



TEN-YEAR STATUTORY REVIEW OF THE BUSINESS DEVELOPMENT BANK OF CANADA

**Report of
The Standing Senate Committee on
Banking, Trade and Commerce**

The Honourable Michael A. Meighen
Chair
The Honourable Céline Hervieux-Payette, P.C.
Deputy Chair

December 2010

Ce document est disponible en français.

* * *

This report and the Committee's proceedings are available online at
www.senate-senat.ca/bancom.asp.

Hard copies of these documents are also available by contacting
the Senate Committees Directorate at (613) 990-0088.

Comments and reactions to this report can be
brought to the attention of the Committee by email at
banking_banques@sen.parl.gc.ca.

MEMBERSHIP

The Honourable Senator Michael A. Meighen, Q.C., Chair

The Honourable Senator Céline Hervieux-Payette, P.C., Deputy Chair

and

The Honourable Senators:

Salma Atallahjan
Irving Gerstein
Stephen Greene
Mac Harb
Vim Kochhar

Paul J. Massicotte
Percy Mockler
Wilfred P. Moore, Q.C.
Donald H. Oliver, Q.C.
Pierrette Ringuette

* Marjory LeBreton, P.C. (or Gerald J. Comeau)

* James Cowan (or Claudette Tardif)

** Ex Officio Members of the Committee*

Other Senators who have participated on this study:

The Honourable Senators Nancy Ruth, Elizabeth Marshall, Donald Plett, Rose-May Poirier, Rod Zimmer.

Parliamentary Information and Research Service, Library of Parliament:

John Bulmer, Analyst
Adriane Yong, Analyst

Senate Committees Directorate:

Louise Pronovost, Administrative Assistant

Clerk of the Committee:

Dr. Line Gravel

FOREWORD

Since 1995, the Business Development Bank of Canada (BDC) has been delivering financial support, consulting services and venture capital to Canadian companies.

I am honoured to present this review of the BDC Act by the Standing Senate Committee on Banking Trade and Commerce.

After going through the process of hearing from a thorough cross section of witnesses and organizations, the Standing Committee has been able to generate several recommendations which should be helpful for the government of Canada's upcoming ten-year review of the BDC Act.

Amongst the themes to emerge in this report, I would like to point out that the Banking Committee is strongly of the view that the activities of the Business Development Bank of Canada should be guided by the principle of ensuring that its support for business development in Canada is complementary to that supplied by Canada's private sector financial institutions; this is, its role should be limited to market gaps or insufficiencies. This Committee is also firm in its conviction that the BDC should primarily focus on support for Canada's small and medium sized enterprises (SMEs).

Supporting Canada's entrepreneurs through the ups and downs of economic cycles is good for job creation and good for maintaining a resilient and dynamic Canadian economy. The BDC has played an important role in providing this support in the past and I am confident that it will continue to do so in the future.

A big thank-you is extended to all the Senators who participated in this study, as well the staff the Senate Committee directorate and the Library of Parliament for the support they have given to Committee Members. It is my hope that this report, the end product of our efforts, will prove to be influential in ensuring that the BDC continues to play an effective role in supporting economic development for the benefit of Canada and all Canadians.

MICHAEL A. MEIGHEN

Chair,
Standing Senate Committee on
Banking, Trade and Commerce

ORDER OF REFERENCE

Extract from the *Journals of the Senate*, Tuesday, October 5, 2010:

The Honourable Senator Meighen moved, seconded by the Honourable Senator Cochrane:

The Standing Senate Committee on Banking, Trade and Commerce be authorized to undertake the 10-year statutory review of the Business Development Bank of Canada, as required by the *Business Development Bank of Canada Act* and,

That the Committee submit its final report no later than December 31, 2010, and retain until January 30, 2011 all powers necessary to publicize its findings.

The question being put on the motion, it was adopted.

Gary W. O'Brien
Clerk of the Senate

TABLE OF CONTENTS

Chapter 1: Introduction	1
Chapter 2: The Business Development Bank of Canada's History, Review	
Requirements and Current Activities.....	3
A. MANDATE	4
B. COMPLEMENTARITY	5
C. FINANCIAL TOOLS	5
D. NON-FINANCIAL TOOLS	8
E. THE CANADIAN SECURED CREDIT FACILITY AND THE BUSINESS CREDIT AVAILABILITY PROGRAM	8
F. DIVIDENDS AND FINANCIAL RETURNS.....	9
Chapter 3: Proposals for Change	11
PURPOSE OF THE BUSINESS DEVELOPMENT BANK OF CANADA AND OTHER FEDERAL FINANCIAL INSTITUTIONS	11
A. THE BUSINESS DEVELOPMENT BANK OF CANADA'S VIEWS	11
B. THE VIEWS OF OTHER WITNESSES	11
C. THE COMMITTEE'S VIEWS AND RECOMMENDATIONS	13
COMPLEMENTARITY.....	15
A. THE BUSINESS DEVELOPMENT BANK OF CANADA'S VIEWS.....	15
B. THE VIEWS OF OTHER WITNESSES	15
C. THE COMMITTEE'S VIEWS AND RECOMMENDATIONS.....	16
FINANCIAL TOOLS	18
A. THE BUSINESS DEVELOPMENT BANK OF CANADA'S VIEWS	18
B. THE VIEWS OF OTHER WITNESSES	19
C. THE COMMITTEE'S VIEWS AND RECOMMENDATIONS.....	20
NON-FINANCIAL TOOLS	22
A. THE BUSINESS DEVELOPMENT BANK OF CANADA'S VIEWS.....	22
B. THE VIEWS OF OTHER WITNESSES	22
C. THE COMMITTEE'S VIEWS AND RECOMMENDATIONS	23
EXPANSION BEYOND THE DOMESTIC MARKET	24
A. THE BUSINESS DEVELOPMENT BANK OF CANADA'S VIEWS.....	24
B. THE VIEWS OF OTHER WITNESSES	24
C. THE COMMITTEE'S THOUGHTS AND RECOMMENDATIONS	26

GOVERNANCE STRUCTURE.....	27
A. THE BUSINESS DEVELOPMENT BANK OF CANADA’S VIEWS.....	27
B. THE VIEWS OF OTHER WITNESSES.....	28
C. THE COMMITTEE’S VIEWS AND RECOMMENDATIONS.....	28
FINANCIAL SUSTAINABILITY, OTHER FINANCIAL ISSUES AND REVIEW	30
A. THE BUSINESS DEVELOPMENT BANK OF CANADA’S VIEWS	30
B. THE VIEWS OF OTHER WITNESSES.....	30
C. THE COMMITTEE’S VIEWS AND RECOMMENDATIONS	31
LENDING THROUGH A TRUST OR ANOTHER INSTITUTION.....	32
A. THE BUSINESS DEVELOPMENT BANK OF CANADA’S VIEWS	32
B. THE VIEWS OF OTHER WITNESSES.....	32
C. THE COMMITTEE’S VIEWS AND RECOMMENDATIONS	32
VENTURE CAPITAL.....	34
A. THE BUSINESS DEVELOPMENT BANK OF CANADA’S VIEWS	34
B. THE VIEWS OF OTHER WITNESSES.....	34
C. THE COMMITTEE’S VIEWS AND RECOMMENDATIONS	35
Chapter 4: Conclusion.....	37
Appendix A: Amendments Proposed by	
the Business Development Bank of Canada	39
SECTION 4: PURPOSE.....	39
SECTIONS 14, 16 AND 23: FINANCIAL TOOLS,	
INCLUDING PAID-IN CAPITAL.....	39
SECTION 17: NON-FINANCIAL TOOLS	40
SECTIONS 5, 6 7, 9, 11, 12, 32 AND 33: GOVERNANCE.....	40
NEW SECTION 4.1 AND SECTION 21: FINANCIAL SUSTAINABILITY	42
Appendix B: Witnesses.....	43
Appendix C: Briefs without the Author’s Appearance.....	45

CHAPTER 1: INTRODUCTION

On 5 October 2010, the Standing Senate Committee on Banking, Trade and Commerce received authorization to undertake the ten-year statutory review of the Business Development Bank of Canada (BDC) that is required by the *Business Development Bank of Canada Act* (the Act).

With this order of reference, over the course of six meetings in October and November 2010, the Committee heard from a variety of groups and individuals with an interest in the review. Those who testified, as well as those who submitted a written brief, provided us with a range of opinions on whether the BDC is fulfilling its current mandate as set out by the Act and whether changes to the BDC's mandate and the Act are needed. We were also presented with thoughts on the status of financing and venture capital lending to Canada's small and medium-sized businesses as well as the role of other federal Crown corporations, such as Export Development Canada (EDC) and Farm Credit Canada (FCC), in domestic and international lending.

This report describes the current mandate of and review requirements in relation to the BDC, as well as potential changes to the Act proposed by the BDC. It also summarizes the views presented to the Committee by other witnesses on various BDC-related issues. The report concludes with our thoughts and recommendations about the Business Development Bank of Canada.

