

EXPORT TRADE FINANCE

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This article discusses the financing sources available to Canadian exporters of goods and services and the methods by which the export of Canadian goods and services is financed by Canadian commercial banks, government financing agencies such as Export Development Corporation and international financial institutions such as the World Bank.

L'auteur de cet article examine les sources de financement offertes aux exportateurs canadiens de marchandises et de services et les méthodes qu'emploient les banques canadiennes, les organismes gouvernementaux de financement, tels que la Société pour l'expansion des exportations, et les établissements financiers internationaux, tels que la Banque mondiale, pour financer ce genre d'exportation.

Introduction

Export trade is of fundamental importance to Canada's economy. Exports of goods and services currently account for approximately thirty-one per cent of Canada's annual Gross Domestic Product, with the jobs of over three million Canadians depending, directly or indirectly, on international trade. The dollar value of Canadian exports for calendar year 1985 was \$120,000,000,000, representing a 7.1 per cent increase over the corresponding figure for 1984. Among the major industrialized nations of the world, only West Germany exceeds Canada in terms of exports as a percentage of Gross Domestic Product.¹ In recent years, over seventy-five per cent of Canada's exports have gone to the United States, with Japan, the next largest single purchaser of Canadian exports, far behind at less than five per cent.² Increasingly over the last several years, concern

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¹ The Department of Economics and Statistics of the Organization for Economic Coöperation and Development (hereafter OECD in the footnotes) has reported (Quarterly National Accounts, OECD, Number 1, 1984) that Canada's exports in 1983 amounted to 27.8% of Gross Domestic Product for the same period. Comparable figures for the same year for the United States are 10.1%, for Japan 15.8%, for France 22.2%, for Italy 23.7%, for the United Kingdom 26.5% and for West Germany 32.2%. The corresponding figures for 1984 (Quarterly National Accounts, OECD, Number 1, 1985) are as follows: Canada 31.3%, United States 9.9%, Japan 17.1%, France 23.8%, Italy 24.4%, United Kingdom 28.8% and West Germany 34.3%. Canada's two principal trading partners, the United States and Japan, are much less dependent than Canada on exports and have access to large domestic markets. France, Italy, the United Kingdom and West Germany are heavily dependent upon exports but have free access to a large market through membership in the European Economic Community.

² Statistics Canada has reported that the United States purchased 72.9% of Canada's exports in 1983, 75.6% in 1984 and 78.8% in 1985, while Japan purchased 5.2% in 1983,

has been expressed with respect to the competitiveness of Canada versus other countries in the world trading market and the need to restore Canada's international trading competitiveness, with the spinoff benefits of increased production, investment and employment which increased exports bring to the Canadian economy.³ Historically, Canada's exports have been concentrated in agricultural products and the resource industries. As the sale of manufactured products brings more benefits to the economy through creation of jobs and development of new products, increasing emphasis is being placed by both government and industry upon the export of manufactured products.

As part of its trade promotional efforts, the Canadian government presently maintains approximately 120 diplomatic, trade and consular offices around the world. Through these offices, potential Canadian exporters are able to obtain assistance in identifying and developing possible export markets for Canadian goods and services. In addition, the federal government has various other programs to assist potential exporters in identifying and pursuing trade opportunities. For example, under the Program for Export Market Development, administered by the Department of Regional Industrial Expansion, the government will assist Canadian businesses in their international marketing efforts by paying up to fifty per cent of eligible costs incurred in specific marketing efforts, the assistance being repayable if export sales are realized. Several Canadian provinces also maintain offices abroad, with a primary objective of cultivating market opportunities for manufacturers having manufacturing facilities in the particular province.

Most Canadian businessmen are experienced in selling their goods and services within the domestic Canadian market and are familiar with the types of problems that arise in domestic sale transactions. The legal and financial risks faced by a seller of goods or services in a domestic sale are relatively easily identified. The major risks are the normal commercial risks, such as the buyer being unable to pay for the goods or services due to lack of funds, the insolvency or bankruptcy of the buyer, or the buyer being unwilling to pay due to a dispute relating to the quantity or quality of the goods or services or the prices charged. The international seller generally faces the same commercial risks, although they may be intensified due to the difficulty often faced by the seller in obtaining accurate and up-to-date information on the financial condition and resources of the foreign buyer. In the international sale, however, there are added risks due to the very fact that the transaction is conducted across interna-

5.0% in 1984 and 4.7% in 1985, thus illustrating our growing dependence upon the United States market.

³ See, for example, the Discussion Paper entitled "How to Secure and Enhance Canadian Access to Export Markets" published in 1985 by the Minister of International Trade of the Government of Canada.

tional boundaries. These additional risks are often categorized as "political risks", and include such matters as war or rebellion, blockage of funds, cancellation of export licences by the authorities in the seller's country and cancellation of import or other licences by the authorities in the buyer's country.⁴ There are also risks arising out of exchange rate fluctuations between the currency of the seller and the currency of the buyer.⁵ As well, there may be the possibility of imposition of foreign exchange controls by the buyer's country which may prevent a willing buyer from paying the purchase price to the seller, or restrict or delay its ability to do so.⁶ Under the Articles of Agreement of the International Monetary Fund, an exchange contract which violates the validly imposed foreign exchange laws of a member of the fund may be unenforceable in any other member country.⁷

⁴ For example, under the Export and Import Permits Act, R.S.C. 1970, c. E-17, as amended, the Governor in Council is given authority to subject the export of goods prescribed by Order in Council, the export of goods to countries prescribed by Order in Council or the import of goods prescribed by Order in Council to a regime of discretionary permits and licences. So far as export permits are concerned, the Act gives the responsible Minister broad discretionary power to amend, suspend, cancel or reinstate any export permit issued under the Act. In many foreign jurisdictions, the import of goods and services from abroad is tightly controlled by the authorities, and a seller may find its goods ineligible for import into the buyer's country because the particular goods were not on an approved list of goods which may be imported or because the required import permit had not been obtained or, if obtained, had been revoked.

⁵ For example, if the seller is unable to require payment in Canadian dollars of the purchase price of the goods or services being sold, the seller may find, upon payment by the buyer of the purchase price in the agreed currency, that it is unable to convert the foreign currency into the anticipated Canadian dollar amount due to a change in the exchange rates between the Canadian dollar and the agreed foreign currency. Depending on whether the Canadian dollar is rising or falling in value *vis-à-vis* the agreed foreign currency, the seller may lose or gain on the conversion.

⁶ Foreign exchange controls are usually administered by the national central bank or other monetary authority. In countries imposing exchange controls, the central bank directly and through licensed foreign exchange dealers normally controls all foreign exchange transactions, including the conversion of the domestic currency into foreign currency and the remittance of payments abroad, through a system of permits and licences. As a foreign buyer will normally be subject to its own domestic law and not have access to foreign currency outside the exchange control regime, foreign exchange control laws may well have an effect on the ability of even the most willing buyer to pay the seller the contracted currency by prohibiting conversion of the foreign domestic currency into Canadian dollars or restricting the availability of Canadian dollars to nationals of the foreign country.

