

Western Canadian Wheat Growers Association

Position Paper

Canadian Grain Commission Mandatory Licensing and Bonding Proposal

September, 2005

The Western Canadian Wheat Growers Association is pleased to provide the following comment on the Canadian Grain Commission's proposal to introduce mandatory licensing and bonding, effective August 1, 2006, as announced by the Commission on May 13, 2005.

Introduction

The Wheat Growers agree that it is timely to review the CGC licensing and bonding provisions. The recent business failures of licensed grain companies have resulted in farmers suffering significant financial losses, in part because the security bond provided by the companies was insufficient to cover all outstanding liabilities to farmers. In some cases, the coverage has been woefully inadequate.

Failures of unlicensed companies have also left farmers with uninsured losses.

The business failure of grain companies, and the resulting shortfall to farmers, is not a new phenomenon. Over the decades, there have been several instances where prairie farmers have suffered severe financial setbacks as a result of inadequate payment security. However the magnitude of the recent shortfalls, and the increasing complexity and cost of CGC monitoring and enforcement, suggests that a new approach to providing payment protection to farmers is warranted.

In our view, introducing mandatory licensing and bonding is not in the best interests of farmers. In this paper, we will provide our reasons for holding this view and then put forward some alternative solutions.

Mandatory licensing and bonding proposal

The Wheat Growers do not support the proposal to introduce mandatory licensing and bonding, effective August 1, 2006. We provide the following comment:

- 1) In our view, the cost of mandatory bonding will drive many small but vital competitors out of the marketplace. Several of these companies have been established for many years, and rely on their reputation to attract business from farmers.

The Wheat Growers recognize that requiring some grain buyers to be bonded and not others is discriminatory. However, under its proposal, where does the CGC intend to draw the line? Currently feedlots and many seed buyers are not bonded. Is the CGC contemplating mandatory bonding for these facilities?

At present, a significant portion of grain is sold by farmers through unlicensed channels. The CGC's background document on this issue states that 5 to 10% of special crop production is handled by unlicensed companies. We note however that the amount of feedgrain sold to feedlots by farmers, either directly or through unlicensed facilities, would be an even higher percentage. If farmers are currently accepting and managing the risk on these sales, why does the Commission seem to believe we are not capable of accepting and managing the risk on our other grain sales?

We note too that many farmers prefer to sell their grain to a local unlicensed facility (as opposed to a distant feedlot or end user) because they feel they are at less risk for non-payment. Forcing some of these unlicensed facilities out of business through mandatory bonding will only serve to increase risks (and costs) for farmers.

In our view, a better way to end the discriminatory application of bonding is to make bonding voluntary for all companies.

- 2) The Wheat Growers note that a CGC bond is by no means a guarantee of payment. In one recent case of a business failure of a licensed company, farmers received as little as 28 cents on the dollar. While we understand the CGC has taken steps to strengthen its monitoring and enforcement measures, the fact remains that farmers continue to be at considerable financial risk, even when dealing with bonded companies.

The Wheat Growers believe farmers should be fully protected when dealing with bonded companies. The presence of a bond should be a clear indication to a farmer that he or she is fully protected against non-payment. We recognize it is difficult for the CGC to protect against all cases where licensees commit fraud and incur liabilities to farmers in excess of their posted bond. To protect against these exceptional circumstances, we believe the CGC itself should be re-insured against such losses, and that the premiums for this insurance be included as part of the bonding fees assessed by the Commission.

In our view, providing farmers with two unambiguous scenarios – full payment protection if bonded; no payment protection if not bonded – would give farmers the ability to make risk management decisions that properly reflect the degree of risk they wish to assume. The decision to acquire payment security should be treated no differently than a farmer's decision to purchase crop insurance. With crop insurance, each farmer chooses the level of weather risk protection that best suits their needs. Likewise, we believe each farmer should have the ability and responsibility to choose the level of payment protection that best suits their needs.

- 3) The cost of imposing mandatory licensing and bonding will be passed on directly to farmers. In its background document, the CGC is estimating the cost for unlicensed facilities to become licensed and bonded will be approximately \$1.30 per tonne. In our discussions with unlicensed companies, the view is that this cost estimate is far below the true cost of compliance, once additional staffing, the cost of the bond itself (including renegotiation of banking arrangements) and the ongoing compliance costs (including audited financial statements) are factored in.

As well, we suspect the monitoring and enforcement costs imposed on the industry will be higher than what the CGC is currently contemplating. We note there are currently 87 licensees that deal directly with farmers as a grain dealer, primary elevator or processor, and that current licensing program costs are approximately \$1.7 million. In its background document, the CGC suggests that requiring the 50 unlicensed facilities to become licensed will increase CGC costs by \$400,000. In our view, this cost estimate is low, especially when one takes into account the higher monitoring and enforcement costs that may be required for those facilities now unlicensed. As you know, all such costs, except any which may be underwritten by the Canadian taxpayer, will be passed on to farmers in the form of lower returns.

- 4) As part of Bill C-40, the Canadian Grain Commission and the Act will be subject to an independent and comprehensive review. The review is to be tabled in the House of Commons by September, 2006. In our view, it would be premature and imprudent to implement such a major policy change while a complete review is being undertaken. At the very least, we recommend the implementation date of the proposed mandatory licensing and bonding policy be delayed until August 2007, so the results of the review can be fully taken into account.

Alternative solutions

The Wheat Growers believe those farmers who wish to have payment protection should have every opportunity to acquire this protection. At the same time, we wish to ensure costs are not excessive. We recognize there is a trade-off between the degree of payment protection, and the cost of providing that protection.