CHAPTER 2: THE BUSINESS DEVELOPMENT BANK OF CANADA'S HISTORY, REVIEW REQUIREMENTS AND CURRENT ACTIVITIES

HISTORY

The Industrial Development Bank (IDB) was created in 1944 as a part of the Bank of Canada; one of its roles was to help small manufacturers that were contributing to Canada's efforts in the Second World War. In 1961, the IDB's mandate was expanded, and the IDB was authorized to provide loans to all types of businesses that were unable to obtain financing with "reasonable" conditions. The Federal Business Development Bank (FBDB), which was the name given to the IDB in 1975, was created as an entity separate from the Bank of Canada. Its mandate was to be a lender of last resort for the financing and management needs of small businesses.

In 1995, in response to an evolving financial services sector and a need for venture capital funding, the mandate of the FBDB was changed and the Business Development Bank of Canada (BDC) was created. The BDC is legislatively mandated to be a complementary lender rather than a lender of last resort.

Since 1995, the BDC has provided \$33 billion in financing, subordinate financing and venture capital lending to more than 60,000 Canadian businesses. The BDC has more than 100 business centres and employs 500 account managers, 45 subordinate financing professionals, 35 venture capital investment professionals, 91 consulting specialists and 500 external consultants.

REVIEW REQUIREMENTS

Section 36 of the *Business Development Bank of Canada Act* describes the statutory review process for the BDC:

36. (1) *Five years after this Act comes into force, and every ten years afterward, the Designated Minister must have a review of the provisions and operation of this Act undertaken in consultation with the Minister of Finance.*

(2) *Within one year after the review is undertaken, the Designated Minister must submit to Parliament a report on the review.*

(3) *The report must be reviewed by any committee of the Senate or of the House of Commons, or any joint committee, that may be designated or established for the purpose of reviewing the report.*

The five-year report, *Supporting Small Business Innovation: Review of the Business Development Bank of Canada*, was tabled in Parliament on 20 June 2001 by the Minister of Industry.

Part X of the *Financial Administration Act* requires a special examination of the financial and management control, information systems and management practices of federal Crown corporations at least once every five years. The last special examination report in relation to the BDC was tabled in Parliament by the Office of the Auditor General of Canada on 29 April 2009.

CURRENT ACTIVITIES

A. MANDATE

Section 4 of the *Business Development Bank of Canada Act* sets out the purpose of the BDC:

4. (1) The purpose of the Bank is to support Canadian entrepreneurship by providing financial and management services and by issuing securities or otherwise raising funds or capital in support of those services.

(2) In carrying out its activities, the Bank must give particular consideration to the needs of small and medium-sized enterprises.

The BDC assists Canada's small and medium-sized businesses primarily through providing financing, venture capital lending and consulting services. Financial assistance is also offered to cyclical industries, such as construction, forestry, fishing and tourism, which can experience difficulties in obtaining financing from commercial financial institutions. During economic downturns, the BDC plays a counter-cyclical role by providing financing to businesses from all sectors when commercial lenders may be reluctant to do so. The terms and conditions of these BDC loans account for their relatively riskier nature.

The BDC's focus is small and medium-sized businesses, often known as SMEs. According to Statistics Canada, a small business has fewer than 100 employees, and a medium-sized business has 100 to 500 employees. While the BDC supports larger businesses, the majority of its clients are SMEs.

Client satisfaction is assessed through annual surveys of BDC clients conducted by an outside third party. In the 2008-2009 and 2009-2010 fiscal years, the percentage of BDC clients which reported that they were "satisfied" with the services offered by the BDC was 93%.

B. COMPLEMENTARITY

The complementary nature of the BDC's activities is indicated in subsection 14(4) of the *Business Development Bank of Canada Act*:

14. (4) The loans, investments and guarantees are to fill out or complete services available from commercial financial institutions.

C. FINANCIAL TOOLS

Section 14 of the *Business Development Bank of Canada Act* sets out the types of **financial services** that the BDC may offer its clients:

14. (1) The Bank may make loans to, or investments in, any person, or give guarantees in relation to any person.

(2) The loans, investments and guarantees may be made or given directly, through arrangements with other financial institutions or by the Bank as a member of a financing syndicate.

(3) The loans, investments and guarantees may be made or given only where, in the opinion of the Board or any committee or officer designated by the Board,

(a) the person is engaged, or is about to engage, in an enterprise in Canada;

(b) the amount invested, or to be invested, in the enterprise by persons other than the Bank and the character of the investment are such that the Bank may reasonably expect that those persons will have a continuing commitment to the enterprise; and

(c) the enterprise may reasonably be expected to prove successful.

(4) The loans, investments and guarantees are to fill out or complete services available from commercial financial institutions.

(5) In any circumstances where the Bank may make a loan or investment to a person, or give a guarantee in relation to a person, under this section, the Bank may

(a) purchase or otherwise acquire real or personal property, including accounts receivable; and

(b) subject to any right of redemption that may exist, hold, lease to the person or subsequently sell, dispose of or otherwise deal with the property.

The BDC's lending is constrained by a **leverage ratio** and by a **risk-weighted capital-adequacy ratio**. The leverage ratio is established in paragraph 30(1)(b) of the Act:

30. (1) The aggregate of

(a) the borrowings of the Bank under subsection 18(1) and section 19, and

(b) the contingent liabilities of the Bank in the form of guarantees given by it

must not at any time exceed twelve times the equity of the Bank.

The risk-weighted capital-adequacy ratio is established by the Treasury Board of Canada and constrains BDC lending according to the type and expected risk. In particular, the ratio is 20:1 (5%) for asset-backed securities, 10:1 (10%) for term loans (net of allowance for credit losses), 4:1 (25%) for quasi-equity loans and 1:1 (100%) for venture capital investments. These leverage and risk-weighted capital-adequacy ratios limit the profitability and potential losses of the BDC for a given level of capital.

Debt issued by the BDC is an obligation for both it and the federal government, which may lend to the BDC from the Consolidated Revenue Fund as set out in section 19 of the Act:

19. At the request of the Bank, the Minister of Finance may, out of the Consolidated Revenue Fund, lend money to the Bank on any terms and conditions that the Minister of Finance may fix.

As such, Standard and Poor's has deemed that the BDC should share the federal government's triple-A debt rating. Moreover, since April 2008, the BDC has borrowed all of its money directly from the Minister of Finance and has, therefore, stopped issuing its own debt.

BDC lending is of two primary types: financing (primarily term loans) and subordinate financing. Term lending may benefit businesses that have difficulty obtaining traditional financing, such as start-up companies with limited financial history, young entrepreneurs with little experience, early-stage SME exporters and knowledge-based companies with few tangible assets. This type of lending increased during the recent recession for all SME sectors.

Subordinate financing is a hybrid of debt and equity financing. The terms of the loan agreement may provide the option to repay the loan through stock options and/or

royalties. This type of lending is typically offered to those seeking financing for transactions valued at less than \$3 million, businesses outside urban centres for which subordinate financing is limited, businesses that are interested in longer-term financing ranging from five to seven years rather than the more traditional three- to five-year loan, and businesses concerned about ownership dilution or control of the company. During the recent recession, transactions of all sizes were affected by decreased availability of subordinate financing; in particular, a number of foreign lenders and funds reduced their activities in the Canadian marketplace.

In the 2009-2010 fiscal year, the BDC loaned more money than at any other point in its history: \$4.4 billion, which was a 53% increase over the preceding year. The average financing in that year was more than \$500,000 per business.

The **paid-in capital limit** of the BDC is described in section 23 of the *Business Development Bank of Canada Act*:

23. (1) The authorized capital of the Bank consists of an unlimited number of common shares with a par value of \$100 each and an unlimited number of preferred shares without par value, but the paid-in capital of the Bank, together with any contributed surplus relating to it and any proceeds referred to in paragraph 30(2)(d) that have been prescribed as equity, must not at any time exceed \$3,000,000,000.

All federal financial Crown corporations have paid-in capital limits. For example, the limit for the Canada Mortgage and Housing Corporation is \$25 million, for the Canadian Commercial Corporation is \$10 million, for Export Development Canada is \$3 billion and for Farm Credit Canada is \$1.25 billion.

As of 31 March 2010, the committed paid-in capital for the BDC reached \$2.997 million, an amount that is close to the statutory limit.

The BDC's mandate to provide **venture capital funding** is not statutory; instead, it is governed by the objectives and priorities established by the Minister of Industry. An analysis of the BDC's venture capital activities and strategies released on 24 March 2007 indicated that these venture capital priorities include pre-seed/seed investment, new specialized venture funds, direct investment in innovative early-stage and start-up companies, commercial applications of technology related to the life sciences, environmental technologies, nanotechnologies, information technologies and advanced materials and other leading-edge technologies, initiatives for commercializing research performed in university-based and other research institutions, regional and sectoral development, foreign investment in venture capital, and working through partnerships or other arrangements.

