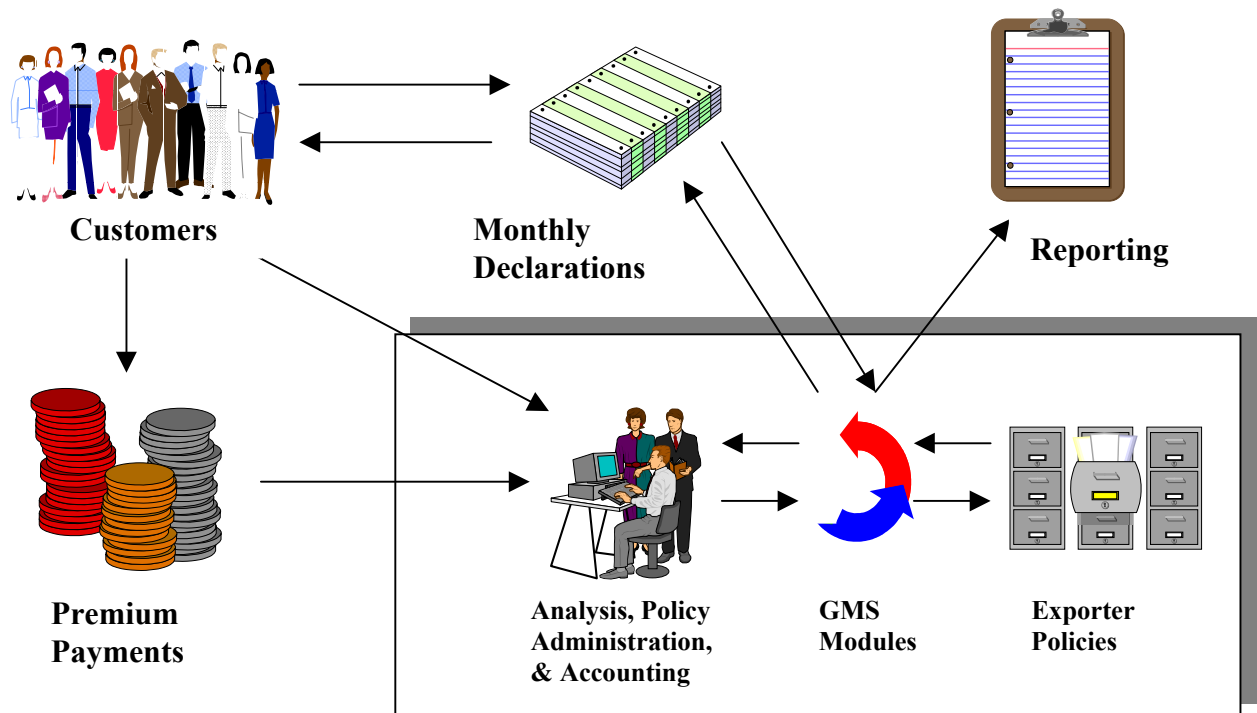
**GMS has successfully been applied to manage EDC's growing business**

Diagram :”Volume of Credits Insurance supported”

Diagram: Premiums Collected

Diagram: Active Declaring Policies

**Today GMS is used to manage all aspects of Credits Insurance including the following:**



## **Credit Administration System (CAS)**

### **Overview**

#### **Credit Administration System**

##### **Background**

- Award winning Mainframe application developed by EDC
- Designed to help STFS analyze and administer EDC's short-term credit portfolio
- First implemented in 1990 as an electronic credit & financial database
- Addition of EDC's Decision Support Model (DSM) in 1992

## **Credit Administration System**

### **Key Features**

- Stores up-to-date credit and financial information on companies that have exposure with EDC
- Direct data transfer of credit and financial information from external sources
- Records all credit decisions
- Keeps track of EDC's exposure
- Enables policy holders to interface with the system using EDC Direct
- Automatically generates letters to inform clients about credit decisions
- Performs credit, trend, and risk analysis
- Generates credit decisions for companies with low, moderate, and medium risk
- Produces risk levels and sets global limits for companies that are stored in the database
- Records and tracks outstanding and overdue payments between exporters and their customers

### **Volume and Turnaround Time**

(diagram Volume and Turnaround Time)

### **Credit Activity**

(diagram Credit Activity)