⁷ See Bretton Woods Agreements Act, R.S.C. 1970, c. B-9, as amended, which carries into effect in Canada the Agreements for the International Monetary Fund and the International Bank for Reconstruction and Development. Section 2(b) of Article VIII of the Articles of Agreement of the International Monetary Fund provides as follows:

Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member.

The degree of risk faced by an international seller varies greatly from one market to another. For example, the political risks in a sale of goods or services to a buyer in a large, politically stable and economically sound country are normally less significant than a sale to a buyer in an unstable or economically unsound country. While political risks can be significantly reduced in certain international sale transactions, they cannot be eliminated entirely.

If a dispute arises between buyer and seller over payment of the purchase price, unless the seller is fortunate enough to have sold to a buyer having assets in the seller's country sufficient to enable the seller to litigate the questions in issue before its own courts, the seller will be forced to commence proceedings against the buyer in the courts in the buyer's jurisdiction, with the delay, increased costs and uncertainty involved in such a case.

It is against this background that public and private sector financing institutions have developed financial and insurance vehicles to facilitate international trade.

I. Types of Transactions

A. Sales

The simplest form of international sale occurs when the seller of goods or services obtains a cash payment from the buyer, either at the time the order is placed or prior to shipment of the goods or provision of the services. In either case, the seller retains title to, and possession of, the goods, or does not provide the services, until payment has been received. The ability of a seller to sell his products or services on such terms depends mainly upon the demand for the product and the relative bargaining powers of the seller and the buyer. If the seller is familiar with the buyer, either through prior dealings or by reputation, the seller may sell on an "open account" basis wherein goods are sold and delivered to the buyer and the buyer is obliged to pay the purchase price to the seller upon presentation of the documents of title to the goods or upon receipt of an invoice. Unless the seller and buyer are well known to each other and there is a large degree of mutual trust, the buyer will normally be reluctant to pay all or a substantial portion of the purchase price prior to receipt of the goods or provision of the services without security for such payments being provided by the seller. Conversely, the seller will normally

In the normal course, a contract involving a transfer of capital would be an "exchange contract" for purposes of section 2(b), whereas a contract for the sale of goods would not be an "exchange contract", even if acquisition of foreign exchange was necessary to carry through the contract. For a detailed analysis of section 2(b) of Article VIII, see *Encyclopaedia of Banking Law*, P.J. Cresswell, W.J.L. Blair, G.J.S. Hill and P.R. Wood (eds.), (1985), F (1512) ff.

be reluctant to ship the goods or perform the services without assurance that payment will be made at the agreed time. In these cases the seller may arrange for payment to be made through a bank, either on a collection basis or through a letter of credit. Under the collection arrangement, the seller draws a bill of exchange on the buyer, either requiring immediate payment or acceptance of the bill of exchange which obligates the buyer to pay the bill of exchange at an agreed point in the future. The bill of exchange is then forwarded by the seller's bank to its branch, subsidiary or correspondent bank in the foreign country, with instructions for the receiving bank to obtain payment of the bill of exchange against delivery of the shipping documents or to have the bill of exchange accepted by the buyer upon delivery of the shipping documents. The cash, or the accepted bill of exchange, is then remitted to the seller through the banking system. An accepted bill of exchange is a negotiable instrument which may be discounted by the seller to its bank for cash. In either case, the point of payment is the country of the buyer.

Under a letter of credit arrangement, the buyer opens an irrevocable letter of credit with a bank in its country in favour of the seller. The letter of credit is "advised" (in which case the advising bank assumes no personal obligation to pay) or "confirmed" (in which case the confirming bank assumes a personal obligation to pay) to the seller by a bank in the seller's country. To obtain payment under the letter of credit, the seller presents the documents specified in the letter of credit to its bank, normally the shipping documents and proof of insurance, at which point the bank pays the seller the amount due.⁸ Payment takes place under this arrangement in the seller's country.

While a detailed discussion of letters of credit is beyond the scope of this paper, the importance of letters of credit in facilitating international trade can hardly be overemphasized. The issuing bank, and if the letter of credit is confirmed by a bank in the seller's country, the confirming bank, assumes a primary obligation to pay the seller upon receipt of the specified documents. In other words, from the seller's point of view, the credit risk is shifted from that of the buyer to that of the issuing (or confirming) bank. Under the auspices of the International Chamber of Commerce, headquartered in Paris, letters of credit procedures have been formalized into a document known as the Uniform Customs and Practice for Documentary Credits. Initially formulated in the 1930's, these procedures

⁸ If the letter of credit is merely "advised" by a bank in the seller's country, upon presentation of the agreed documents to the advising bank by the seller, the advising bank notifies the issuing bank that the agreed documents in proper form have been presented under the letter of credit and requests authority to pay. If authority is not given, the seller normally must pursue its rights directly against the issuing bank. If the letter of credit is "confirmed" by a bank in the seller's country, the confirming bank pays to the seller the amount due under the letter of credit upon presentation of the agreed documents in proper form without reference back to the issuing bank for authority to pay.

describe the basic types of documentary credits, deal with methods of notification, transfer and confirmation, spell out the responsibilities of banks in relation to documentary credits and set forth the requirements for acceptance of documents under letters of credit. The latest revision of the Uniform Customs and Practice, the 1983 Revision, came into effect in October, 1984.⁹ Under Canadian law, the Uniform Customs and Practice do not apply to letters of credit as a matter of law; they must be incorporated into individual letters of credit by express provision.¹⁰ Banks and banking associations in over 160 countries have adopted previous revisions of the Uniform Customs and Practice. It is anticipated that the current revision will be equally well received, so that virtually all documentary credits issued by banks will incorporate the provisions of the Uniform Customs and Practice, thus promoting uniformity of practice with respect to letters of credit.

B. *Countertrade*¹¹

Of growing importance to the Canadian seller of goods or services in the international market place is the issue of countertrade. In one sense, countertrade or barter is the original form of commerce under which, without payment of money, sellers of goods or services exchanged their goods or services with others whose goods or services they in turn wished to buy. From its simplistic beginnings, countertrade has reached the point where its various forms are estimated to be a factor in about ten per cent of world trade, with some eighty-eight countries involved in the practice. The Canadian government estimates that in 1984 only about one half of one per cent of total Canadian exports involved some form or degree of countertrade. The large variance between ten per cent of world trade and one half of one per cent of Canadian trade is explained on the basis of the dominance of the United States and other Organization for Economic Cooperation and Development countries (where countertrade is not widely practiced) as Canada's trading partners, and the fact that Canada's primary exports of agricultural products and raw materials are not the types of export products where countertrade has become extensive.

⁹ See Uniform Customs and Practice for Documentary Credits, 1983 Revision, International Chamber of Commerce Publication No. 400.

¹⁰ No specific form of wording is required but a usual wording in a letter of credit incorporating the Uniform Customs and Practice is: "This Letter of Credit is issued subject to the Uniform Customs and Practice for Documentary Credits, 1983 Revision, International Chamber of Commerce Publication No. 400."