D. NON-FINANCIAL TOOLS

The non-financial tools that are offered by the BDC to its clients are listed in section 17 of the *Business Development Bank of Canada Act*:

17. *The Bank may provide, or enter into agreements for the provision of,*

(a) business planning services;

(b) management counselling and training, including seminars, conferences and meetings; and

(c) information.

E. THE CANADIAN SECURED CREDIT FACILITY AND THE BUSINESS CREDIT AVAILABILITY PROGRAM

In the 2009 budget, the federal government asked the BDC to create and manage the Canadian Secured Credit Facility (CSCF) in response to a shortage of financing for consumers and businesses wishing to purchase vehicles and equipment. The objectives of the CSCF were to stimulate sales and leasing of vehicles and equipment through the purchase of asset-backed securities, and to promote renewed investor participation and confidence in the asset-backed securities market. The BDC was authorized to purchase up to \$12 billion of Canadian triple-A-rated term asset-backed securities by 31 March 2010. Through the CSCF, the BDC purchased \$3.7 billion in asset-backed securities through five transactions with Canadian subsidiaries of foreign corporations.

The budget also introduced the Business Credit Availability Program (BCAP). This program was designed to improve access to financing for Canadian businesses through enhanced cooperation between private-sector financial institutions and the BDC and EDC. The BDC and EDC were authorized to provide at least \$5 billion in additional loans and other forms of credit support, at market rates, to businesses with viable business models whose access to financing would otherwise be restricted. One objective of the BCAP was to fill gaps in market access; it was also designed to encourage additional lending by private-sector financial institutions. The BDC provided \$2.7 billion in additional lending to 14,000 SMEs. This lending was for specific projects and for working capital. Most of these transactions were referred to the BDC by private-sector financial institutions.

F. DIVIDENDS AND FINANCIAL RETURNS

Section 25 of the *Business Development Bank of Canada Act* provides that, in any fiscal year, the BDC may declare dividends and pay them to the BDC's sole shareholder, the federal government:

25. (1) In any financial year of the Bank, it may declare and pay to the shareholders of the Bank any dividends out of the retained earnings or surplus account of the Bank.

(2) The Bank may not declare or pay a dividend if there are reasonable grounds for believing that

(a) the Bank is, or would after the payment be, unable to pay its liabilities as they become due; or

(b) the realizable value of the Bank's assets would, after the payment, be less than the aggregate of its liabilities and paid-up capital of all classes.

The BDC has been profitable since its establishment in 1995. Over the 2000 to 2009 period, the BDC's average annual return on equity was 8.2%. Because of its profitability, the BDC has remitted dividends to the federal government every year since 1997. Since 1997, \$173.5 million has been remitted.

CHAPTER 3: PROPOSALS FOR CHANGE

PURPOSE OF THE BUSINESS DEVELOPMENT BANK OF CANADA
AND OTHER FEDERAL FINANCIAL INSTITUTIONS

A. THE BUSINESS DEVELOPMENT BANK OF CANADA'S VIEWS

In its appearance before the Committee, the Business Development Bank of Canada (BDC) requested that the *Business Development Bank of Canada Act* reconfirm the BDC's particular focus on small and medium-sized businesses (SMEs). It told the Committee that, in order to be able to respond to the uncertain future financial needs of Canada's SMEs, its mandate should be changed so that its purpose is more closely tied to the needs of entrepreneurs. The BDC wants flexibility in order to support businesses in their development plans and to contribute to the competitiveness of Canada. It suggested amendments to section 4 of the Act, as outlined in Appendix A.

B. THE VIEWS OF OTHER WITNESSES

In general, other witnesses supported the BDC and its work, both during and prior to the recent global financial and economic crisis. For example, Canadian Manufacturers & Exporters (CME) found the BDC to be "an invaluable business partner to our members," stating that approximately one-third of the BDC's business activities were conducted with CME members. CME argued that its SME members sought financing from the BDC, sometimes at a relatively higher cost, because of the flexibility of loan terms and conditions that the BDC could provide. According to a CME member that is an SME, "[t]here is no way that we could have executed our plans without the BDC's support."

These views were echoed by the Canadian Chamber of Commerce, which noted that its members found the BDC's support to be critical during the global financial and economic crisis, particularly after foreign banks and non-banks, including market securitization agents, "vacated the market." According to it, the BDC, in concert with EDC, "virtually replaced the asset-backed financing marketplace, which was essentially closed."

In its appearance before the Committee, the Canadian Bankers Association (CBA) remarked that, in 2006, data indicated no measurable market gap in Canada's financial sector at that time. However, during the recent global financial and economic crisis, the CBA found that the BDC played a "counter-cyclical role" and was successful because of its complementary role. According to the CBA, through the Business Credit Availability Program, the BDC was able to ensure that credit was available at a time when non-bank lending sources, including securitization, were impeded.

From its perspective, the Canadian Federation of Independent Business (CFIB) said that there are both structural and cyclical gaps in financing for small businesses. It told the Committee that Canada's small businesses generally face significant financial barriers throughout the business cycle, including in securing financing and providing collateral; CFIB survey results indicated that 61% and 41% of respondents respectively faced those barriers in April 2010. As well, the CFIB's survey revealed that, when compared to requests for bank loans made by firms with more than 50 employees, there was a greater proportion of rejected loan requests from firms with fewer than five employees (25.3%) and from small businesses with more than five but fewer than 50 employees (16.5%). The CFIB also noted that new companies and service-oriented firms had particular difficulty in accessing credit, including firms in arts and recreation (33.3%), hospitality (24.7%), personal services (21.5%), transportation (23.4%) and retail (23.0%).

The Conference Board of Canada indicated that the BDC has a role to play, both when credit is relatively easy and when it is relatively difficult to access, with this role growing and shrinking throughout the business cycle. According to the Conference Board, there are market niches that the BDC can continue to serve throughout the business cycle, including those firms with inadequate information and those without a secure business model.

A different view was provided by Howell Pipe & Supply, a firm with approximately 50 employees. It told the Committee that the BDC's services were "cumbersome and expensive," and argued that the BDC impeded its ability to complete a particular project.

Professor Douglas Cumming, from York University's Schulich School of Business, stated that the federal government should have clear evidence of a credit gap before entering the financial sector. In his view, there is little evidence of a credit gap, although venture capital and nascent-stage entrepreneurs have difficulty accessing capital, especially those with insufficient collateral to obtain a loan from a chartered bank. Professor Cumming also noted that there is a role for government-funded institutions to support credit markets during a financial crisis or recession.

Witnesses also expressed concern about existing and/or potential overlaps among the mandates of federal financial institutions, notably Export Development Canada, the Business Development Bank of Canada and Farm Credit Canada.

In its submission to the Committee, EDC stated that the actual overlap between EDC and the BDC is minimal as a result of "collaboration and regular engagement" as well as of a two-way referral system when the request is made to the wrong institution. EDC informed us that, through this system, 165 transactions have been referred to the BDC by it while it has received 27 referrals from the BDC in the last 20 months. The organizations also work collaboratively, providing financing through *pari passu* lending, with equal participation from both institutions, and complementary lending, where each institution plays "different but parallel roles in the transaction. These approaches, along

with regular meetings and the sharing of market information, minimize overlap between EDC and the BDC.

Farm Credit Canada indicated, in its submission to the Committee, that the issue of mandate overlap among federal financial institutions is not new and was identified by the Standing Senate Committee on Banking, Trade and Commerce in its April 1996 report entitled *Crown Financial Institutions*. FCC stated: “Since then, the BDC and FCC have entered into formal and informal agreements” to minimize this overlap. Furthermore, in the view of FCC, it is not important to define, in statutes, the businesses that should fall within the mandate of each institution. FCC argued that observers should understand that overlap will occur, and that federal financial institutions should be permitted to resolve overlap issues through collaboration for the benefit of Canadian businesses.

Desjardins stated that the issue of overlap could be addressed through future merger of the BDC and EDC. Alternatively, it believed that one institution could focus on direct investments, probably the BDC, while the other could focus on providing loan guarantees, probably EDC.

The Conference Board of Canada told the Committee that a merger between the BDC and EDC would cost the federal government \$3 million because the BDC and EDC have different competencies. It characterized the BDC as principally a balance-sheet financier, while EDC was identified as, generally, a manager of offshore risk. The Conference Board admitted that some overlap is inevitable but can be addressed through a clear understanding of the primacy of each institution and of how conflict will be resolved. The Conference Board noted that overlap is good for Canada insofar as it “means we do not have gaps in the marketplace.”

The Canadian Chamber of Commerce felt that overlap between the BDC and EDC could be addressed through proper guidelines for each institution.

