Intelligence MEMOS

From: David Powell

To: Department of Finance

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Re: **Filling the Gap: Emergency Funding Programs and Asset-Based Finance in Times of Economic Crisis**

In times of economic crisis, the federal government should have in place a large-scale program for funding asset-based finance intermediaries. No one wants to see a repeat of the 2008-09 crisis where many non-bank lenders were lost, and Canadians were left with a less competitive market of available capital.

The asset-based finance industry (ABF) is very important to the Canadian economy, and is the biggest available financing alternative to classic bank lending.

In 2018, the value of ABF financing on the books was an estimated $416 billion of vehicles and equipment for consumer and business customers in Canada. That is equivalent to 22 per cent of non-mortgage loans made by the total private banking sector.

The ABF industry supports a broad network of dealers, manufacturers, distributors, vendors and brokers, and their customers throughout the country.

ABF is offered by banks, credit unions, insurance companies, government financial institutions, manufacturer finance companies, and independent finance companies. Several of these entities are regulated and therefore have access to existing Bank of Canada programs for emergency lending. Others, however, are not, and I focus on these in a forthcoming C.D. Howe Institute Commentary, as they are also critical to the functioning of the economy.

Ninety per cent of new vehicles – from automobiles to big rigs – are financed, and non-bank asset-based finance companies handle almost half. If the big rigs are to be kept on the road transporting essential supplies, this industry needs to be supported in times of stress.

Similarly, almost 40 per cent of all machinery and equipment (M&E) is financed by this industry and almost two-thirds of that is financed by non-bank ABFs.

ABF entities ran into deep trouble during the 2008-2009 global financial crisis and required an emergency liquidity program that took months to devise and implement. The primary source of funding of the ABF sector was, and is, the asset-backed commercial paper and securitization markets, often with bank backup or standby lines, purchased by private pools of investment capital – insurance companies, pension plans, hedge funds, banks and others.

The 2008-2009 experience revealed that a complete loss of liquidity could occur within a few weeks, even days. Government was needed to step into the shoes of absent private-sector investors.

To avoid something similar today, and given the ABF industry's low delinquencies, I argue that, during periods of extraordinary financial market turmoil, the federal government should activate a large-scale securitization program to fund ABF intermediaries who finance customers based on real assets. It would purchase term asset-based securities backed by a pool of assets and their receivables, receiving the same protection and profit that a private-sector investor would receive.

Once liquidity is restored and private investor confidence returned, the commercial markets would again resume their normal functioning and government could withdraw its temporary emergency funding program.

The 2009 federal budget established the Canadian Secured Credit Facility, a $12-billion fund administered by the Business Development Bank of Canada (BDC) to purchase these securities. Since then, under successor programs, the BDC has continued to purchase asset-based securities, albeit on a smaller scale. With more than 10 years of experience, the BDC understands the policies and rules for such funding. Existing BDC programs could, therefore, be easily scaled up in a severe downturn, with experienced people in place for effective, prudent and efficient funding.

For more than 50 years, federal governments have sought to diversify the number of financial service providers. If liquidity is not supported, many non-bank financing entities and service providers will disappear from the Canadian marketplace leaving fewer financial alternatives available to Canadians.

In a profoundly disrupted market, the policy objective should be to restore liquidity to allow the financial services sector to continue offering financing to credit-worthy consumers and businesses in support of the Canadian economy, and that includes the ABF industry.

David Powell is the former president and CEO of the Canadian Finance & Leasing Association, and was previously a partner in the Montreal office of a national law firm.

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