To ensure payment protection is available and affordable to farmers, the Wheat Growers recommend the CGC consider the following options:

- 1) Providing grain companies (and all other grain buyers) with the option to be bonded or not. Under this scenario, those farmers who wish to have payment protection would seek out those companies that offer a CGC bond. Those farmers who are prepared to accept the financial risk would, as is the case now, be free to choose non-bonded companies. In our view, rather than making it “mandatory” for all companies to be bonded (and arbitrarily drawing a line on payment protection, depending on the type of grain buyer), a CGC bond should be optional for all companies, including feedlots and other grain buyers that have traditionally

been unlicensed. Important however, is to ensure that when a company is bonded that farmers know they are fully protected.

- 2) Alternatively, rather than have grain companies bonded or not (i.e. all-in or all-out), we suggest that grain companies could offer bond protection on a transaction-by-transaction basis. That is, at the time of delivery, the farmer would have to declare whether he wants the payment guaranteed by a CGC bond, or whether he is prepared to accept the risk of non-payment (presumably in exchange for a slightly higher price). In other words, payment protection would be at the “farmer’s option”, rather than imposed on all transactions. Such an approach would ensure that farmers are not paying for a bond when it’s clearly not needed (i.e. in those cases where companies have unquestioned credit worthiness) and yet be fully protected in those cases where they consider the company’s creditworthiness to be of questionable soundness. Again, as risk managers, we are confident farmers can make these decisions, on a case-by-case basis, and would be better served knowing they are fully protected when they choose to have their payment secured by a CGC bond.
- 3) The Wheat Growers recognize that it is very important for farmers to know when they are dealing with a non-bonded company. For this reason, we would support a regulation that would require all non-bonded companies to display prominent signage in their facilities advising potential customers that they are not protected by a CGC bond. Further, wording should be placed on the cash tickets to clearly indicate that payment is not insured by the CGC.
- 4) To limit exposure for the CGC, we would support the capping of liability to each farmer in the case of default by a bonded company. We note for example that the Canadian Deposit Insurance Corporation (CDIC) guarantees the principal amount on all deposits in CDIC-insured financial institutions up to \$60,000. The Wheat Growers recommend that a similar approach be adopted by the CGC to limit its exposure to any individual farmer in the case of a business failure. Such a limit, say \$100,000, would need to be well-publicized, so that farmers know they are “on the hook” for any amounts owing from a single bonded grain company over that specified amount, and can manage their risk accordingly. In our view, such a provision would allow the CGC to better manage its exposure risk, and would help ensure bonding costs to farmers are not excessive.
- 5) Adopting the clearinghouse proposal. As you know, a risk management vehicle is presently under development by the Western Barley Growers Association under the risk management pillar of the Agricultural Policy Framework. While this project is more than a year away from implementation, we are confident that it will lead to a risk management program whereby farmers (and other grain trade participants) can obtain payment protection on a transaction-by-transaction basis. Adoption or endorsement of this program by the CGC may eliminate or sharply reduce the need for bonding. The Wheat Growers recommend that at the very least, any decision to impose mandatory licensing and bonding be delayed until 2007, to allow time for the clearinghouse project to be fully developed.

- 6) The Wheat Growers have also considered whether to adopt a check-off based insurance fund, similar to the one in Ontario that is established to offer payment protection for corn, soybean and wheat producers. The Wheat Growers do not recommend implementation of this model. In our view, the creation of an insurance pool would in effect mean that reputable and creditworthy firms would be cross-subsidizing uncreditworthy firms. In other words, a check-off would be collected unnecessarily on thousands of transactions, to protect those farmers who choose to deal with unsound businesses. In our view, the risk of dealing with those firms that are less creditworthy should be borne by those farmers who patronize that business, and not by those farmers who patronize solid businesses.

Licensing versus bonding

In our view, the issue of licensing and bonding should be treated separately. We accept that all grain companies in the business of buying grain from farmers (other than feedlots seed companies or other farmers) should be licensed. A mandatory licensing requirement will help ensure these companies are aware of and comply with the regulations under the Canada Grain Act, help maintain Canada's grain quality assurance system and ensure farmers have access to the grain grading appeal provisions and other remedies contained in the Act. However a requirement to obtain a license should not extend to a requirement to obtain a bond, and the fee for obtaining a license should be nominal.

Summary

The Wheat Growers have put forward several options for the Canadian Grain Commission to consider as an alternative to its proposal to adopt mandatory licensing and bonding on August 1, 2006. As noted earlier, introduction of the CGC's proposal would presumably mean that grain sold by farmers to several types of buyers (e.g. feedlots, seed purchasers, other farmers) would continue to be exempt from the licensing and bonding provisions. Thus, the new policy would not solve the "uneven playing field" issue, and in fact may make it worse.

In our view, there are two ways in which the CGC can level the playing field. It can either make bonding mandatory for all, or voluntary for all. As this paper notes, introducing "mandatory" bonding still leaves the CGC in a position where it must determine which types of grain buyers fall under the "mandatory" banner. Consequently, we believe the best way to ensure a "level playing field" for all industry participants is to introduce optional bonding, either at the option of companies or at the option of farmers.

The clearinghouse project may also provide a good alternative to the CGC's present bonding requirements, although such a program is more than a year away from implementation. Given this, and given the comprehensive review of the Canada Grain Act that is now pending, we urge the CGC to delay implementation of any proposal to impose mandatory licensing and bonding until August 1, 2007 at the earliest.

Respectfully submitted,
Western Canadian Wheat Growers Association