C. THE COMMITTEE’S VIEWS AND RECOMMENDATIONS

The Committee acknowledges that gaps exist in Canadian financial markets, and that some gaps have been – and can continue to be – addressed by the Business Development Bank of Canada. We believe that, to date, the BDC has succeeded in supporting Canada’s small and medium-sized businesses, including in instances where these businesses have not been able to access credit from other financial institutions. In this context, we feel that the BDC’s mandate should be amended to ensure a more explicit focus on meeting the needs of these businesses. Recognizing that small and medium-sized businesses are critically important engines of the nation’s economic growth and that support for them will have positive economic benefits for the nation, the Committee recommends that:

the federal government amend the *Business Development Bank of Canada Act* to ensure that the Business Development Bank of Canada's primary focus is assisting Canada's small and medium-sized businesses.

COMPLEMENTARITY

A. THE BUSINESS DEVELOPMENT BANK OF CANADA'S VIEWS

In its appearance before the Committee, the BDC requested that the *Business Development Bank of Canada Act* reconfirm the concept of complementarity when the BDC provides services, as indicated in section 14 of the Act. It told us that this complementarity involves assessing the needs of the entrepreneur and offering financing with terms and conditions that cannot be considered as competitive with commercial financial lenders. In assuming a higher level of risk than other financial institutions, the BDC sets its terms and conditions to account for this risk.

B. THE VIEWS OF OTHER WITNESSES

In general, the Committee's witnesses supported a continuing complementary role for the BDC in the financial services sector. Some sought limits on direct competition between the BDC and the private sector in respect of financing.

Canadian Manufacturers & Exporters recognized the complementary role played by both EDC and the BDC with respect to financing, noting that the BDC provides another option to companies that are unable to access financing from their primary financial institutions.

The Canadian Bankers Association also supported complementarity and partnerships between the BDC and private-sector financial institutions for three reasons: federal Crown agencies should be used as policy tools and should not replicate private-sector services; the BDC should make loans that could not, for reasons of prudence, be made by private-sector financial institutions; and federal Crown agencies should not use Crown-related borrowing cost advantages to compete with private-sector financial institutions. In the CBA's view, the BDC has occasionally "compet(ed) head-to-head with the private sector," a situation that the CBA opposes. The CBA requested that the role of the BDC be clearly defined and not shift over time.

The CBA also stated its view that the BDC should assist SMEs. As those SMEs grow and become large companies, they should seek private-sector sources of financing. This view was shared by the Conference Board of Canada, which stated that the BDC ought to work "as a partner or as a gap-filler" that serves small businesses. In supporting the BDC's complementary role, the Conference Board argued that the BDC "should not be in the business of matching private-sector financing."

Like the CBA, Credit Union Central of Canada (CUC) noted that, on occasion, the BDC has competed directly with its members. However, CUC stated that this competition has not appeared to "originate from ... BDC policy." Rather, CUC attributed the occasional competition between its members and the BDC as something that has

occurred temporarily at the local level, and not across the country. Generally, CUC supported the BDC's efforts, noting that – with the BDC's assistance and in partnership with the BDC – credit unions have been able to conduct transactions that otherwise would not have been possible. Furthermore, according to CUC, the BDC offers products and services that are not always offered by credit unions. An audit mechanism was requested by CUC to assure that the BDC is fulfilling its complementary mandate.

The Canadian Chamber of Commerce (CCC) voiced “considerable scepticism (about) the role of the government in the economy, especially where it finds itself in competition with Canadian business.” Furthermore, the CCC told the Committee that while it expected its members to resent the presence of the BDC in the financial services sector, it was surprised to find that its members, which include both banks and credit unions, were not resentful. The CCC stated that the BDC has “been shrewd enough in the way it approaches its relationships to be seen as a complement and a support rather than a competitor. That is to their credit, and ... the government should reward (the BDC) for that.”

While admitting the existence of limited evidence to support its claim, the Canadian Federation of Independent Business expressed concern that if the BDC remains a support to small businesses, interest rates for those firms would remain relatively high, since the BDC charges higher interest rates than private-sector financial institutions. The CFIB expressed its hope that lending by private-sector financial institutions will replace loans from the BDC as the Canadian economy recovers.

In its submission to the Committee, Wellington Financial said that it was not able to compete with the BDC as a result of the BDC's “pricing power.” Although the *Business Development Bank of Canada Act* states that the BDC must complement the private sector, Wellington Financial argued that the BDC does, in fact, compete with the private sector on a “deal-by-deal” basis. It also noted that when the BDC competes with the private sector, it takes financial resources away from those Canadian entrepreneurs who do not have access to private lending.

F. Lee Green asserted, in his written submission to the Committee, that the BDC should not compete with commercial lending institutions. In his view, for every loan proposal, the BDC should verify and provide proof that its financing services are complementary.

C. THE COMMITTEE'S VIEWS AND RECOMMENDATIONS

The Committee believes that the BDC's legislative mandate to provide services that are complementary to those provided by Canada's financial institutions has value. In essence, we feel that the BDC's role in filling gaps should be its *raison d'être*, and that continuous efforts should be made by the BDC and those financial institutions, and ongoing monitoring by the federal government should occur, with a view to ensuring continued complementarity. Believing that the BDC creates value for Canada and

Canadian businesses by providing financing in situations where financing would not otherwise be available, the Committee recommends that:

the federal government ensure that the Business Development Bank of Canada continues to provide financial services that are complementary to those provided by Canada's financial institutions.

FINANCIAL TOOLS

A. THE BUSINESS DEVELOPMENT BANK OF CANADA'S VIEWS

According to the BDC, it should be permitted to provide **financial tools** beyond those outlined in section 14 of the Act, the concept of the business being “in Canada” should be removed, and it should be permitted to finance through not-for-profit organizations and other entities. In its view, these changes would enable it to meet the needs of Canada’s businesses, including SMEs that are having difficulty in accessing indemnities and/or bonding services. It also proposed an ability to offer financial support for domestic infrastructure projects. Appendix A contains the specific amendments proposed by the BDC to section 14 of the Act and to section 16, which sets out the criteria for the acquisition of loans, to ensure consistency between the sections of the Act.

While the BDC did not wish to provide the Committee with a list of specific services that it hopes to provide, it mentioned that it would be interested in offering services such as securitization, indirect lending to clients through partnerships and trusts in order to facilitate and expedite lending, and bonding to SMEs.

In its presentation to the Committee, the BDC indicated that its support would remain focussed on financing commercial transactions. In particular, we were told that the BDC does not wish to offer retail banking services and is not seeking the power to offer:

- bank accounts;
- residential or non-commercial loans;
- term deposits or investment certificates;
- registered retirement savings plans;
- direct insurance; or
- investment counselling and portfolio management services.

Regarding its **paid-in capital limit**, the BDC – in its appearance before the Committee and in its submissions – proposed that this limit be removed or, alternatively, increased to \$6 billion, believing that this change would enable a timely response to a crisis situation requiring the resources of the BDC. In its view, the removal would also give the federal government more flexibility to use the BDC to address the needs of capital-intensive activities, such as infrastructure projects and the venture capital sector. According to the BDC, the major disadvantage associated with removal of the limit would be that Parliament would oversee investments in the BDC only during the annual review of the BDC’s Corporate Plan Summary or by special appearance before a parliamentary committee.

The BDC stated that there are sufficient controls in the system to safeguard any future investment by the federal government, and highlighted such controls as:

- the BDC's capital adequacy ratios;
- the capital-injection approval process, which includes the consent of the Ministers of Industry and Finance; and
- the BDC's approval process for its corporate plan.

The BDC's proposed changes to section 23 of the Act are outlined in Appendix A.

B. THE VIEWS OF OTHER WITNESSES

The Committee's witnesses had various views with respect to the BDC's request for expanded **financial tools**, such as securitization and indirect loans issued through a trust or another organization.

Farm Credit Canada supported the BDC's request for the ability to offer a broader array of financial and non-financial tools as well as the authority to make loans abroad.

Professor Douglas Cumming, of York University's Schulich School of Business, was somewhat concerned about the BDC's request to engage in securitization, noting that the BDC – in its appearance before the Committee – was not explicit in defining its exact goals. He highlighted the issues that have arisen in relation to securitization in recent years, particularly regarding securities issued by institutions without an appropriate governance structure. However, he also indicated that securitization can be beneficial if arranged and governed properly. Professor Cumming was less concerned about the implications of allowing the BDC to provide indemnities or bonding services.

The Canadian Bankers Association was also concerned about the BDC's request for additional financial tools, noting that the desired tools were not precisely defined by the BDC in its appearance before the Committee. It requested that the BDC provide more clarity in this regard. The CBA also highlighted the need for assurance that these proposed tools would not have any impact on the BDC's complementary role. It argued that bonding services are not unlike stand-by lines of credit, and suggested that if the BDC was permitted to provide bonding services, it could be competing with private-sector financial institutions in that market.