### **Policyholder Credit Requests**

(diagram Policyholder Credit Requests)

## Extranet Using EDC Direct Overview

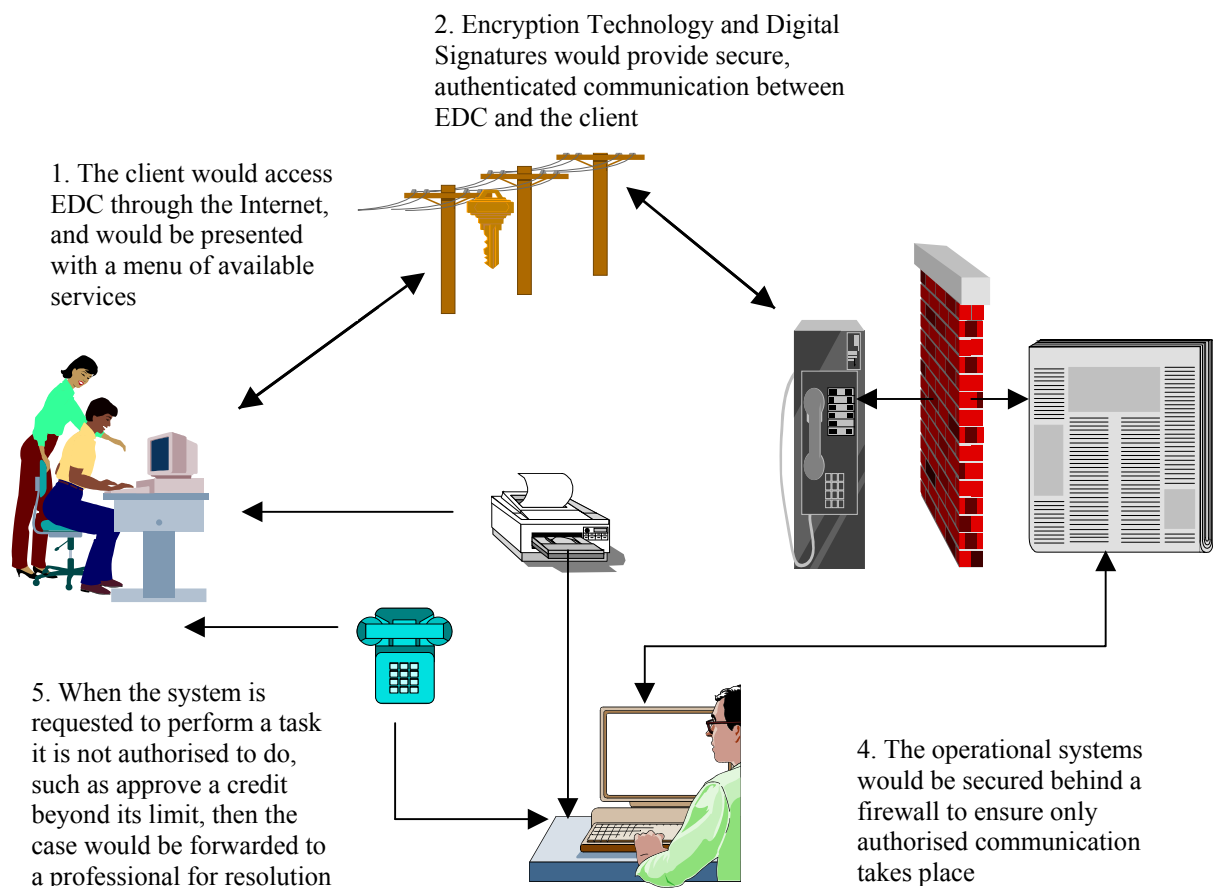
### EDC Direct Web Interface

(diagram EDC Direct Web Interface)

### What is EDC Direct?

- Enables customers to interface with EDC's Credit Administration System (CAS)
- Built with Internet-based technologies, the service is currently available through a private network
- Secure and reliable data transfer

### EDC Direct



## **EDC Direct Future Enhancements**

Policyholders will have direct access to:

- Statement(s) of account(s)
- List(s) of Approved Credit
- Application forms for Small & Medium Enterprises (SME'S)
- Submit declaration forms & claim applications
- Report overdue & problem accounts