¹¹ An excellent starting point for developing an understanding of countertrade in its various forms and the countertrade practices of various countries active in the area is *Countertrade Primer for Canadian Exporters*, published in October, 1985 by the Department of External Affairs of the Government of Canada. The discussion of countertrade in this article is based upon information published in that booklet. Other sources of information on current countertrade practices and transactions include the periodicals, *International Financial Law Review* and *Euromoney Trade Finance Report*.

With the growing debt servicing difficulties experienced by, among others, the lesser developed countries and Eastern European countries through the 1970's and early 1980's, Eastern European countries began in the 1970's to use countertrade as a way of generating hard currency for industrial projects and fostering the sale of domestic products to the developed countries. These techniques have been copied, and developed further, by a number of lesser developed and developing countries to the point where countertrade would appear to be one of the major issues to be addressed by international sellers of goods and services in the foreseeable future.

The common forms of countertrade include barter, counterpurchase, advance purchase, offsets, buyback and bilateral agreements. True barter transactions, involving exchange of goods without payment of money, are not common between private parties, mainly due to difficulties in establishing the value of goods in terms of each other. The most common form of countertrade is counterpurchase where a seller of goods is required by the buyer, as a condition of entering into the sales contract, to enter into a separate purchase agreement to buy goods from the buyer having a value equal to a stipulated percentage of the value of the underlying sales contract. Thus a seller of equipment to a buyer in country A may be required to agree to purchase a stipulated value of products produced in country A for resale outside country A by the seller, with penalties attached if the seller fails to complete his purchase obligations within the agreed period of time. Frequently, a seller in such circumstances will "sell" its counterpurchase obligation to a specialist counterpurchase trading house to avoid the necessity of being involved in the sale of products which may be well outside the normal range of products sold by it. Under the advance purchase arrangement, a seller of goods to country A will arrange for the sale of products of country A in advance of delivery of its own goods to the buyer in country A, with the proceeds of the first sale being placed in escrow outside country A and available for payment to the seller upon delivery of its goods to the buyer in country A. Advance purchase would normally be used where country A was severely indebted or where, absent the advance purchase and sale, the buyer in country A would be unable to gain access to foreign currency to satisfy its payment obligations to the seller under the sales contract upon delivery of the goods.

Offsets involve the provision of industrial or economic benefits to country A resulting from the purchase of goods from the seller, such as local procurement or production of a portion of the goods being sold, either with or without a transfer of technology, or the establishment or expansion of a local subsidiary. Offset packages are frequently negotiated in connection with acquisition of military equipment, an example being Canada's recent purchases of long range patrol aircraft and fighter aircraft from American corporations. In the case of sales of capital plant and equipment, a seller may be required to enter into a buyback arrangement

under which the seller receives payment of a percentage of the sale price through supply of the product produced by the plant, or the seller agrees to purchase specified amounts of the product to generate a portion of the funds necessary to pay the sale price of the plant. Finally, two countries may enter into bilateral arrangements under which goods are bartered on an ongoing basis without payment of currency from one to the other. By way of example, in mid-1985 the Indonesian and Philippine governments entered into an arrangement, valid for five years, under which Indonesia agreed to deliver ammonia to a state-owned chemicals company in the Philippines and the Philippines agreed to deliver phosphoric acid to a state-owned chemicals company in Indonesia on a true barter basis, without monetary payments being made by either party.

II. *External Financing*

To this point, export transactions have been considered where direct financing of the export sale has not been required or where the parties themselves have provided the required financing, either through the seller providing deferred payment terms to the buyer, without security or upon the security of a bill of exchange or letter of credit, or the buyer providing advance payments to the seller prior to actual delivery of the goods. A seller may also utilize its own operating lines of credit with its bankers to provide the necessary working capital to produce goods for export. However, the financing of particular transactions may be well beyond the capabilities of the parties themselves, requiring resort to external financing sources. There are three basic groups of financing sources open to the Canadian exporter in connection with sales of goods or services abroad: commercial banks; Canadian federal and provincial government financing agencies; and international financial institutions.

A. *Commercial Banks*

Canadian banks offer a broad range of financing vehicles for the potential exporter. As the major Canadian commercial banks and Canadian subsidiaries of large foreign banks have a presence in many jurisdictions outside Canada, either directly through branch operations or indirectly through affiliates and correspondent relationships, they are an excellent source of financial and other information for Canadian sellers with respect to proposed purchasers in such jurisdictions.

Due to the large domestic branch network of the major banks, most potential sellers into foreign markets have an established banking relationship with one or more commercial banks and will naturally turn to those banks for advice and assistance in connection with export trade. Over the last several years the major banks have established specialty offices in major Canadian centres to deal with trade financing matters. A potential exporter is normally referred by local branch officials to one of

that bank's specialty offices where personnel familiar with the particular problems of financing cross-border transactions are available.

Since the 1980 revision of the Bank Act,¹² which permitted, for the first time, the incorporation of wholly-owned Canadian banking subsidiaries of foreign banks as Schedule B banks (the domestically-owned banks being called Schedule A banks), a large number of foreign banks have entered the Canadian market.¹³ Several of these banks are subsidiaries of foreign banks noted for their expertise in trade related financing. They bring to the Canadian market not only the particular expertise of the parent and related domestic presence in the home jurisdiction of the parent but also an increase in competition. This leads to more innovative services being offered by other Canadian banks.

Commercial banks provide the bulk of required financing for Canada's export trade, especially where the financing is concluded on a short term basis of up to one year.¹⁴ On medium and long term sales abroad, particularly to Third World countries, the involvement of Canadian commercial banks generally has been more limited and the involvement of government sponsored financing agencies, such as the Export Development Corporation, is more pronounced.¹⁵

The traditional bank methods of facilitating trade include: issuance and confirmation of letters of credit; provision of lines of credit and loans at market rates to foreign buyers of Canadian goods and services; collection of foreign receivables through affiliates and correspondents abroad; and bid and performance guarantees to provide financial back-up for contractual undertakings given by the bank's customers.¹⁶ In addition, commercial banks offer discounting arrangements designed to turn foreign receivables into cash, thereby reducing cash flow difficulties experienced by sellers who would otherwise not have the use of the money represented by the foreign receivable until the buyer pays the account.

¹² Banks and Banking Law Revision Act, 1980, S.C. 1980-81-82-83, c. 40.

¹³ As of February, 1986, there were ten domestically-owned Schedule A banks and fifty-six foreign-owned Schedule B banks operating in Canada.

¹⁴ Export Financing—Consultation Paper, Government of Canada, January, 1985, p. 3.

¹⁵ *Ibid*, p. 4.

¹⁶ Under the 1980 Bank Act, Canadian banks were given specific power to issue guarantees for the payment, or repayment, of fixed sums of money, with or without interest (see s. 173(1)(g) of the Banking and Banking Law Revision Act, *supra*, footnote 12). Prior to enactment of this provision, the power of Canadian Banks to issue guarantees was open to some doubt, perhaps due to the fact that United States banks are generally not permitted to issue financial guarantees, thus giving rise to development of the "standby letter of credit" which, while couched in terms of a letter of credit, is equivalent to a financial guarantee.