Desjardins was not opposed to allowing the BDC to indemnify loans, and the Canadian Chamber of Commerce was not opposed to allowing the BDC to provide bonding or indemnification services, noting that the BDC would probably not be a significant competitor in those markets. The CCC also stated that its members had not identified BDC indemnification or bonding services as potential problems.

The Conference Board of Canada argued that the BDC should retain the powers it was given by the federal government during the recent global financial and economic crisis so that they are available when needed.

Ogilvy & Ogilvy, an insurance brokerage that specializes in surety, supported a role for the BDC in providing bonding activities. It indicated that most public and private construction work requires surety bonding and that a more robust construction industry could be developed if the BDC assisted small Canadian contractors with bond applications.

The views of the Committee's witnesses on the removal of the **paid-in capital limit** were mixed, although most witnesses did not want the capital limit to impede the BDC's lending.

The Office of the Auditor General of Canada recognized that the BDC is relatively close to its current paid-in capital limit and that it can be time consuming to amend the *Business Development Bank of Canada Act*. Additionally, Canada's Venture Capital & Private Equity Association remarked that it did not want the BDC's lending to be constrained in a crisis or its capital limit to hinder the BDC's participation in venture capital markets; for this reason, it supported contemplation of an increase in, or removal of, the BDC's paid-in capital limit.

The Conference Board of Canada supported the BDC's request to remove the paid-in capital limit and argued that, given the BDC's regular reporting, high degree of transparency and ability to pay dividends, the capital limit could be removed. Alternatively, it proposed that, should Parliament wish to retain a limit, it could be set at a very high level.

In contrast, and recognizing the importance of controls and risk limits, the Canadian Bankers Association felt that the paid-in capital limit should remain, and that Parliament should debate further increases to that limit. The Canadian Chamber of Commerce argued that some limit for the BDC's paid-in capital is important; however, it did not indicate what that limit should be.

The Canadian Federation of Independent Business shared the Canadian Bankers Association's and the Canadian Chamber of Commerce's view about the need for a limit, and advocated retention of the current limit in order to protect taxpayer's from potential losses. Additionally, the CFIB was concerned that, if the ceiling was removed, the BDC would not continue in its complementary role and could become a competitor. The CFIB also supported the retention of the capital limit as a method to constrain the BDC's growth.

C. THE COMMITTEE'S VIEWS AND RECOMMENDATIONS

As noted earlier, the Committee believes that the BDC's primary focus should be Canada's small and medium-sized businesses. In our view, the BDC would be able to

assist them better if it had greater flexibility in the financial tools that it could use. From that perspective, the Committee recommends that:

the federal government, following consultations with the Business Development Bank of Canada, amend the *Business Development Bank of Canada Act* to provide the Business Development Bank with the additional tools it needs to assist Canada's small and medium-sized businesses. The tools should include guarantees, indemnification and bonding.

The Committee is aware that, during the recent global financial and economic crisis when the federal government desired a broadened mandate for the BDC, Parliament acted expeditiously to ensure that the needed statutory changes were made. We also recognize that the BDC is close to reaching its current paid-in capital limit of \$3 billion, and that the BDC is subject to a variety of financial safeguards, such as leverage and capital-adequacy ratios as well as the Minister of Finance's control over capital injections into the Bank, as set out in the *Business Development Bank of Canada Act*. In our view, there must be a limit on the BDC's paid-in capital limit, in the same way that a limit exists for Canada's other federal financial Crown corporations. As well, we believe that a parliamentary role regarding the BDC's financing is both appropriate and important. Nevertheless, we feel that an increase in the paid-in capital limit is warranted, particularly since the current limit is very close to being reached. For these reasons, the Committee recommends that:

the federal government amend the *Business Development Bank of Canada Act* to increase the paid-in capital limit to \$6 billion, provided that the Ministers of Finance and Industry believe that this increase is required in order to assist the Business Development Bank of Canada in meeting the needs of Canada's small and medium-sized businesses.

NON-FINANCIAL TOOLS

A. THE BUSINESS DEVELOPMENT BANK OF CANADA'S VIEWS

According to the BDC, difficulties encountered by SMEs and entrepreneurs when seeking consulting services include the cost of these services, difficulty in choosing a consultant with the appropriate expertise and receiving unbiased advice that provides value. It told the Committee that it receives \$10,000 for its average consulting agreement with businesses, which is relatively more affordable than private consultants and accounting firms. The BDC's account managers meet with businesses to discuss their business plan and/or to introduce consultants with appropriate expertise.

The BDC informed the Committee that the list of management services described in section 17 of the *Business Development Bank of Canada Act* is too restrictive and prevents it from providing services to groups and informing entrepreneurs on information and communications technology. The BDC told us that it would like to expand its business support services to include a range of technical, advisory and financial services, and proposed the amendments to section 17 that are found in Appendix A.

B. THE VIEWS OF OTHER WITNESSES

The Committee's witnesses were generally supportive of the BDC's consulting services, and commented that those services do not compete with those provided by the private sector. For example, Desjardins, which provides consulting among other services, noted that it typically competes with "boutique" professional consulting firms and accounting companies. It told us that some businesses use the BDC strictly for its consulting services, and not for financing, because of the reasonable cost and independence of these services.

Moreover, the Canadian Chamber of Commerce stated that its members have found the BDC's consulting services to be useful, and that none of its members, consulting firms or otherwise, have had difficulties with the BDC's provision of these services. It also noted that it was not aware of any vigorous competition between the BDC and private-sector consulting services.

From its perspective, the Office of the Auditor General of Canada (OAG) suggested that the BDC needs more comprehensive indicators to measure the performance of its consulting services. According to the OAG, client satisfaction and retention do not provide an adequate assessment of the validity of this service. It was unclear to the OAG whether the BDC's consulting services create value for, or improve the long-term performance of, the BDC's clients.

Canadian Manufacturers & Exporters argued that the BDC should be permitted to provide a broader array of services, including the ability to establish consortia of companies to match supply chain opportunities both in Canada and abroad.

For its part, the Conference Board of Canada requested an assurance that the BDC's advisory and business services would remain complementary and would not compete directly with similar private-sector services.

The Canadian Federation of Independent Business echoed this view, stating that it believed that existing competition with private-sector consulting services was already unfair. Consequently, it could not support a broadened BDC mandate in this regard. It suggested that consultations should be undertaken to assure that the BDC does not offer services already available from the private sector.

Professor Douglas Cumming, of York University's Schulich School of Business, generally supported allowing the BDC to provide more and different types of advice, noting that "the advice given (by the BDC) is more important than the capital (it provides)."

C. THE COMMITTEE'S VIEWS AND RECOMMENDATIONS

The Committee acknowledges that the BDC is restricted, by legislation, in the types of non-financial tools it can offer to its clients. We are hesitant, however, to allow the BDC to provide tools that we feel might compromise what we believe should be its primary focus: providing financial support to Canada's small and medium-sized businesses. Furthermore, as a general approach, we are opposed to the practice of tied selling, and have some concern that – even in the absence of the ability to provide additional non-financial tools – pressure might exist for businesses to access BDC's non-financial services, such as consulting, as a precondition to receiving its financial services. For these reasons, the Committee recommends that:

the federal government, following consultations with the Business Development Bank of Canada, amend the *Business Development Bank of Canada Act* to provide the Business Development Bank with the non-financial tools it needs to assist Canada's small and medium-sized businesses. These tools should include a range of business support services.

The government should also take the actions needed to ensure that the Business Development Bank of Canada does not engage in activities that could be characterized as tied selling.

EXPANSION BEYOND THE DOMESTIC MARKET

A. THE BUSINESS DEVELOPMENT BANK OF CANADA'S VIEWS

As noted earlier, sections 4 and 14 of the *Business Development Bank of Canada Act* require the BDC to support Canadian entrepreneurship and individuals who are engaged, or who are about to engage, in an business in Canada. The BDC remarked to the Committee that these sections are too restrictive. In particular, the BDC argued that it needs to be able to provide financial support to SMEs that wish to expand beyond the limited domestic market as these businesses seek to invest outside Canada in order to:

- protect their competitive position by acquiring competitors and establishing joint ventures;
- allow co-location with suppliers in other countries or risk losing their positions in the supply chains and perhaps their domestic relationships; and
- access new technologies and new markets with millions of potential customers.

In respect of foreign corporations that wish to establish a subsidiary in Canada, the BDC noted that the Act restricts BDC support of such entities. The BDC told the Committee that further analysis must be done of the subsidiary's management in Canada and the extent to which decision making is done in Canada before lending can be considered. In the BDC's view, these types of foreign investments benefit Canada through job opportunities as well as access to new technology and foreign networks. The BDC stated that these types of investments strengthen Canadian firms, resulting in larger domestic head offices with more research and development, information technology, and sales and marketing positions. The BDC also believed that providing financing to a Canadian subsidiary outside of Canada would prevent the Canadian head office from becoming over-leveraged by allowing the subsidiary, rather than the head office, to incur the debt.