## **Claims & Recoveries System**

**(CRS)**

### **Overview**

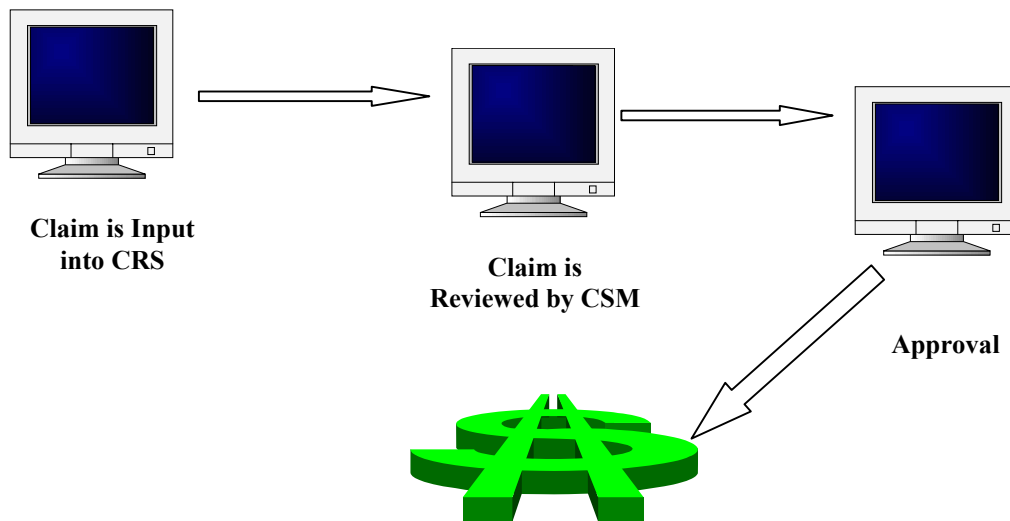
What is CRS?

- CRS is a major corporate control system used for the following purposes:
  - On-line claim processing and approvals
  - On-line recovery processing
- All claims are stored and processed by CRS (i.e. paper files only exist as keepers of paper)
- CRS is linked to all underwriting, accounting and corporate control systems

### **CRS - History**

- CRS went into production in 1988
- CRS was the first automated system at EDC for processing claims
- The application helped EDC leap from a manual process to a fully automated, on-line processing and approval system
- The implementation of CRS resulted in cost-effective improvements to the claims and recoveries business process

## Claim Process on CRS



### CRS - Controls

- All delegated authorities for approvals are controlled through CRS
- CRS is table driven allowing easy modifications to authority levels, products, and program controls
- The linkages to upstream and downstream systems provides strong control over the claims process

### Summary

The use of these support systems has resulted in several benefits, including those outlined below:

- A built-in flexibility to evolve with the business and to support increased volumes
- Build-in features that enhance Corporate control over the approval & payment processes
- Constant improvements in the speed and delivery of services to EDC's customer
- Accurate baseline data that allows for robust reporting both for operational and strategic considerations
- Lower operating costs

## Operating Results

### Customer Satisfaction

- Annual survey of customers' satisfaction with EDC services
- Composite score (out of 10) rates overall satisfaction and likelihood to recommend

		<u>CSI Score</u>
1995	Actual	8.5
1996	Target	8.6
1996	Actual	8.8
1997	Target	8.8

### Customers Served

- Increasing number of customers served is priority for EDC shareholder and EDC

		<u>Customers Served</u>
1995	Actual	2,462
1996	Target	2,900
1996	Actual	2,965
1997	Target	3,6000

### Business Volume

- A key measure of EDC's service in meeting the needs of customers is volume of business concluded

		Business Volume <u>(\$Billions)</u>
1995	Actual	17.2
1996	Target	20.5
1996	Actual	22.0
1997	Target	27.5



### Productivity

- Productivity is measured by the volume of business supported per dollar spent on administration

		<u>Productivity Ratio</u>
1995	Actual	302
1996	Target	317
1996	Actual	367
1997	Target	400

### Profitability

- Ability to operate on a self-sustaining basis and ability to take more risk on behalf of EDC customers both depend on EDC's ability to operate profitably

		<u>Net Income</u> <u>(\$Millions)</u>
1995	Actual	44
1996	Target	45
1996	Actual	112
1997	Target	226