In a typical discounting arrangement involving, for instance, the sale of equipment abroad, a Canadian seller concludes the transaction and receives, at the time of delivery, an accepted bill of exchange constituting the agreement of the buyer to pay the purchase price to the seller up to one year after the date of delivery of the equipment. Frequently, such extended payment terms are agreed in order to permit the buyer to generate cash flow through use of the equipment prior to being required to pay the purchase price. If the Canadian seller chooses to carry the receivable on its books until maturity, the income represented by the receivable is tied up and cannot be used by the seller for other purposes. The Canadian seller may choose to borrow against the receivable under previously arranged working capital lines of credit with its banker (under which its banker permits borrowing for working capital purposes up to the lesser of: (i) a previously agreed percentage of the value of inventories and eligible receivables and (ii) a maximum dollar amount). However, such borrowing against the foreign receivable may limit the amount otherwise available to the seller in respect of its working capital lines. Moreover, a bank may be reluctant to lend against a security interest in foreign receivables due to the inability or difficulty in perfecting that security interest under the laws of the foreign jurisdiction. More importantly, the seller retains for its own account the political and commercial risks of non-payment at maturity, as well as uncertain carrying costs of the receivable due to possible interest rate fluctuations under its line of credit, while still remaining responsible to the bank for the amount borrowed in respect of the receivable. The seller may frequently avoid these difficulties by arranging for its bank, or a specialty subsidiary of the bank, to discount or purchase the receivable for cash. After satisfying itself as to the creditworthiness of the foreign buyer, the bank purchases the accepted bill of exchange from the seller by paying the seller in cash the face amount of the bill less a discount to compensate the bank for the risk of non-payment, its cost of funding the amount until payment and its profit on the transaction. The discount cost is established at the outset and may be built into the overall sale price of the equipment by the seller.

The risk of non-payment may thus be shifted from the seller to the purchasing bank and the seller receives cash, available for its other purposes, at the time of delivery of the equipment. In some cases indeed, the bank purchases the bill without recourse to the seller, although commonly the seller remains liable to the bank if non-payment by the buyer results from the seller's non-performance of the underlying sales contract, or a dispute between the buyer and the seller over the nature or quality of the equipment supplied. Alternatively, the seller may choose to assume the credit risk of the buyer, in which case the seller sells the receivable to the bank on a full recourse basis, receiving cash from the bank at the outset but remaining liable if, for any reason, the receivable is not paid on its due date. As the bank does not assume the risk of non-payment by the

buyer, the dollar value of the discount factor is normally less than if the bank assumes full risk of non-payment (assuming the bank is satisfied with the creditworthiness of the seller). In certain cases, the discounting bank requires the seller to obtain from Export Development Corporation, the Canadian export credit agency, an insurance policy in favour of the bank under which the risk of loss to the bank due to non-payment by the foreign buyer at maturity is insured by the Corporation.¹⁷ While there are additional costs involved, these costs can normally be ascertained by the seller at the outset and incorporated into the contractual price of the equipment being supplied.

Forfaiting is similar to the discounting arrangement outlined above. Initially a European development, the use of forfaiting is increasing among North American banks as a means of financing larger and longer term transactions than can be accomplished with the pure discounting arrangement, though the end result for the seller is essentially the same. A typical forfaiting transaction arises out of the sale of capital goods by a seller to a foreign buyer. The buyer issues in favour of the seller a series of promissory notes in respect of the purchase price, the notes maturing over a period of up to five years. Rather than holding the promissory notes until maturity, thus incurring cash flow restrictions and assuming the political and commercial risks referred to above, the seller, as payee of the notes, sells them, without recourse, to a bank in a transaction known as forfaiting. Because of the size and term of forfaiting transactions, a first class bank guarantee of the promissory notes is normally required as a condition precedent to purchase. As in the pure discounting arrangement, the bank purchases the promissory notes and pays the seller their face amounts, less a discount factor based upon the bank's funding costs and its assessment of the political and commercial risks of the transaction. The result is a fixed price cost, to both the seller and the buyer, of providing the financing which can be built into the underlying purchase price.¹⁸

¹⁷ See below under Export Credit Agencies.

¹⁸ By way of example, assume a Canadian entity has obtained a contract to supply heavy equipment to a foreign buyer with delivery of the equipment being made over a two year period. The buyer requires a five year payment period for the contract price with an interest rate of 6% per annum on the outstanding balance of the purchase price, that interest cost being below current Canadian market rates. As shipments of the equipment are received by the buyer, the foreign buyer will issue a series of promissory notes to the seller representing the payments due under the contract. The series of notes mature over a five year period, bear interest at the agreed upon rate of 6% per annum and are guaranteed by a first class bank. Rather than holding the notes until maturity, the seller arranges for its bank to purchase the notes. The bank has previously agreed to purchase the notes, provided the yield to the bank is, for instance, 12% per annum. The discount cost to yield this result is calculated and determines the amount to be paid to the seller by the bank at the time of purchase. The seller will gross up the contract price of the equipment to yield to the seller, following discount, the required amount.

Forfaiting has become popular as a means of financing larger international sales because of the simplicity of the documentation and the flexibility and speed of the transaction as compared to the more traditional but time-consuming full fledged loan agreement between lender and borrower. The technique is also useful where the national content of the goods being sold is below the minimum level required by export credit agencies, such as Export Development Corporation, and, as a consequence, neither export credit loan nor insurance facilities are available to support the transaction. As discussed below, Export Development Corporation offers a forfaiting program for transactions which meet its requirements, including its Canadian content requirements.

B. *Export Credit Agencies*

Most industrialized countries have specific government departments or agencies with the responsibility of developing, promoting and financing export sales of that nation's products. Through insurance, loan and guarantee programs, the official export credit agencies seek to ensure that, to the extent practicable, sellers of national goods and services who are otherwise internationally competitive remain so when financing of the sale is taken into account. In order to ensure that the ultimate benefit of the financing remains within the exporting country, these national agencies restrict their program availability to transactions involving exports having a high degree of national content. Thus, the Canadian export credit agency, Export Development Corporation, requires that a relatively high percentage of the purchase price of the goods or services it finances be represented by Canadian content. Recognizing that the achievable level of Canadian content varies from transaction to transaction, depending upon the type of goods involved in the specific transaction, the Corporation requires the level of Canadian content on each transaction it finances to be the "maximum practicable" level and, in any event, not less than a level stipulated for each transaction. The stipulated level is based upon a detailed review by the Corporation's industrial analysis personnel of Canadian content documentation prepared and furnished by the seller in each transaction.

It has been estimated by the Canadian government that approximately ninety per cent of Canadian exports are sold without any governmental financing involvement.¹⁹ In these cases, either no financing at all is required, or the required financing is provided by the parties themselves or through third party non-governmental financing agencies, such as commercial banks. It is also estimated by the government that roughly fifty per cent of Canadian exports to Third World countries are supported through various government programs.²⁰ Of the ten per cent of Canadian

¹⁹ *Op. cit.*, footnote 14, p. 3.