The BDC's proposed changes to sections 4 and 14 of the *Business Development Bank of Canada Act* are outlined in Appendix A.

B. THE VIEWS OF OTHER WITNESSES

In general, the Committee's witnesses supported the BDC's request to finance the foreign expansion of Canadian SMEs.

The Canadian Bankers Association wondered whether the ability of the BDC to provide services to businesses operating abroad would duplicate activities currently undertaken by EDC. Furthermore, it was concerned that the BDC's expansion abroad could lead to increased competition between the BDC and private-sector financial institutions, with an impact on the requirement for the BDC to provide a complementary service.

The Conference Board of Canada noted that EDC cannot currently finance foreign investments made by Canadian SMEs; EDC does provide financing for receivables and political risk, but typically does not play the role of “balance sheet financier.” The Conference Board also recognized that if Canadian businesses want to grow, they must consider foreign expansion. From this perspective, it supported the BDC’s request to be permitted to support and finance Canadian businesses abroad.

This view was supported by Canada’s Venture Capital & Private Equity Association (CVCA), which noted that venture capital companies are not only major employment and research creators, but also more internationally oriented than the average Canadian SME. CVCA recognized that venture capital companies need to be the best in the world, not simply the best in Canada. Therefore, CVCA supported the BDC’s request to finance foreign investments made by Canada’s SMEs.

These views were shared by Professor Douglas Cumming, of York University’s Schulich School of Business, who remarked that the marketplace is global and that successful businesses need to expand abroad. According to him, the BDC should be allowed to support that expansion.

Canadian Manufacturers & Exporters noted that its members cannot move forward and support domestic employment without expanding to the “United States, Asia, Europe and all over the world.” In its opinion, many companies would not have survived without expanding abroad and retaining the high-value-added activity in Canada. According to CME, the same can be said for SMEs with fewer employees; should SMEs choose to expand abroad, they will require financial services to realize that objective successfully.

Desjardins supported the BDC’s request to finance foreign direct investment by Canadian SMEs, and said that a number of businesses with revenue of \$2 million or \$3 million are now exporting. It argued that those businesses are not firmly established and need support to expand abroad. According to Desjardins, once a business moves into the range of \$15 million to \$20 million in annual revenue, it can access private-sector sources of financing exclusively. It also noted that should the BDC receive additional powers, it would be important to clarify the role of EDC and the BDC in Canada and abroad in order to minimize duplication and cost.

The Small and Medium-sized Enterprises Advisory Board of the Department of Foreign Affairs and International Trade (DFAIT) indicated that it also supports the BDC’s request to support entrepreneurs who wish to enter foreign markets. The Board’s main concerns were that the BDC not compete with the private lending sector and that any BDC activity in foreign markets be in collaboration with EDC and DFAIT.

In its written submission to the Committee, the Heiltsuk Economic Development Corporation suggested that the BDC should focus its activities on the development of

businesses in Canada and, in particular, provide assistance for the financial needs of Canadian Aboriginal businesses.

C. THE COMMITTEE'S THOUGHTS AND RECOMMENDATIONS

The Committee is aware that Canada is a small, open, trade-dependent country, and that the nation benefits when businesses are able to operate in foreign markets. In our view, our small and medium-sized businesses may be in particular need of financial and other assistance as they seek to expand beyond the domestic market. In this context, we believe that the BDC's focus should be supporting Canada's small and medium-sized businesses in their domestic and international operations, but in a way that is complementary to any current or future activities of Export Development Canada. That being said, we feel that support for foreign endeavours should not compromise the nature or extent to which the BDC is able to assist small and medium-sized businesses operating in Canada, and hope that this support results in net gains in employment in Canada. Consequently, the Committee recommends that:

the federal government amend the *Business Development Bank of Canada Act* to permit the Business Development Bank of Canada to assist the nation's small and medium-sized businesses in their foreign operations. This assistance should be complementary to any assistance provided by Export Development Canada.

Moreover, the government should develop mechanisms to ensure that this support for foreign operations does not compromise the support that the Business Development Bank provides to Canada's small and medium-sized businesses operating domestically.

GOVERNANCE STRUCTURE

A. THE BUSINESS DEVELOPMENT BANK OF CANADA'S VIEWS

During its appearance before the Committee, the BDC proposed several changes to the governance provisions of the *Business Development Bank of Canada Act* that it believes would modernize the Act and provide board committees with some decision-making power. In its opinion, this practice is widely adopted in commercial banks and other publicly listed corporations, but board members would remain accountable for the manner in which duties are carried out and powers exercised. The changes proposed by the BDC would:

- add a requirement for directors to be financially literate (section 5);
- remove term limits for directors and add the requirement that the Board of Directors be consulted about the appointment of directors and have the right to recommend candidates for the position of director to the designated minister (section 6);
- allow the Board of Directors to manage or supervise the management of the BDC, to establish any committee and not solely an Executive Committee, and to delegate its powers to as well as define the duties and authority of its committees (section 7);
- increase the time period during which an acting President may act from 90 to 120 days (section 9);
- allow the Board of Directors to delegate power and duties to any officer, employee or agent of the Bank on matters not specifically reserved for the Board or one of its committees (section 11);
- require that the oath of office that directors, officers and employees must take should be at the request of the BDC such that there is no breach of the Act if this task is inadvertently not done (section 12);
- change the restriction preventing the BDC from providing a loan, investment or guarantee to a director or officer of the BDC to one that would require disclosure of a conflict of interest in the annual report (section 32); and
- remove the disclosure requirements for applicants to the BDC who may have a conflict of interest (section 33).

Appendix A contains the BDC's proposed amendments to the Act in relation to its governance structure.

B. THE VIEWS OF OTHER WITNESSES

The BDC's governance structure was not a significant concern for the Committee's witnesses. That being said, Professor Douglas Cumming, of York University's Schulich School of Business, could see no reason not to support the BDC's request for an amended governance structure. The Office of the Auditor General of Canada recognized that the board of directors of many institutions can delegate authority to a particular committee, and told us that the governance amendments proposed by the BDC would modernize the *Business Development Bank of Canada Act*; it expressed no view about whether that modernization should occur.

C. THE COMMITTEE'S VIEWS AND RECOMMENDATIONS

The Committee is familiar with issues of corporate governance, having examined – and reported on – corporate governance during hearings that led to the following reports: *Corporate Governance* in 1996, *The Governance Practices of Institutional Investors* in 1998; and *Navigating through “The Perfect Storm”: Safeguards to Restore Investor Confidence* in 2003. We also examined corporate governance issues in 2001 when we studied amendments to the *Canada Business Corporations Act*.

Similarly, the Committee has previously shared its views on financial literacy issues. Our concerns exist not only in relation to Canadians generally, as we described in our 2006 report, *Consumer Protection in the Financial Services Sector: The Unfinished Agenda* and in our October 2010 report, *Canadians Saving for their Future: A Secure Retirement*, but also in relation to corporate executives and members of boards of directors.

The Committee believes that board members should serve for fixed terms of a reasonable length, that the ability to reappoint individuals for a limited number of terms should exist, and that terms should be staggered in order to ensure needed continuity. Moreover, while we support committees, and recognize the valuable work they do and the benefits of the expertise of committee members, we are firmly of the view that the Board of Directors must, in all cases, be responsible, including for decisions made by committees created by it.

On the issue of confidentiality, the Committee feels that an oath must be mandatory for directors and officers of an organization; greater flexibility is, however, probably not harmful in respect of agents, advisors and consultants that organizations may hire.

Finally, the Committee is opposed to actions that would lead to real or perceived conflicts of interest, as has been noted in a number of our earlier reports, including *Corporate Governance* in 1996 and *Navigating through “The Perfect Storm”: Safeguards to Restore Investor Confidence* in 2003. We hold these views about financial literacy, terms of service and renewals, committees and responsibility for their decisions,

confidentiality, and real and perceived conflicts of interest generally and with respect to federal entities, including the BDC. Consequently, the Committee recommends that:

the federal government ensure that the *Business Development Bank of Canada Act*:

- **requires all members of the Board of Directors of the Business Development Bank of Canada to be financially literate;**
- **permits members of the Board of Directors to serve for staggered four-year terms;**
- **requires directors and officers of the Business Development Bank of Canada to take an oath of confidentiality;**
- **does not permit situations that could give rise to real or perceived conflicts of interest.**

Moreover, the government should ensure that the Act permits the Board of Directors to establish committees, bearing in mind the Board's ultimate responsibility for all decisions. It should also permit the Business Development Bank of Canada to require agents, advisors and consultants to take an oath of confidentiality, if appropriate.

FINANCIAL SUSTAINABILITY, OTHER FINANCIAL ISSUES AND REVIEW

A. THE BUSINESS DEVELOPMENT BANK OF CANADA'S VIEWS

In its appearance before the Committee, the BDC requested that the *Business Development Bank of Canada Act* be amended to impose a statutory obligation for the BDC to be financially sustainable; this requirement is currently set out in the Treasury Board of Canada's guidelines. These guidelines require the BDC to be financially sustainable and to have a return on equity that exceeds its cost of capital.

