

SUBMISSION TO THE ESTF (ECONOMIC SECURITY TASK FORCE)

The Canadian Venture Capital and Private Equity Association (CVCA) appreciates the invitation to provide comments to the Economic Security Task Force (ESTF) at Public Safety Canada regarding economic-based threats to national security. The CVCA agrees with the ESTF in that Canada must continue to be agile and vigilant in mitigating the evolving sophistication of these threats, while maintaining a vibrant, innovative, and dynamic economy.

The CVCA represents more than 270 member firms and 1,800 individuals and is proud to advocate on behalf of the industry, as well as connect private capital professionals with market intelligence, expert insights, and other industry authorities. Our members are as unique as the companies they work with. Our venture capital members are building new enterprises from the ground up, pursuing cutting-edge discoveries and developing novel products, services, and platforms, while our private capital members are engines of growth for established firms that are expanding their business through the deployment of new investments, technologies, and services. Together, venture capital and private equity play a critical role in Canada's economic success.

An inherent aspect of the private capital industry is to invest both money and expertise in a business to create additional value (either via a minority or majority equity stake), and then sell that equity stake at a later date (i.e., "exit"), ideally making a profit on the transaction. In turn, the CVCA and its members have a strategic interest in working with the ESTF to ensure Canada's approach to economic-based threats continues to be balanced. It is in this spirit of collaboration and partnership that the CVCA presents this submission.

The Importance of the Private Capital Industry

The private capital industry is a critical source of investment that supports innovation, job creation, productivity, and wealth creation. On average, private capital investment in Canada ranges from \$20 billion to \$25 billion per annum. In 2019, prior to the pandemic, there were 560 venture capital investment transactions totalling \$6.2 billion, and 661 private equity investment transactions totalling \$19.4 billion. During the same year, there were 39 venture capital exits valued at \$3 billion and 44 private equity exits valued at \$1.9 billion.

The Canadian private capital market is highly integrated with that of the United States (U.S.). The CVCA's venture capital members often syndicate with U.S.-based investors, while our private equity members often transact with American private equity firms, both on the buy and sell side. This cross-border collaboration is a positive and tangible example of the long-standing, strategic and deliberate economic relationship between Canada and the U.S. Together, the two countries invest, innovate, grow, and compete globally from an integrated North American economic platform.

Therefore, as the ESTF considers additional measures to mitigate economic-based threats to national security, the CVCA stresses the importance of ensuring that the U.S., and Canada's other strategic allies, do not become subject to unnecessary measures that add risk, cost, or time to transactions that pose little threat to national security.

Consultation Questions Specific to Venture Capital

The consultation paper Economic Threats to National Security poses two specific questions regarding the venture capital industry. Below is the CVCA's perspective on both questions.

1. *Have you or the members of your organization operating in sensitive technology sectors experienced challenges in accessing venture capital?*

In general, the CVCA's members and their portfolio companies in sensitive technology sectors have not experienced challenges in accessing venture capital. Since the implementation of the Venture Capital Action Plan (VCAP) in 2013, which was followed-up by the Venture Capital Catalyst Initiative (VCCI) in 2017, Canada's venture capital industry has experienced strong development, growing from \$1.9 billion (2013) to \$6.2 billion (2019). While venture capital investment dropped in 2020 due to the pandemic (\$4.4 billion), this still represents the second highest annual investment total. Moreover, the first quarter of 2021 witnessed the strongest quarter on record, reaching \$2.7 billion in venture capital investment across 175 deals.

Moving forward, the announcement in Budget 2021 of \$450 million over five years for a Renewed Venture Capital Catalyst Initiative (Renewed VCCI) program ensures that the strong growth in the Canadian venture capital industry will be sustained and bolstered through 2026-27. In addition, the Business Development Bank of Canada (BDC) recently announced that it established a \$200 million Deep Tech Venture Fund to provide early-stage investment to Canadian companies working in technology areas that align with sensitive technology sectors, further supporting access to risk capital for Canadian start-ups and entrepreneurs.

Stating this, it is important to note that the Canadian venture capital market is still young and maturing, especially in comparison to the U.S. venture capital industry. Access to capital, therefore, is a dynamic issue that requires ongoing monitoring and evaluation. However, with programs such as the Renewed VCCI and BDC's Deep Tech Fund in place, Canada has established mechanisms to channel funds to the market as required.

2. *What are your views on how Canada can best ensure that cross-border capital flows are safe and don't bring with them the potential for unwanted transfer of sensitive goods, technologies, and associated R&D, or IP? In your opinion, what should the role of the Government of Canada be in providing venture capital to sensitive technology firms (or your industry) through alternative loan or grant programs?*

One of the most effective ways to ensure safe cross-border flows of venture capital is through increased and ongoing dialogue with the venture capital industry. The venture capital industry, by design, manages risk – it does this on a day-to-day basis. The vast majority of foreign investment transactions originate from the U.S. or other countries friendly to Canada, making the universe of concern regarding threats to national security small and well defined. Therefore, initiating dialogue with the industry will enable Canadian venture capital firms to become knowledgeable and sophisticated partners in combating economic-based threats to national security. The CVCA is eager to work with the ESTF to establish and maintain such a dialogue.