²⁰ *Ibid.*, p. 4.

exports generally which are supported by governmental programs, financial support provided by the Export Development Corporation is estimated to account for approximately five per cent, the Canadian Wheat Board one to two per cent,²¹ and the Canadian International Development Agency two per cent. The remaining one to two per cent is provided by various other governmental agencies, such as the Canadian Commercial Corporation, the Canadian Dairy Commission, the Freshwater Fish Marketing Corporation and the Canadian Saltfish Corporation.²²

(1) *The Canadian International Development Agency*

The Canadian International Development Agency is the primary vehicle through which Canada's international aid money is channelled to recipient countries. In addition to straight aid funding made available to promote Third World economic development, the Agency provides funding to assist Canadian firms in performing feasibility studies for projects in developing countries and in providing technical assistance. It also participates in parallel financing arrangements with the Export Development Corporation, under which it provides funds on an aid basis and the Corporation provides funds on export credit terms, with the total package being used to support the international sale of Canadian goods and services.²³

(2) *The Export Development Corporation*

A large portion of the government-provided financing for export sales is made available through the Export Development Corporation, which offers a broad range of insurance, guarantee and loan programs designed to promote the sale of Canadian goods and services abroad. By

²¹ Canada has been financing the sale of wheat on credit for over 30 years. Approximately 12% of Canada's international wheat sales in 1984 were on credit, with the percentage being financed fluctuating year by year, depending on prevailing market conditions at the time. The major international seller of Canadian wheat is the Canadian Wheat Board which, on a credit sale, borrows from commercial banks an amount equal to the portion of the price being financed and pays this amount to the farmer for the grain. These loans, which are backed by a full guarantee from the federal government, are repaid by the Wheat Board as the foreign purchaser of the wheat pays the Wheat Board.

²² *Op. cit.*, footnote 14, p. 4.

²³ An example of this type of joint effort occurred in mid-1984 with the signing of parallel financing agreements with India under which the Canadian International Development Agency (hereafter CIDA in the footnotes) provided long term aid loans and the Export Development Corporation (hereafter EDC in the footnotes) provided buyer credits on normal export credit terms to support the export of Canadian equipment and services for the Chamara Hydroelectric Project in Northern India. In addition to official development assistance made available through CIDA directly to the foreign recipient or on a parallel basis in cooperation with EDC, since 1981 the federal government has also provided a mixed credit program through EDC where concessional loans may be made available by EDC to assist otherwise competitive Canadian sellers in obtaining financing that at least matches foreign concessional financing offers.

virtue of its act of incorporation, the Export Development Act,²⁴ the Export Development Corporation is for all purposes an agent of Her Majesty in right of Canada. It raises funds for its operations in the international capital markets through a variety of financing arrangements, including the issuance of notes and commercial paper.²⁵ As an agent of the Crown, it is able to borrow funds internationally on terms comparable to rates obtainable by Canada itself in the international markets. In providing financial support for export sales, the Corporation acts either for its own corporate account under sections 24 (insurance) and 29 (loans and guarantees) of the Export Development Act, or for the account of the federal government under sections 27 (insurance) and 31 (loans and guarantees).²⁶ In financing for its own account, it provides support on essentially commercial terms. In acting for the federal government account, it provides support for transactions which are determined by the federal government to be in the national interest but which are, in the opinion of the Corporation's Board of Directors, for terms on, or amounts in excess of those, which the Corporation would normally undertake for its own account.

In supporting export sales, the Corporation does not seek to subsidize such sales, but rather to ensure that a Canadian seller who has a competitive product in terms of price, quality, delivery and after-sales services is not at a disadvantage *vis-à-vis* its foreign competitors when financing is taken into account. It offers three distinct programs for financing international sales contracts: an export insurance program; an export loans program; and a note purchase and forfaiting program.

²⁴ Export Development Act, R.S.C. 1970, c. E-18, as amended.

²⁵ While the Minister of Finance of Canada is authorized to loan money to EDC out of the Consolidated Revenue Fund, since 1978 EDC has funded its operations in the international capital markets. In 1985, the trade publication, Euromoney (Euromoney, October, 1985), named EDC as the borrower of the year for innovative techniques brought to the Euromarket. Traditionally, issuers in the Euromarkets have raised funds through the issuance of fixed and floating rate bonds and notes underwritten and purchased by investment banks as principals. In the United States domestic capital markets, the practice has been for issuers to issue commercial paper to be sold through investment dealers to retail purchasers of the commercial paper. In the late spring of 1985, EDC became the first issuer of a Euro-commercial paper program structured in a manner similar to the United States domestic paper programs. Under its short term note program, EDC establishes each day the rate at which it wishes to issue short term notes and dealers then try to sell the notes to retail investors on a best efforts basis. EDC will accept funds at the posted rate for any maturity up to 364 days and in denominations over \$10,000. This transaction was the first transaction in the Euromarkets where the dealers worked together and acted as the borrower's agents, thus allowing the borrower to control the price at which the notes were sold.

²⁶ During 1984, EDC extended financial support totalling \$3.68 billion in respect of international sales of Canadian goods and services of which approximately \$2.58 billion (70%) was represented by insurance and approximately \$1.1 billion (30%) was repre-

(a) *Export Insurance Program*

As discussed above, a Canadian seller of goods or services abroad faces certain political risks which are not normally encountered in a purely domestic sale, as well as the normal commercial risks which would arise whether the sale was international or domestic. The seller may obtain protection against non-payment by a foreign buyer through purchase of an insurance policy from the Export Development Corporation. No minimum value of export business is required as a precondition to obtaining insurance coverage. A major principle of credit insurance is that the entire risk should not be covered by insurance.²⁷ Accordingly, the Corporation normally provides insurance cover for ninety per cent of the loss, with the seller retaining ten per cent of the loss for its own account. The risks covered by the insurance are commercial risks; insolvency of the buyer, default of the buyer, and repudiation or termination of the sales contract by the buyer which is not caused by, and does not arise from, any breach of the sales contract on the part of the seller. Political risks are also covered; blockage of funds or transfer difficulties which prevent the seller from receiving payment, war or hostilities, cancellation or non-renewal of Canadian export permits and cancellation or non-renewal of import permits in the buyer's country. While most insurance policies provide cover for both commercial and political risks, as discussed below, special policies are available which provide cover for only political risks on an all country basis or for selected countries.

The basic insurance policy issued by the Corporation is Global Comprehensive Insurance. It insures a seller against loss from stipulated commercial and political risks arising out of export sales where the payment term is not more than six months. There are limited optional exclusions, such as sales to the United States, sales to entities affiliated with the seller or sales where payment of the purchase price is secured by an irrevocable

sented by loans. In addition, approximately \$460 million in lines of credit and protocols for the financing of possible future sales of goods and services, including renewals of expiring lines of credit and protocols, were signed by EDC in 1984. In 1985, financial support totalling approximately \$2.82 billion was extended by EDC of which approximately \$2.2 billion (78%) was represented by insurance and approximately \$620 million (22%) was represented by loans. Approximately \$700 million in lines of credit and protocols, including renewals, were signed during 1985. Source: EDC Annual Reports for 1984 and 1985. Year to year comparisons, particularly with respect to dollar volumes on the loans side, are difficult because of the effect a single large transaction may have on the figures. For example, in 1984, a single loan (referred to in note 23) accounted for over \$400 million which represents most of the "decrease" in loans volumes between 1984 and 1985. Loans were made in 110 transactions in 1984 and in 92 transactions in 1985.