Appendix A contains the changes proposed by the BDC, which would involve the creation of a new section and changes to section 21 for consistency.

B. THE VIEWS OF OTHER WITNESSES

The Committee's witnesses recognized that the BDC's mandate requires it both to be profitable and fulfill certain public policy objectives.

After acknowledging that the BDC is profitable, the Office of the Auditor General of Canada recognized that, as a federal Crown corporation, the BDC has – as is appropriate – begun to articulate its public policy objectives more clearly, rather than behaving like a private-sector financial institution. It also noted that, in the past, it had criticized the BDC for not sufficiently articulating its public policy role.

Canadian Manufacturers & Exporters argued that the BDC should break even and that Canadian taxpayers should not subsidize BDC's lending. According to CME, the BDC should focus on filling financial market gaps, such as venture capital, and should make riskier loans than private-sector financial institutions are willing to make. Furthermore, it argued that the BDC's role is a delicate balance, but that the organization has maintained this balance effectively for the last ten years.

The Canadian Bankers Association noted that the BDC should not behave in the same manner as a private-sector financial institution, generating profits by borrowing at a low interest rate and competing directly with the private sector. In the CBA's view, the BDC needs to take risks and increase the financial system's capacity through its complementary role.

The Conference Board of Canada argued that the BDC should generate a return on investment that is at least as high as the yield on long-term federal bonds. The Conference Board stated that if the BDC's focus was on profit margins, the BDC would lose its value by no longer financing projects that were not "fully creditworthy" according to private-sector lending criteria.

This view was shared by Desjardins, which stated that if the pressure for the BDC to make dividend payments to its sole shareholder – the federal government – became too strong, the BDC could begin competing directly with financial institutions; this approach would be inconsistent with its statutory complementary role.

Finally, rather than a ten-year legislative review, Desjardins supported the possibility of conducting a review of the *Business Development Bank of Canada Act* every five years.

C. THE COMMITTEE'S VIEWS AND RECOMMENDATIONS

The Committee recognizes that, to date, the BDC has been a financially sustainable corporation. We believe that continued financial sustainability is a desirable, and appropriate, goal. Moreover, we feel that such a goal should be legislative, rather than occur consistent with a Treasury Board of Canada guideline. From this perspective, the Committee recommends that:

the federal government amend the *Business Development Bank of Canada Act* to require financial sustainability by the Business Development Bank of Canada.

The Committee is aware that, from time to time, the federal government may want the Business Development Bank of Canada to undertake special roles, such as that which occurred with the Canadian Secured Credit Facility and the Business Credit Availability Program during the recent global financial and economic crisis. That being said, and as noted earlier, we believe that Parliament should play a role in relation to the BDC's financing as well as its operations. From that perspective, we feel that financial matters in relation to the BDC should be subject to ongoing parliamentary oversight as its needs, and as changes to its mandate, evolve. Consequently, the Committee recommends that:

the federal government ensure that all changes to the Business Development Bank of Canada's mandate, financing and similar matters are reviewed by Parliament.

In the Committee's view, the ten-year review required by the *Business Development Bank of Canada Act* and the five-year review undertaken by the Office of the Auditor General of Canada are not sufficient. Regarding the statutory review, we feel that a five-year review would be more appropriate, particularly given the rapidly changing global marketplace and – consequently – needs of Canada's small and medium-sized businesses. For these reasons, the Committee recommends that:

the federal government amend the *Business Development Bank of Canada Act* to require a statutory five-year review of the operations of the Business Development Bank of Canada.

LENDING THROUGH A TRUST OR ANOTHER INSTITUTION

A. THE BUSINESS DEVELOPMENT BANK OF CANADA'S VIEWS

The BDC requested that it be permitted to provide financial support to Canadian entrepreneurs through such means as a trust or partnership with another institution, such as the Canadian Youth Business Foundation. The changes proposed by the BDC to sections 4 and 14 of the Act are included in Appendix A.

B. THE VIEWS OF OTHER WITNESSES

In general, the Committee's witnesses supported an ability for the BDC to conduct lending in partnership with another institution.

The Atlantic Association of Community Business Development Corporations supported the BDC's request to be able to provide loans to SMEs through trusts or partnerships with other entities. It argued that such a change would help it to build capacity and would give the BDC greater leverage in its lending.

Similarly, in their submissions to the Committee, the Canadian Youth Business Foundation (CYBF) and Community Futures Network of Canada (CF) supported such a change. According to the CYBF, with this amendment, the BDC could make "a direct financial infusion into CYBF's start-up capital," and more young entrepreneurs would be assisted. The CF also indicated that funding from the BDC would increase its capacity and facilitate lending to rural entrepreneurs.

As well, the Canadian Federation of Independent Business recognized that collaboration between the BDC and organizations such as the Canada Youth Business Foundation could eliminate duplication and administrative expenses.

Professor Douglas Cumming, of York University's Schulich School of Business, argued that allowing the BDC to lend through such organizations as the Canadian Youth Business Foundation and other not-for-profit institutions would be a role that would be easier to defend than allowing the BDC to engage in securitization and indemnification.

C. THE COMMITTEE'S VIEWS AND RECOMMENDATIONS

The Committee is of the view that the BDC should be permitted to provide loans to small trusts, not-for-profit organizations or similar entities that would then support Canada's small and medium-sized businesses. We believe that, through such collaborations, the BDC could provide better support to Canadian entrepreneurs in some sectors. In our opinion, the result would be beneficial for the BDC, which would be fulfilling its mandate, for the organizations with which the BDC partners, since they could experience reduced administrative expenses and enhanced access to expertise, and

for the parties who are assisted by the collaborative work of the BDC and the trust, not-for-profit organization or other entity, as the case may be. Consequently, the Committee recommends that:

the federal government amend the *Business Development Bank of Canada Act* in order to permit the Business Development Bank of Canada to provide loans to small trusts, not-for-profit organizations and similar entities that provide financing directly to small and medium-sized businesses in Canada.

VENTURE CAPITAL

A. THE BUSINESS DEVELOPMENT BANK OF CANADA'S VIEWS

According to the BDC, the Canadian venture capital market is characterized by low funding, an end to most provincial labour-sponsored investment funds, a shortage of Canadian entrepreneurs, a low level of commercialization activities, a shortage of angel investors, undercapitalized syndicates, gaps in early-stage and late-stage financing, a withdrawal of fund investors due to relatively poor returns and few initial public offerings, among other considerations.

Since 2000, the BDC has invested \$1.2 billion in 450 high-technology companies and \$330 million in 23 private-sector venture capital funds. The BDC told the Committee that the venture capital industry has not been profitable, and that its venture capital activities have lost \$20 million to \$100 million in each of the past five years. According to the BDC, the relatively poor return on investment is due to venture capital funds being managed by inexperienced general partners with few international connections.

B. THE VIEWS OF OTHER WITNESSES

In the view of the Committee's witnesses, the BDC has made a critical contribution to venture capital financing in Canada.

According to Canada's Venture Capital & Private Equity Association, the Canadian venture capital sector is in crisis: currently, venture capital in Canada is at a 14-year low with \$18 billion invested in venture capital in the United States in 2009, and \$1 billion invested in Canada. CVCA told the Committee that, according to the World Economic Forum, in 2009-2010, Canada was 18th in the world on the "venture capital availability" ranking; total investments in venture capital in Canada declined from about \$5.9 billion in 2000 to about \$1 billion in 2009. CVCA indicated that the BDC is also a key syndicate partner in many venture capital deals, and that these "deals ... might not have happened without the presence of (the) BDC."

Canadian Manufacturers & Exporters recognized that the BDC plays an important role as a supplier of venture capital financing, thereby reducing the shortage that exists, while the Canadian Bankers Association noted that venture capital is crucial but may not fall within the role or risk-management limits of commercial banks. The CBA identified the shortage of venture capital financing as a significant concern, and acknowledged that the BDC has a role to play in meeting the need for this type of financing.

For its part, the Canadian Federation of Independent Business argued that the federal government should create conditions favourable to the emergence of venture capital in Canada, rather than have government entities, such as the BDC, finance venture capital.

In its submission to the Committee, Wellington Financial indicated that the BDC's commitment to venture capital funding is lower in 2010 than it was in 2009, and that the BDC is demonstrating a more conservative approach to higher-risk financing, such as venture capital.

C. THE COMMITTEE'S VIEWS AND RECOMMENDATIONS

In the Committee's view, venture capital funding is critically important if Canada wants to continue to grow, innovate and enhance its international presence. We recognize the shortage of such funding in Canada, as well as the losses associated with the Business Development Bank of Canada's venture capital activities. Despite those losses, we feel that the BDC plays a valuable role in providing venture capital funding, thereby making a positive contribution to the nation's future prosperity. As a result, the Committee recommends that:

the federal government ensure that venture capital activities are an important focus for the Business Development Bank of Canada.

