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In Union is Strength

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Comments by the National Farmers Union

Regarding: Regulations Amending the Canada Grain Regulations Canada Gazette, Part Ⅰ Vol. 147, No. 40 — October 5, 2013

The National Farmers Union (NFU) welcomes the opportunity to comment on the proposed regulations amending the Canada Grain Regulations with regard to adoption of an insurance-based producer payment protection model in the Canadian Grain Commission's Licensing Program.

The regulatory impact analysis provided on the Canada Gazette Part I is unduly narrow, focusing on only a select few of the effects on licensed grain companies that would result from a shift from bond-based security to an insurance system. The analysis fails to examine the impacts on farmers and the effects of the proposed change on broader public interests. When the proposed changes are examined in this broader context, it is clear that an insurance-based producer payment security system will benefit a few large companies at the expense of farmers, some smaller licensed grain companies, Canadian financial institutions and Canadian regulatory authority over grain transactions. While the federal government's regulatory change analysis attempts to frame the proposed regulation as a simple housekeeping type of measure, in fact, if adopted, it would have significant, long-term economic and governance implications.

Currently, the CGC licenses companies and requires them to hold a bond or other security with bonding companies approved by the Treasury Board of Canada. The amount of security required is set by the CGC and adjusted as necessary based on mandatory monthly reporting of outstanding liabilities (payments owing on grain received) of the companies. In the event a licensed company refuses to pay, becomes insolvent or closes without paying for grain it has received, the CGC uses the security to pay farmers what they are owed.

In the 2012 Budget Implementation Act, the Canada Grain Act was amended to allow regulations to establish an insurance-based system to replace the long-standing bond security system. The proposed regulations are the means to implement this change.

Briefly, the new insurance-based system would eliminate the requirement for licensed grain companies to hold bond security. Instead, they would be required to take out credit insurance. The CGC has engaged a single company to provide insurance for all licensees. Licensed companies will no longer be required to report their obligations for payment and security position to the CGC. Under the proposed new system, farmers will be able to make a claim if they do not get paid, but they must submit their claim within specified time limits, and the maximum payout will be reduced to 95% of what they are owed.

Effects on Farmers

Currently the CGC allows a farmer to submit a claim for non-payment within 90 days following delivery or 30 days after receiving a cash purchase ticket or cheque, whichever is less. The new system will require the farmer to submit a claim for non-payment within 45 days of getting an elevator receipt or grain or attempting to cash a cash purchase ticket, or within 75 days of delivery if the grain receipt was exchanged for a cash purchase ticket. Once he or she receives the claim form, the farmer has 30 days to complete and return it.

If a payout is necessary, a farmer will receive only 95% of what he or she is owed. Under the bond/security system, there have been very few failures to pay and in most cases bond security has been sufficient to cover 100% payouts. The bankruptcies of Naber Seeds in 2002 and Venture Seeds in 2004 were the only payouts of less than 95% under the CGC's current bond security system.

There is uncertainty regarding how quickly claims will be processed and paid by Atradius, and whether claims will be challenged and/or delayed due to efforts by the insurance company to require that farmers first attempt to recover payments from licensed companies through other means.

Elimination of security requirements for terminal elevators will turn the producer car delivery option into an empty right. The government's regulatory impact analysis claims that terminals no longer deal directly with producer car shipments. In fact, the demand that farmers must complete a sale with a licensed company before shipping is a requirement made by the grain companies who also own terminal elevators, not a regulatory requirement. Removing payment security protection for this option eliminates the practical possibility for farmers to sell directly to terminal elevators, some of which are independent. The proposed regulation thus prevents farmers from taking full advantage of the benefits of using producer cars.

Effects on Licensed Grain Companies

Insurance premiums will replace the requirement to hold bond security. Money tied up in security holdings will become available as capital that can be used other purposes. Monthly sales reports to the CGC will no longer be required. While the government's regulatory impact analysis claims that costs to companies will be reduced as a result of these changes, the claim is unsupported because the cost of insurance premiums is unknown.