²⁷ The major reason for requiring that ten per cent of the risk be retained by the seller is that the insurer has no direct contract with the debtor and depends on rights of subrogation in attempting to recoup insurance payouts from the debtor. Having the insured retain a portion of the risk helps ensure cooperation of the insured in exercising rights against the debtor following a payout under the insurance policy.

letter of credit. Normally, however, all foreign business of the seller must be covered by the Global Comprehensive Insurance policy on the theory that a large volume of transactions in many different markets, with many types of commodities and different types of transactions, is likely to result in a broad spreading of the risks and reduced administrative costs. Thus, a lower average premium is possible than would be the case if a seller were permitted to restrict coverage to particular transactions in selected markets.

Short term sales contracts of a broad range of goods and services may be covered under the Global Comprehensive Insurance policy. They include sales of raw materials, semi-processed goods, consumer goods and general commodities, and the provision of engineering, technical and similar services. So-called "invisible exports", such as the sale or licensing to a foreign customer of rights in a patent, trademark or copyright, leasing contracts and advertising, consultant and management fees, are also insurable. Capital goods and services sold on a medium term basis (that is, up to five years) may also be insured under other similar policies issued by the Export Development Corporation. The Corporation recently introduced policies of insurance to cover short and medium term sales of bulk agricultural commodities to foreign governments or to other foreign parties, secured by irrevocable letters of credit.

It is important to note that the insurance programs do not cover losses arising out of trade disputes between a seller and buyer, and any such disputes must be settled between the parties before payment will be made under a policy. For example, if a buyer defaults in paying the purchase price for goods or services because it is unable to pay, a claim would be paid within the time limits set forth in the policy (which vary from immediately to several months depending upon the event giving rise to the loss). In contrast, if a buyer chooses not to pay because it disputes that the goods or services supplied meet the contractually stipulated terms and conditions, the Corporation will not honour a claim for payment until the dispute is settled between the parties. Sellers should therefore ensure that the underlying sales contract deals specifically, and clearly, with the ability of the buyer to withhold payment in the event that the buyer alleges non-compliance of the goods or services.²⁸ In addition, the contract should require independent verification of non-compliance so that only legitimate non-compliance allegations may be made. While a seller may well be able to convince the Corporation that an alleged "trade dispute" is in reality not of any substance and should be ignored, payment of a claim in such cases may well be delayed.

In addition to global insurance policies covering all sales to specified countries (excepting the optional exclusions referred to above), the Cor-

²⁸ For instance, in the case of sales of equipment, inspection and acceptance of the equipment in Canada, prior to overseas shipment, will greatly assist the seller in eliminating allegations of non-compliance following delivery in the buyer's country.

poration issues policies in respect of one-time contracts for services, capital goods and projects. It also issues specific market policies, covering specified commercial risks only, arising out of short term sales of goods and services into the United States.

As with its other programs, the level of Canadian content of goods and services is an important consideration in determining the availability of the Corporation's insurance program for particular transactions. Prior to agreeing to issue the relevant policy, and at each renewal, the Corporation reviews the expected Canadian content of the goods and services which it is anticipated will be sold during the term of the policy. If the anticipated level of Canadian content is not assessed to be adequate, or if the level actually achieved during the preceding period in the case of a renewal is below the required level, it may decline to issue or renew the policy or may insure less than the usual ninety per cent of losses incurred.

In order to accommodate a seller's banking arrangements, the payment of proceeds of an insurance policy may be made directly to the seller's bank. Frequently, in order not to impair existing lines of credit with its bankers, a seller generates immediate cash flow by discounting or selling the foreign receivable to its bank on a limited recourse basis.²⁹ In such a situation, provided the receivable is covered under a global comprehensive insurance policy, the Corporation will extend protection under the policy directly to the discounting bank. The bank assumes as its own responsibility the residual ten per cent of the loss which would have been borne by the seller but for the discounting, unless the receivable is not paid by the buyer due to factors within the control of the seller, such as non-fulfillment by the seller of its obligations in the underlying sales contract. In such a case, the loss is not covered by the policy and the discounting bank has full recourse to the seller.

Finally, on the insurance side of its operations, the Export Development Corporation has a range of insurance policies tailored to protect a seller against loss arising out of a wrongful call by a buyer under advance payment guarantees,³⁰ or performance guarantees provided by a bank on the seller's behalf, or an arbitrary or improper call under a letter of credit or guarantee issued to a foreign buyer as part of the tendering process in an export transaction. In many large international projects, the size alone or the inter-disciplinary nature of the project may require a group of Canadian sellers to join together in a joint bid in respect of the project and, upon contract award, to carry out the contract jointly. Buyers fre-

²⁹ See discussion, *supra*, with respect to discounting arrangements with commercial banks.

³⁰ A guarantee issued by a bank to a buyer in respect of downpayments or other payments made by the buyer to the seller prior to shipment of goods or provision of services.

quently insist upon joint performance security being provided when dealing with joint bidders and contractors to avoid the difficulty of the buyer establishing, as a precondition to a call under the security, which party failed to fulfil its obligations.³¹ From the point of view of an individual member of the consortium, such joint performance securities may expose that individual member to liability to the buyer for non-performance by another member of the consortium whose performance it cannot control. To meet this concern, the Corporation offers consortium insurance protecting individual members of the consortium against loss arising out of such a joint performance guarantee being called for reasons other than that member's own non-performance.

(b) *Export Loans Program*

The Export Development Corporation's export loan program provides direct financing to buyers of Canadian goods and services. Loan financing by way of buyer credits enables the buyer to pay the purchase price in cash to the Canadian seller. Among the twenty-two member countries of the Organization for Economic Cooperation and Development there is an understanding, referred to as the "Consensus",³² relating to the ground rules to be followed by member countries in providing official finance assistance for exports of their national products. The primary objective of the Organization for Economic Cooperation and Development Consensus is to avoid export credit wars between member countries.³³ The Consensus sets maximum maturities for different categories of products, minimum downpayment requirements (fifteen per cent) and minimum interest rates for three categories of countries. It also requires

³¹ Absent a joint performance security, a buyer would normally be required to establish which particular member of the consortium had failed to fulfil its obligations so that a call under the individual performance security of that member could be made. Because responsibilities of the various parties in a joint contract are normally interrelated, a buyer would normally have great difficulty in establishing individual responsibility, except in the clearest of cases.

³² Initially developed in 1978, the official name of the Consensus is the "Arrangement on Guidelines for Officially Supported Export Credits".