CHAPTER 4: CONCLUSION

The Committee believes that the Business Development Bank of Canada continues to play a significant role in assisting Canada's entrepreneurs, particularly the nation's small and medium-sized businesses, and that it was an important vehicle in helping the nation address the recent global financial and economic crisis. For the future, we envision a continued role for a modernized and financially sustainable BDC that is more focused on meeting the domestic and international needs of the nation's small and medium-sized businesses, which are the engines of the country's growth.

To that end, this report contains recommendations in a number of key areas in relation to the BDC: its purpose, the principle of complementarity, the financial and non-financial tools available to it to achieve its purpose, a limited international focus, a modernized governance structure, financial sustainability and statutory review requirements, loans through some other entities and a venture capital role. The Committee believes that implementation of these recommendations would enable the BDC to meet the needs of Canada's small and medium-sized businesses in a more comprehensive manner, with benefits for the businesses and the nation. We look forward to a review of any statutory amendments proposed by the federal government, and encourage the inclusion of our recommendations in any proposals for legislative change.

**APPENDIX A: AMENDMENTS PROPOSED BY THE BUSINESS
DEVELOPMENT BANK OF CANADA**

SECTION 4: PURPOSE

4. (1) The purpose of the Bank is to foster entrepreneurship by providing direct and indirect support to enterprises in order to promote the economic development of Canada.

**SECTIONS 14, 16 AND 23: FINANCIAL TOOLS, INCLUDING PAID-IN
CAPITAL**

14. (1) The Bank may provide financial support to or in relation to any person, including by

(a) making loans to, investments in, or giving guarantees or indemnities to, or in relation to, any person;

(b) acquiring, disposing, leasing or otherwise dealing with any interest in or any property of any person;

(c) entering into any arrangement for the purpose of extending credit, providing undertaking to pay money or otherwise providing liquidity to any person, including through repurchase agreements and securities lending arrangements; and

(d) acting as agent in respect of such support.

(2) The financial support described in subsection (1) may be provided by the Bank on a stand-alone basis, through arrangements with other persons, or as a member of a group.

(3) The financial support described in subsection (1) may be provided only where, in the opinion of the Board or any committee or officer designated by the Board, the person to, or in relation to whom support is to be provided is engaged, or is about to engage, in an enterprise which may reasonably be expected to prove successful.

(4) The financial support described in subsection (1) is to fill out or complete services available from commercial financial institutions.

16. Without limiting the scope of section 14, the Bank may acquire and deal with as its own any loan, investment, guarantee, indemnity, interest, arrangement or other property, made, given, acquired or entered into by another person if

(a) it is part of a block of loans, investments, guarantees, indemnities, interests, arrangements or other property, a majority of which meet the eligibility criteria set forth in subsection 14(3); or

b) the investment criteria followed by such other person in respect of those loans, investments, guarantees, interests, arrangement or other property are, in the opinion of the Board or of any committee or officer designated by the Board, at least equivalent to those set forth in subsection 14(3).

23. (1) *The authorized capital of the Bank consists of an unlimited number of common shares with a par value of \$100 each and an unlimited number of preferred shares without par value.*

SECTION 17: NON-FINANCIAL TOOLS

17. (1) The Bank may provide, or enter into agreements for the provision of business support, including

(a) consulting services;

(b) counselling, mentoring and training;

(c) referral, network and advisory services;

(d) sourcing and pooling services; and

(e) research and information.

(2) The Bank may provide such other services as are ancillary or incidental to any support described in subsection (1).

(3) The Bank may act as agent or intermediary in respect of business support activities.

SECTIONS 5, 6 7, 9, 11, 12, 32 AND 33: GOVERNANCE

5. (3) All directors shall be financially literate and the Chairperson shall have relevant financial experience.

6. (4) The other directors are to be appointed by the Designated Minister, after consultation with the Chairperson and with the approval of the Governor in

Council. The Chairperson may, from time to time, suggest candidate directors to the Designated Minister.

6. (5) Directors are to be appointed for a term not exceeding four years that will ensure, as far as possible, the expiration in any one year of the terms of office of not more than a third of the directors.

7. (1) The Board shall manage or supervise the management of the business and affairs of the Bank.

7. (3) The Board may establish any committee or advisory group that the Board considers advisable, and determine its composition and duties and the tenure of its members.

7. (4) The Board may delegate power to, and specify the duties and authority of, any of its committees to act in all matters that are not by this Act or any by-law or resolution specifically reserved to be done by the Board.

9. (1) The President is the chief executive officer of the Bank and has, on behalf of the Board, the direction and management of the business and affairs of the Bank with authority to act in all matters that are not by this Act or any by-law or resolution specifically reserved to be done by the Board or one of its committees.

(2) If the President is absent or unable to act, or if the office of President is vacant, the Board may authorize an officer or employee of the Bank to act as President, but that person may not act as President for a period of more than one hundred and twenty days without the approval of the Governor in Council.

11. The Board may delegate power to, and specify the duties and authority of, any officer, employee or agent of the Bank to act in all matters that are not by this Act or any by-law or resolution specifically reserved to be done by the Board or one of its committees.

12. All directors, officers and employees of the Bank, and all agents, advisers and consultants whose services are engaged by the Bank, must, before entering on their duties, if requested by the Bank, take an oath or make a solemn affirmation of office and confidentiality in the form set out in the schedule before a commissioner of oaths or other person having authority to administer the oath or solemn affirmation in the place where it is taken or made.

32. The amount of any contract entered into between the Bank and one of its directors, officers or any person for whom disclosure of interest would be required under section 116 of the Financial Administration Act, and the name of any such director, officer or other person must be included in the annual report that the Bank is required to submit under subsection 150(1) of the Financial Administration Act.

NEW SECTION 4.1 AND SECTION 21: FINANCIAL SUSTAINABILITY

4.1 The Bank must remain financially sustainable in the long term.

21. (1) The Bank may carry out duties or functions that may be assigned to it by the Designated Minister in relation to the administration of any program supporting enterprises and enter into any transaction or class of transactions in connection with such program, to the extent that it is reasonable, in the opinion of the Board, that the Bank will not suffer any significant loss in carrying out such duties or functions or in respect of any such transaction or class of transactions.

(2) Where the Bank advises the Designated Minister that it cannot administer a program or enter into a transaction or class of transactions, pursuant to the provisions of subsection (1), and the Designated Minister is of the opinion that it is in the national interest that the Bank administers a program or enters into a transaction or class of transactions, the Designated Minister, with the concurrence of the Minister of Finance, may authorize the Bank to do so, to the extent that the Bank is kept whole of the losses which the Bank may suffer in respect of such program, transaction or class of transactions.

APPENDIX B: WITNESSES

Date appeared	Name of organization	Name of presenter(s)
October 20, 2010	Business Development Bank of Canada	Jean-René Halde /Brian Hayward
October 21, 2010	Office of the Auditor General of Canada	Sheila Fraser/Nancy Cheng
October 21, 2010	Raymond Chabot Grant Thornton	Louise de Martigny/G�rard Daly (no brief submitted)
October 21, 2010	Canadian Manufacturers & Exporters	Jean-Michel Laurin
October 28, 2010	Canadian Bankers Association	Terry Campbell/Marion Wrobel
October 28, 2010	Credit Union Central of Canada	Robert Martin/Marc-Andr� Pigeon
November 3, 2010	The Conference Board of Canada	Glen Hodgson (no brief submitted)
November 3, 2010	Desjardins	St�phane Achard/Bernard Brun
November 3, 2010	Canadian Chamber of Commerce	Warren Everson
November 3, 2010	Canadian Federation of Independent Business	Corinne Pohlmann
November 4, 2010	York University – Schulich School of Business	Professor Douglas Cumming (no brief submitted)
November 4, 2010	Canada’s Venture Capital & Equity Association	Greg Smith/Richard M. R�millard

APPENDIX C: BRIEFS WITHOUT THE AUTHOR'S APPEARANCE

Name of organization	Name	Date brief was received and distributed to members
As an individual	Lee Green	November 2010
Atlantic Association of CBDCs	Basil Ryan	October 2010
Canadian Youth Business	Vivian Prokop	November 2010
Community Futures Network of Canada	Joe Brennan	November 2010
Department of Foreign Affairs and International Trade, Small and Medium-sized Advisory Board	Murad Al-Katib	November 2010
Export Development Canada	Rose-Marie Boyle	November 2010
Farm Credit Canada	Greg Willner	November 2010
Heiltsuk Economic Development Corporation	J. A. Richardson	November 2010
Howell Pipe and Supply	Duncan Stacey	November 2010
Ogilvy & Ogilvy	Bruce Ogilvy/David W. Ogilvy	November 2010
Wellington Financial	Marc McQueen	November 2010