Atradius will decide insurance premiums based on its own analysis of each company's risk of non-payment. Its conclusions regarding risk are likely to differ from those generated by CGC's security assessment process, resulting in some relative cost advantages and disadvantages among grain companies following adoption of the credit insurance system. Companies CGC has assessed as prudent may be seen as risky by Atradius, warranting higher premiums -- and vice versa. Consequently, licensed grain companies' competitive positions relative to one another may change when the new system is implemented.

Companies will have no choice of insurance provider. Should Atradius decide to withhold insurance, which is its right, a company's licence would be voided and it would be unable to obtain insurance from another provider.

Effects on the Canadian Grain Commission

The CGC will no longer benefit from the monthly reports on obligations and deliveries by each licensed grain company that have provided the Commission with important information about the grain industry's financial strengths and weaknesses. The CGC will also lose personnel and expertise, as the staff who now interpret grain company reports will no longer be needed.

Atradius, a foreign private company, will have de facto control over which companies are licensed via its ability to withhold insurance. These decisions will be business decisions made in the interests of Atradius shareholders, not regulatory decisions made by the CGC, a public institution with a mandate to act in the interests of Canadian grain farmers.

Broader Implications

Today, the Canadian Grain Commission regulates transactions through its licensing and bonding processes. The proposed insurance scheme will transfer this regulatory authority to a foreign insurance company. Atradius will do its own risk assessment of licensed grain companies and set its premiums, limitations and any other conditions desired based on solely on its business priorities. It will be Atradius's call to determine whether a company is insurable, and thus it will have the *de facto* authority to cancel a company's licence by denying it insurance. These important decisions that regulate Canada's grain trade will be transferred from the control of our publicly accountable institution - the CGC – into the governance of one of the world's largest private insurance companies.

As the single insurance provider, Atradius will obtain power through the information they will collect or have access to, which will be largely invisible and non-transparent while the company remains unaccountable to the Canadian people. The proposed regulatory change will mean that the CGC will no longer have access to detailed information about each company's sales, which provides an important public window into the dynamics of the grain trade. Atradius, however, will no doubt require that companies provide detailed financial information to be insured and therefore licensed. The shift to a credit insurance system therefore empowers the insurance company while simultaneously blindfolding the CGC.

Under our current bond-based payment security system, the CGC has a direct connection to the company itself and to payments to producers. When a company fails, payouts are administered fairly by the CGC. In most cases, the cause of failure is clear and/or is investigated by the CGC which allows for actions to be taken to prevent similar failures in the future. For example, if a company failed because it could not get timely rail service, this was clearly understood by all parties. Farmers as well as governments could then look for and make changes to improve this factor. Under the new system, Atradius may look at causal effects of a company's failure to pay in efforts to reduce its obligations or to transfer its liabilities to other parties. Two outcomes will result: the regulation of the grain trade will shift from Canadian to private foreign hands over time; and Canada will be unable to effectively monitor and adjust operations such as rail transportation.

Some farmers will be induced to deal with companies that offer high prices which may actually be too good to be true. If – or when – such a company refuses payment, the farmer can collect 95% of that higher price through insurance. The non-paying company may eventually be disciplined by higher premiums, but until then it can increase its market share and accept premium increases as a cost of doing business. This type of behaviour will increase the overall risk in the system, driving up total claims and increasing premiums for all licensees. To recover these costs, companies will increase the basis and overall, grain farmers will end up receiving lower prices. Bonding on the other hand, is a direct discipline on individual companies: their own money is at risk; payouts affect the company's reputation; and the CGC is able to take specific proactive actions to address the company's particular situation when there is a risk of insolvency or insufficient security.

The shorter time frame for making a claim will discipline companies to pay farmers on time; however this benefit to farmers could be diminished if the potential increase in a company's individual insurance premiums does not offset what they gain from non-payment. There is no apparent mechanism for ensuring that the premium structure will discipline companies to pay promptly.