³³ In spite of the existence of the OECD Consensus, export credit agencies continue to encounter instances where a departure from Consensus requirements is necessary to avoid risking loss of an export sale due to financing offered by an export credit agency of another country on terms which depart from Consensus requirements. An example involving Canada occurred in connection with the 1982 sale of subway cars by Bombardier, Inc. to the Metropolitan Transportation Authority of New York (MTA). As appears from public documents filed with the United States Department of Commerce, in the belief that the other was offering financing to the MTA which was more favourable to the MTA than permitted by the Consensus, both the French export credit agency and Canada's Export Development Corporation offered financing outside Consensus requirements to secure the subway order for their respective manufacturers. In the end, Bombardier of Canada won the contract which subsequently led to pressure from the losing American bidder to have the United States Eximbank match the foreign financing to secure the order for an

prior notification to other member countries in the event a member country intends to offer export financing on terms that do not comply with Consensus requirements.³⁴ Every six months, representatives of the Organization for Economic Cooperation and Development member countries meet to revise the "minimum" interest rates, based upon a formula taking into account average interest rates during the preceeding six month period.

The Export Development Corporation's export loans program has operated generally within Consensus requirements, though it has been observed that there has been an increased use over the last few years of so called mixed credits or "concessional financing" in order to meet foreign financing competition.³⁵ Concessional financing occurs when normal export credits (that is, complying with the Consensus) are combined in a single financial package with aid money attracting little or no interest and having a very long repayment term. This produces an overall blended term and rate which, on the whole, is more favourable to the buyer than required Consensus terms and rates.

Concessional financing practices of member countries of the Organization for Economic Cooperation and Development over the last several years have produced much heated debate among member countries, with the United States being the most outspoken opponent of the practice. Due to worldwide economic conditions over the last decade and the consequential slowdown of economic activity, the number of large international projects has decreased substantially and competition to secure the remaining projects has increased. With increased competition has come an increased need for competitive financing. While combining aid money with regular export credit loans is only one way that financing from a particular country can be made more attractive than that of another country, it has attracted the most debate recently.³⁶ The Consensus rules with respect to concessional financing have been revised several times, each time increasing the minimum percentage of aid money which must be included in any financing package and requiring prior notice to be given to the other member countries of any transaction where an export credit

American manufacturer (unsuccessful) and to have the United States Department of Commerce impose countervailing duties on the import of the subway cars into the United States (successful in part).

³⁴ Under the Consensus, countries are grouped into three categories by degree of development. Those countries with the highest degree of development are categorized as "relatively rich" countries and attract the highest minimum level of interest rates. Countries with the lowest level of development are categorized as "poor" countries and are assigned the lowest level of minimum rates of interest. In the middle are the so-called "intermediate" countries.

³⁵ *Op. cit.*, footnote 14, p. 17.

³⁶ See, for instance, James Ball, *Mixed Credits; Winners, Losers and Users*, Euromoney Trade Finance Report, October 1985, p. 18.

agency of a member country intends to offer aid money as part of a financing package. By raising the minimum required percentage of aid money if any aid money is to be part of the financing package, opponents of concessional financing hope to discourage use of any aid funds by making it simply too expensive for member countries to include the required percentages.³⁷

Under its Export Loans Program, the Export Development Corporation offers two basic types of arrangements: buyer credits tied to specific commercial contracts, and lines of credit which provide financing for sales contracts to be identified in the future.

(i) *Buyer Credits*

Under a typical buyer credit arrangement, the Export Development Corporation enters into a loan agreement with a foreign borrower whereby it agrees to lend to the borrower up to eighty-five per cent of the purchase price of goods and services being sold pursuant to a separate sales contract between the borrower/buyer and the Canadian seller. Loans are most frequently denominated in Canadian or United States dollars, although other major freely convertible currencies are normally available to meet the requirements of specific transactions. A separate three party agreement, called a "Disbursement Procedures Agreement", is entered into between the borrower, the seller and the Export Development Corporation, setting forth the precise mechanics of disbursement of the loan funds. The mechanics for disbursement closely parallel the payment arrangements agreed upon between the seller and the buyer in the underlying sales contract, and normally provide for direct disbursement to the Canadian seller upon presentation of stipulated documentation to the Corporation by the seller. The practical effect of a buyer credit of this sort is to provide the Canadian seller with a cash sale and the buyer with deferred payment terms.

It is important to appreciate however that, like any other loan agreement, such a loan agreement does not evidence an unconditional obligation on the part of the lender to advance funds; rather, the lender agrees to advance funds provided the borrower remains in compliance with the provisions of the agreement.³⁸ Frequently, a loan agreement will provide

³⁷ As of April 1985, the minimum required percentage was raised to 25% and the United States has strongly advocated that the minimum percentage should be raised to 50%.

³⁸ For instance, in a normal loan agreement a borrower is required to observe certain covenants, with the failure to observe resulting in an event of default. In addition, other events of default will normally be triggered if a borrower fails to pay its debt obligations as they become due or, in the case of a commercial borrower, if the borrower becomes insolvent or bankrupt, or, in the case of a sovereign borrower, if a moratorium on payment of foreign debt is imposed. Occurrence of an event of default, or an event which with

for disbursement of loan funds to be made upon shipment of goods by the seller to the buyer against presentation to the Corporation of copies of the shipping documents. Particularly if the goods are custom manufactured, a seller will have incurred significant production costs by the time the goods are ready for shipment to the buyer, and the seller would incur a loss if the buyer's access to loan funds under the loan agreement were suspended or terminated prior to shipment due to a breach of the loan agreement conditions by the buyer. To protect a seller from loss in these circumstances, the Corporation makes available to sellers of goods financed under a loan agreement a loan pre-disbursement insurance policy under which the seller may claim for losses incurred by reason of work performed prior to the seller being notified of a suspension or termination of the buyer's right to disbursement of funds under the loan agreement. In other words, the seller receives payment from the Corporation at the time of shipment, not out of funds provided under the loan agreement, but rather under an insurance policy issued by it.

In accordance with Consensus requirements, repayment of Export Development Corporation loans is normally required to be made in semi-annual instalments, commencing six months after delivery of the goods or provision of the services in respect of which the financing is being made available. Repayment terms for buyer credits generally follow Consensus requirements, which allow maximum maturities of from eight and one-half to ten years, depending upon the nature of the goods or services being financed.³⁹ Interest rates on buyer credit loans are both fixed and floating. Fixed rate financing is generally made available at or above Consensus minimums, while floating rate funding is available at a margin above Canadian or United States prime rates or the London interbank offered rate. Frequently, the availability of fixed rate funds for up to ten years is of considerable attraction to a foreign borrower as it enables the borrower to establish its debt service costs at the outset of the transaction. It is primarily the availability of fixed rate and longer term funds which sets Export Development Corporation financing apart from term financing available from Canadian banks.

The Export Development Corporation in fact seeks to include Canadian commercial banks wherever practical in its financing arrangements. This may occur on a joint loan basis where a bank will join in a single financing agreement as a named lender and provide a portion of the

lapse of time or notice would constitute an event of default, entitles the lender to suspend or terminate the borrower's right to draw down funds under the loan agreement.

