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CREDIT OPINION
1 December 2021

Update

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RATINGS

Business Development Bank of Canada

Domicile	Montreal, Quebec, Canada
Long Term CRR	Not Assigned
Long Term Issuer Rating	Aaa
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Business Development Bank of Canada

Update to credit analysis

Summary

Business Development Bank of Canada (BDC), which has a mandate to promote the development of small and medium-sized Canadian businesses, is rated Aaa for long-term senior unsecured obligations and Prime-1 for commercial paper, reflecting its status as an Agent of Her Majesty in right of Canada (Aaa stable). As a Crown corporation with Agent status, BDC can bind the Crown by its actions, with the Crown ultimately fully liable for those actions undertaken by BDC within its mandate. As such, BDC's obligations constitute direct obligations of Canada and our ratings of BDC therefore mirror those of the Government of Canada.

In March 2020, the Government of Canada announced the Business Credit Availability Program to support Canadian small- and medium-sized businesses (SMEs) as part of its pandemic economic action plan. As part of that program, BDC launched co-lending programs for SMEs and mid-market businesses and a venture capital program, increased direct lending, and offered new advisory services. Later in 2020, Canada also announced the Highly Affected Sectors Credit Availability Program; a similar program, but targeted to the tourism, arts and airline industries.

Credit strengths

» Full faith and credit of the Government of Canada

Credit challenges

» Same as those of the Government of Canada: relatively high general government debt burden

Outlook

Consistent with Canada's outlook, our ratings outlook for BDC is stable. This reflects our expectation that the risk of a material, long-lasting shock to Canada's economic or fiscal strength, including from the coronavirus shock, is low. Even in the event of such a shock, for example emanating from the housing sector or externally, the resilience of the economy, supported by very strong institutions that have demonstrated timely and effective policy responses to shocks, would likely keep Canada's credit attributes consistent with a Aaa rating.

In addition, despite a sharp deterioration in the government's fiscal position this year, Canada's long-standing political consensus on fiscal health will remain a priority for the government and fiscal consolidation measures will be effectively implemented after the pandemic subsides. Diminishing confidence that Canadian policymakers will take effective

action to achieve fiscal consolidation after the economy begins a sustained recovery would weigh on the sovereign's credit profile.

Factors that could lead to an upgrade

» As we assign our highest rating to BDC, an upgrade is not possible.

Factors that could lead to a downgrade

» The key driver of a downgrade for BDC's ratings would be any negative rating actions with respect to the Government of Canada. BDC's rating would also likely be lowered should it ever lose its status as an Agent. However, even in this scenario, the benefits of Agent status would remain fully applicable to all debt entered into by BDC until the date of such revocation.

Profile

BDC has a mandate to promote the development of entrepreneurship in Canada with a focus on small and medium-sized Canadian enterprises through lending, investment and advisory services, which it provides on a commercial basis. BDC was established as a Crown corporation by an Act of Parliament in 1974 and reports to Parliament through the Minister of Small Business and Export Promotion. At 30 June 2021, BDC had a gross loan portfolio of CAD 32.8 billion.

Canada

Canada's Aaa government bond rating reflects "aa3" economic strength, "aaa" institutional strength, "a3" fiscal strength, and "a" susceptibility to event risk.

We assess Canada's **economic strength** at "aa3," one notch above the initial score of "a1," to reflect its large and diverse economy, very high per capita income levels, reasonably high growth potential and comparatively strong demographics. The gap is driven by higher than usual volatility in GDP growth due to the coronavirus shock. Key structural features of the Canadian economy include relatively flexible labor and product markets, a well-capitalized and regulated financial system and a flexible exchange rate. These attributes, combined with an effective macroeconomic policy, contribute to the economy's capacity to absorb shocks, helping reduce growth volatility.

Canada's tested capacity to adjust to economic shocks further supports our assessment of economic strength. Examples include Canada's resilience to sharply slower growth in the US (Aaa stable) during the global financial crisis (GFC) and successful management of the oil price shock of 2014-15 through effective countercyclical policy measures. In 2020, the Canadian economy contracted 5.3% due to the strong dual shock from the coronavirus pandemic and sharp decline in global oil prices. This year, economic activity has rebounded and we expect real GDP growth of about 5.2%.

Our "aaa" assessment of **institutions and governance strength** reflects the very high quality of legislative and executive institutions, very strong civil society and judiciary, and a demonstrated track record of sound and consistent fiscal and monetary policy effectiveness. Our assessment is supported by the country's robust and independent institutions, high regard for the rule of law, clear separation of powers, and high levels of transparency. Canada's mature and highly effective public institutions have a demonstrated track record of timely and well-targeted fiscal, monetary and macroeconomic policy responses to evolving economic conditions and shocks. In addition, Canada's macroprudential framework and well-capitalized and regulated financial system support the government's ability to contain systemic implications of potential shocks, including those emanating from the coronavirus pandemic and housing market.

We assess Canada's **fiscal strength** at "a3," three notches above the initial score of "baa3," which balances strong federal finances and typically stable debt dynamics with a relatively high level of overall general government debt. The gap is driven by a negative debt trend adjustment due to sizable fiscal stimulus spending and weaker government revenue collection from the coronavirus pandemic. However, as a reserve currency country, we consider Canada to have materially higher capacity to carry a larger debt burden, and therefore focus much more on debt affordability metrics.