We do not know enough detail about the claim-making process. If it is complicated, time-consuming and/or requires specialized skills, knowledge or legal support, the process may be a barrier that prevents some farmers from being paid. Farmers may also find it difficult to meet the shortened time limit for submitting non-payment claims, particularly if it occurs during busy harvest or seeding seasons.

Large companies with access to more credit and better terms would more easily meet the shorter timeframe for payment, while smaller companies might find it more difficult to meet the 45-day turn-around time for payment. What is in fact a short-term problem could initiate a vicious cycle: more claims; less trust from farmers; losses to both farmer and small company; unaffordable insurance premiums; and eventual business failure. Further concentration of the grain business would occur.

By relieving licensed grain companies of the need to hold securities – which in some case amount to millions of dollars – this capital will be freed up to be used for other purposes. Today the grain trade is in a major transition following the end of the Canadian Wheat Board single desk. As private grain companies increase their wheat- and barley-related activities, they will seek capital for expansion. Sudden access to surplus capital will likely accelerate the acquisition and merger activities already happening, as companies buy competitors and small companies become more attractive as takeover targets. Once again, the result will be increasing concentration in the grain sector.

A shift from bonding to insurance also has implications for the privatization of the CWB. When the CWB was the farmer-operated single desk selling agent for prairie wheat and barley, it was exempt from CGC bonding requirements because the federal government provided the payment security. The current government-controlled CWB is still secured by the federal government, but when privatized will require a CGC license to operate. By changing from bonding to insurance, a newly privatized CWB would have lower capital requirements and thus be a more attractive target for private investors.

Atradius, the single insurer selected, is a large multinational corporation based in Europe, which obtained revenues of Euros 1.6 billion in 2012, whereas the bond system was distributed among many Canadian financial institutions. Using this insurance corporation shifts wealth out of our country. The regulatory change means that Canadian financial institutions will no longer hold grain company security bonds worth millions of dollars, premiums paid to Atradius will exit Canada, and Atradius profits will go to foreign

shareholders. Atradius does have a branch office in Canada, but the business may be structured in a way that allows grain company insurance-related profits to be booked in a low-tax jurisdiction in Europe and thus not be taxable here, resulting in significant loss of both wealth and tax revenue to Canada's economy.

Using a single insurer instead of multiple bond holders also introduces vulnerability. If this one company gets into difficulty – perhaps due to economic crises in Europe – Canadian grain producers may suffer losses if coverage is not available when it is needed. In fact, Atradius lost more than Euros 100 million in each of 2008 and 2009.

The costs and problems with the current bond-based producer payment security system detailed in the federal government's regulatory impact analysis stem primarily from reporting time lags. These problems could easily be managed by requiring weekly reporting and a rolling security assessment for companies to ensure there are no gaps. The cost of maintaining bond security is something to which all licensed grain companies are subjected, and which can be controlled through prudent business management. The problems with the status quo have been overstated and are minor when compared to the implications of the proposed credit insurance system.

The NFU therefore recommends that the proposed regulation NOT be adopted.

The NFU further recommends that:

- Frequency of mandatory reporting be increased to weekly.
- The CGC monitor insurance claims, and report to farmers, government and the public through websites and the media, the size of claims and the companies involved on a monthly basis.
- The CGC analyze and report annually on why claims were made and why companies failed.

If the regulation is adopted the NFU recommends that:

- In the event of payment failure, farmers receive 100% payout, as they delivered 100% of their grain in the transaction.
- The time period for producers to submit claims be extended to at least 120 days following delivery of grain.
- Terminal elevators are required to participate in the credit insurance program so that producers will be able to submit claims for non-payment on sales to terminal elevators.
- In the event that a claim is necessary, the CGC act as the agent for the farmer to ensure prompt payment and remove the costs of filing or negotiating the claim.