Also, and as stated above, Canada should consider clearly defining that the U.S. and other allied countries are not the target of these measures. Providing country-based exemptions, or specific guidance regarding enforcement practices, would ensure that the flow of low-risk investments would continue unabated, while focus, effort, and resources were placed on high-risk investments and transactions.

The CVCA is pleased to see that the consultation paper Economic Threats to National Security does not raise the issue of the composition of venture capital funds. This issue has been raised and/or overlooked in other jurisdictions, which has resulted in the introduction of unnecessary complexity into the investment review process. CVCA strongly believes that the General Partner of a venture capital firm

is the sole active investor, while the Limited Partners that invest into a venture capital fund are purely passive investors. In fact, the structure and central tenet of a Limited Partner Agreement is built around the concept of participating as a passive investor in a venture capital fund. Therefore, the focus of any relevant national security review involving a venture capital investment should solely be focused on the origin and affiliation of the venture capital fund's General Partner, and not its Limited Partners. It should be noted that the same applies for a private equity fund and its Limited Partners.

Finally, it is important to note that venture capital investments are dynamic and time-sensitive – i.e., transactions can materialize and finalize very quickly. Moreover, these transactions most often involve small businesses. In turn, if the ESTF does consider implementing additional measures, the CVCA recommends that the ESTF contemplate the administrative burden, both in terms of cost and time, that such measures would impose. Overly complex processes and requirements and/or lengthy review processes would undermine low-risk cross-border investment flows. This is especially important regarding exits. If Canada introduced additional, complex, and time-consuming review requirements, valuations of Canadian firms would be negatively affected, as it would become increasingly difficult to attract potential buyers to the Canadian market.

Regarding the role of the Government of Canada in investing in sensitive technology firms, CVCA believes that the government has a significant role to play, both on a macro and micro level. On the macro level, programs such as VCAP, VCCI, and the newly announced Renewed VCCI, are proving highly successful at cultivating a strong domestic venture capital industry. A strong domestic industry is important, as a self-sustaining venture capital industry will be able to attract private capital to the asset class. This capital will support many of Canada's most promising firms that are involved in sensitive technologies. Therefore, the government of Canada's continued support to build a strong, resilient, and sustainable venture capital industry is a strategic measure to combat economic-based threats to national security, as a strong domestic industry will ensure Canadian entrepreneurs can start and scale a business in Canada primarily leveraging Canadian-led risk capital.

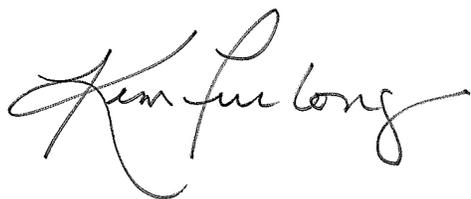
On the micro level, there are times when private capital does not flow quickly enough to emerging technology areas. This can be the result of a lack of risk capital in the market, or because the risk profile of a new technology is too high to attract private dollars. In these instances, dedicated government programs, such as those deployed through the BDC, Export Development Canada, and Innovation, Science and Economic Development Canada (ISED), can fill these market gaps, and help nurture sensitive technology firms until private capital markets engage. The successful identification and coordination of such policies and programs would benefit from strong collaboration between government and industry. While the CVCA currently collaborates with the Government of Canada across many domains, we would be very willing to deepen our collaboration in the context of mitigating economic-based threats to national security.

Moving Forward: Further Collaboration & Consultation with the Venture Capital Industry

The consultation paper *Economic Threats to National Security* raises several important issues, more than can be addressed in this submission. The CVCA believes that we, along with our members, can provide valuable input to the ESTF. Therefore, as part of this submission, the CVCA would like to offer to the ESTF to host an industry roundtable discussion to provide more depth to the perspectives provided above, as well as to discuss additional issues of importance not addressed in this submission. We have no doubt that such a roundtable would provide significant value for all parties involved, and thus we encourage to the ESTF to accept this offer.

Conclusion

The CVCA very much appreciates the opportunity to share its views on this important topic. The invitation to participate in this consultation demonstrates the care and forethought that the ESTF is taking to ensure that Canada maintains the delicate balance of protecting the country from economic-based threats to national security, while enabling the free flow of capital and ideas that is essential to foster innovation. Our hope is that this is the start of an ongoing dialogue and partnership that will assist in maintaining this important balance, as the pace of innovation accelerates, and the sophistication of threats evolve.



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