Before the coronavirus pandemic, Canada's general government debt burden, at 78% of GDP in 2019, was higher than the nearly 40% median for Aaa-rated sovereigns. Provincial and municipal debt comprised the majority of the country's total general government debt and, at around 46% of GDP in 2019, was the highest among its Aaa-rated peers. We estimate that contingent liability risk from the provinces is very low because of the high intrinsic creditworthiness of Canadian provinces, which indicates a low probability that financial support from the federal government would be needed. In response to the pandemic, like many of its Aaa-rated peers, the Canadian federal government significantly increased fiscal support measures to households and businesses in 2020 and some measures were extended into 2021. This increased spending, along with weak economic activity and revenue collection, drove the general government fiscal deficit to around 10.8% in 2020, from near balance in 2019. We expect the deficit to remain wide at around 9.8% of GDP in 2021and to decline thereafter as the government winds down emergency support programs and revenues increase in line with a recovery in economic activity. As a result, the general government debt burden increased significantly to about 104% of GDP in 2020 and we expect it to rise to around 107% in 2021, driven mainly by the federal government deficit. We expect the debt burden to remain around that level until gradually declining over the medium term as the government advances its planned fiscal consolidation measures.

Nonetheless, as a reserve currency country, we focus much more on Canada's debt affordability in our assessment of fiscal strength. Canada's debt affordability has improved significantly over the past two decades and has benefited from further declines in global interest rates. It has also benefited from increased demand for Canadian dollar-denominated assets from stable foreign official investors, resulting in lower funding costs at all levels of government. Debt affordability, as measured by the ratio of general government interest payments to revenue, strengthened to 7% in 2020 from 16% in 2000. Overall, declining funding costs have largely offset the effect of a rising government debt stock on the country's fiscal strength. We expect Canada's debt affordability to remain strong, but to gradually weaken over time given the expected increase in global interest rates.

We assess **susceptibility to event risk** at "a," driven by banking sector risk, which reflects the positive credit fundamentals of Canada's banking system. Political and external vulnerability risks are assessed at "aa" and government liquidity risk at "aaa."

Detailed credit considerations

The Aaa/Prime-1 ratings of Business Development Bank of Canada's obligations reflect the application of our rating methodology for government-related issuers (GRIs). Since BDC's status as an Agent makes its obligations direct obligations of the Government of Canada, we do not assign an independent baseline credit assessment but instead use a credit substitution approach where BDC's ratings are tied to those of Canada.

BDC is funded primarily through its share capital and retained earnings, capital markets debt and direct borrowing from the federal government under the Crown Borrowing Program (CBP). Since April 2008, all debt funding has been obtained under the CBP. At 30 June 2021, approximately 99% of BDC's debt was owed to the Government of Canada.

BDC's capital management framework is based on an Internal Capital Adequacy Assessment Process (ICAAP), which is aligned with the Office of the Superintendent of Financial Institutions' guidelines and the Capital and Dividend Policy Framework for Financial Crown Corporations from the Department of Finance. Under the new framework, BDC monitors its internal capital ratio (available capital as a percentage of economic capital required) and an operating range to mitigate the impact of unplanned capital volatility. BDC's actual available capital at 30 June 2021 was CAD 18.5 billion. At 30 June 2021, BDC's internal capital ratio was 115.5%, which is above its target capital ratio of 110%. As well, BDC's debt to equity of 1.03:1 at 30 June 2021 was well within the maximum 12:1 limit set out in the Business Development Bank of Canada Act.

Environmental, social and governance (ESG) considerations

We take account of the impact of environmental (E), social (S) and governance (G) factors when assessing sovereign issuers' economic, institutions and governance and fiscal strength and their susceptibility to event risk. In the case of Canada, the materiality of ESG considerations to the credit profile is as follows:

Environmental considerations exert limited direct influence on Canada's credit profile, notwithstanding the country's proactive measures to address climate change. Nonetheless, protests from some civil society groups over the potential negative environmental implications of Canadian oil and gas pipeline projects have at times temporarily disrupted economic activity.

Social risks are not a material consideration affecting Canada's credit profile. Relative to many other advanced economies, Canada's demographics are generally favorable and will support future growth. The country's high level of wealth, low unemployment rates and broad access to healthcare and basic services mitigate social risks related to labor markets and living conditions that are present in other sovereigns. However, we regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety.

Canada's very sound framework of governance reflects its very high institutional strength, supported by strong government effectiveness and rule of law, which rank very high in international surveys, and a demonstrated capacity for fiscal, monetary and macroeconomic policy to effectively manage and absorb shocks.

All of these considerations are further discussed in the "Detailed credit considerations" section above. Our approach to ESG is explained in our report on how ESG risks influence sovereign credit profiles and our cross-sector methodology General Principles for Assessing ESG Risks.

Ratings

Exhibit 1

Category	Moody's Rating
BUSINESS DEVELOPMENT BANK OF CANADA	
Outlook	Stable
Issuer Rating -Dom Curr	Aaa
Senior Unsecured -Dom Curr	Aaa
Commercial Paper	P-1

Source: Moody's Investors Service

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Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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