³⁹ The OECD Consensus does not apply to all types of sales. Separate OECD understandings apply to financing of nuclear power plants and ships, other than off-shore oil rigs. Negotiations are ongoing with respect to an understanding to govern official export financing for aircraft and agricultural products. Military equipment financing falls outside Consensus guidelines.

required financing, or it might happen under a separate participation agreement in which an interest in the loan made by the Corporation under the financing agreement is sold to the bank, either with or without recourse to the Corporation in the event of non-payment by the borrower. Alternatively, the bank may provide its share of the financing under a separate, parallel financing agreement in which the bank finances a portion of the purchase price of the goods and services.⁴⁰

While negotiations with respect to the terms and conditions of an export financing agreement are conducted by the Corporation and the borrower without direct involvement of the seller, the Corporation levies an exposure fee on the seller in connection with its financing services. The seller factors the cost of the exposure fee into the price of the goods or services to be provided pursuant to the underlying sales contract. The Corporation justifies the exposure fee on the basis that, in its export loans program, it bears the full risk that the buyer/borrower will not repay the loan in the agreed manner. On the other hand, under the insurance program the Export Development Corporation will normally insure only ninety per cent of the potential loss, with the seller retaining ten per cent of the risk for its own account. The repayment risks assumed by the Corporation under the export loans program are similar to those covered by export credit insurance for which insurance premiums are paid by the seller, and the exposure fee is intended to compensate it for the added degree of risk assumed under the export loans program. Exposure fees, which vary with the term of exposure, degree of risk assessed in lending to the specific country and whether the borrower is a sovereign risk,⁴¹ are imposed on sellers in respect of all loan transactions. As the seller normally wishes to pass on the cost of the fee to the buyer as part of the overall purchase price, it is important that the Corporation be consulted early in the sale process, prior to agreement being reached with the buyer. The existence of the exposure fee is disclosed to the buyer/borrower in the financing agreement, though the actual dollar amount of the fee is left for disclosure by the individual seller.

A variation of the straight buyer credit is the specialized credit arrangement under which the Corporation makes loans to a creditworthy Canadian entity which purchases Canadian goods for permanent use by

⁴⁰ In any event, the portion of the financing made available by a Canadian commercial bank usually bears interest on a floating rate basis, tied to prime rate, certificate of deposit rate or the interbank offered rate, rather than a fixed rate basis for the term of the loan. While Canadian commercial banks have recently become more willing to provide fixed rate financing than was previously the case, because of the way in which banks raise their loan funds it would be unusual to encounter a situation where a Canadian bank would extend financing at a fixed rate for more than a five year term.

⁴¹ Sovereign risk status means that the borrower engages the credit of the foreign government, as opposed to a commercial risk where only the assets of the particular borrower are available to meet its obligations.

that entity outside Canada, or where the Canadian entity purchasing the goods leases the goods to another for use outside Canada. This is a variation of the normal practice of making direct loans only to foreign entities.

The Corporation also guarantees loans made by Canadian or foreign banks and financial institutions to foreign buyers of Canadian goods and services where the institution providing the financing is unwilling to assume for its own account the credit risk of the foreign buyer.

(ii) *Lines of Credit*

In order to simplify and streamline procedures for smaller export transactions the Export Development Corporation had, as of December, 1985, entered into lines of credit arrangements with some twenty-seven banks and public agencies around the world. Under these arrangements, it agrees to make funds available to financing intermediaries in various countries for use in financing specific purchases of Canadian goods and services approved by it for financing during the term of the line of credit. Several of the lines of credit presently in place permit the financing of purchases in several jurisdictions rather than being restricted to transactions in a single country. The basic terms and conditions of the loans to be made available under the line of credit and the general disbursement procedures to be employed are agreed at the outset. Thus, upon individual buyers and sellers being identified, financing for the particular transaction may be completed more quickly and at less cost than if the normal credit approval and loan negotiation process is followed. Upon identification of the specific transaction and its approval for financing under the line of credit, an allocation of financing is made by the Export Development Corporation under the line of credit and a simplified form of disbursement procedures agreement or disbursement order is entered into between the Corporation, the particular borrower and the seller. From the Corporation's perspective, its credit risk is that of the financing intermediary which is the borrower under the line of credit rather than the ultimate buyer. From the viewpoint of the foreign financing intermediary, it bears the credit risk of the buyer but has a committed source of funding for its loan to the buyer. The additional charges which the financing intermediary may impose in connection with its loan to the buyer are normally restricted, so as to ensure the overall cost of the loan to the buyer remains competitive. Finally, the Canadian seller enjoys the benefit of direct disbursement of funds by the Corporation without the sometimes lengthy process of putting in place a buyer credit loan agreement between the Corporation and the foreign buyer. The Corporation has also entered into line of credit arrangements with foreign entities, such as utilities, which regularly purchase Canadian goods and services, in order to simplify on-going purchases by avoiding the need for new loan negotiations as each new purchase agreement is finalized.

(iii) *Note Purchase Program*

The mechanics of note purchase and forfaiting have been discussed above in relation to export finance provided by Canadian commercial banks. The Export Development Corporation offers note purchase arrangements which complement similar facilities available from commercial banking institutions. Generally speaking, its note purchase facilities are available to a seller if the seller is unable to secure financing from commercial sources or if the financing package offered is not competitive.

C. International Financial Institutions

Several international financial institutions⁴² have been established to provide financing for trade transactions with countries falling within their particular mandates. Probably the best known of these international agencies is the World Bank, composed of the International Bank for Reconstruction and Development headquartered in Washington, D.C. and its affiliated institutions, the International Finance Corporation and the International Development Association. Established following the Second World War, the International Bank for Reconstruction and Development funds itself from its approximately 150 member countries, as well as the international capital markets, and extends long term financing to or under the guarantee of a foreign government in connection with certain categories of projects in lesser developed countries. Most of its loans are limited to projects involving the construction of infrastructure in the transportation, energy and agricultural sectors, as well as projects related to education, communications and industry. The International Finance Corporation makes direct equity investments, or lends funds at market rates, to commercially viable projects in lesser developed countries, and the International Development Association provides long term aid for projects in the world's poorest nations.

Canadian exporters have generally not been aggressive in seeking out opportunities to sell equipment and materials to projects being financed by the international financial institutions.⁴³ In an attempt to assist Canadian firms in securing a larger share of the potential market in such projects, Canada has opened an Office for Liason with International

⁴² The World Bank, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank and the Caribbean Development Bank are commonly referred to as the "International Financing Institutions". As implied by their names, several of these institutions are concerned with financing projects in specific geographic areas of the world. In addition, there are other international agencies, such as the United Nations Development Program, involved in development programs which provide opportunities for export markets for sellers of goods and services in the developed countries.

⁴³ In 1984, the international financial institutions committed loans and credits of approximately \$21 billion to projects in developing countries.

Financial Institutions within the Canadian Embassy in Washington. The office identifies current and upcoming projects in which Canadian firms have the capacity to participate and provides to Canadian industry information and assistance with respect to participation in such projects financed by the international agencies.