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## **Standing Committee on Public Accounts**

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**EVIDENCE**

**Thursday, September 29, 2016**

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**Chair**

**The Honourable Kevin Sorenson**



## Standing Committee on Public Accounts

Thursday, September 29, 2016

• (1530)

[English]

**The Chair (Hon. Kevin Sorenson (Battle River—Crowfoot, CPC)):** Good afternoon.

This is meeting number 25 of the Standing Committee on Public Accounts, on Thursday, September 29, 2016.

Today we're conducting a hearing on "Report 1, Venture Capital Action Plan", from the Spring 2016 Reports of the Auditor General of Canada.

**Mr. David Christopherson (Hamilton Centre, NDP):** I have a point of order, Chair, whenever it's appropriate.

• (1535)

**The Chair:** I'll recognize your point of order immediately after I introduce the witnesses.

Appearing before us today we have, from the Office of the Auditor General of Canada, Mr. Michael Ferguson, the Auditor General of Canada; and Richard Domingue, principal.

From the Department of Finance, we welcome Richard Botham, assistant deputy minister of the economic development and corporate finance branch. It's good to see you again.

From the Department of Industry, we have Christopher Padfield, director general, small business branch, of small business, tourism and marketplace services.

From the Business Development Bank of Canada, we have Jérôme Nycz, executive vice president of BDC Capital; and Neal Hill, vice president of market development, BDC Capital.

I understand that we have an opening statement from the assistant deputy minister, Richard Botham. We'll begin with the Auditor General of Canada's opening statement.

Before we begin, I would like to advise everyone that we have with us today a six-member delegation of international auditors currently undergoing training with the Canadian Comprehensive Auditing Foundation. These auditors are from Vietnam, Tanzania, Ghana, and Cameroon. We will have an opportunity to meet with this delegation and our international colleagues at the end of today's meeting.

I can advise our guest auditors that the Canadian Comprehensive Auditing Foundation has also been very generous in sharing advice and helping our committee train for our work early in the 42nd Parliament.

As your chair, I want to alert MPs and witnesses, who will want to be mindful during today's meetings that we have these international auditors here and we would really like it if they all thought we got along all the time. It is good to have them here and we look forward to the opportunity of meeting them after.

With that, I will now turn to the point of order from Mr. Christopherson.

**Mr. David Christopherson:** Thank you, Chair. I will be very brief.

I make this intervention as the longest-serving, continuous member on this committee. I'm referencing the presence, again, of the parliamentary secretary to the treasurer.

I accept that it is her right as a member of Parliament and as an associate member of the committee to sit here. I recognize this seems like a small matter, but it has big implications, as the government ran on a platform of removing the influence of parliamentary secretaries from committees. For the most part, that has happened, and it has been a good thing. I complimented that when we finally got around on PROC to where that was the case, where we got rid of the parliamentary secretary, and I gave the government credit for that. It was a good move.

We are called upon here to get above our partisanship, because we're the premier oversight committee in Parliament. It hearkens back to the old days that the government said they were going to be different when it comes to the parliamentary secretary being here. It cannot do anything but leave the impression that the government is riding shotgun on public accounts. If ever there should be a committee where all of us are not being directed or influenced by the parliamentary secretary, it's here.

I have two more points, Chair.

Number one, I'm not alone, and this is not new. A colleague, the member for Carlton Trail—Eagle Creek, was quoted in the paper recently as saying, "The Liberals promised to remove the influence of ministers and parliamentary secretaries on the committee, and this appears to be a promise broken."

That was in another committee, and I would make the same argument here, that the government is not honouring the pledge they made to remove the influence of parliamentary secretaries, particularly at the oversight committee, particularly given that our major oversight is Treasury Board.

I'm going to leave it there for now. I won't even mention the picture that the parliamentary secretary refused to get out of when we were trying to take a picture of the committee. We still couldn't have it because you and I wouldn't be in it unless the parliamentary secretary got out of it, and she wouldn't.

I'm asking the government—I've done it nicely, and I've done it now my first time publicly—please, honour your promise. Ask the parliamentary secretary to please not come to these meetings. It's serves all of us best.

Thank you so much, Mr. Chair.

**The Chair:** Thank you very much, Mr. Christopherson.

I would also say that any member of Parliament, if they are an associate member, can attend these committees. The parliamentary secretary is welcome to attend, but her input will be limited in that capacity when there is a full contingent of people here.

It is a point of order. I don't want to dwell on it. We have guests here today. We'll just carry on, but we do welcome all members here for this.

We'll begin with the Auditor General of Canada's opening statement, please.

Welcome.

**Mr. Michael Ferguson (Auditor General of Canada, Office of the Auditor General of Canada):** Mr. Chair, thank you for this opportunity to discuss our 2016 spring report on the venture capital action plan.

Joining me at the table is Richard Domingue, the principal responsible for the audit.

Venture capital is a major source of financing for innovative high-growth firms and their entrepreneurial owner managers. Venture capital investment in early stage firms has helped to create and grow many of today's leading global technology companies. Many countries are interested in promoting such an ecosystem, since venture capital is widely recognized to be a key driver of innovation and economic development in advanced economies.

In budget 2012, the Government of Canada announced \$400 million to help increase private sector investments in early stage venture capital and to support the creation of large-scale venture capital funds led by the private sector. In this audit, we looked at how the Department of Finance Canada, the Business Development Bank of Canada, and Innovation, Science and Economic Development Canada, formerly Industry Canada, assessed the policy need for the action plan, how they implemented the action plan in order to meet the stated objectives, and how they measured the performance of the action plan.

[*Translation*]

We found that at the time of the Budget 2012 announcement, the Government of Canada had already identified a number of issues faced by the national venture capital ecosystem and had performed preliminary analysis of the market gap. However, the government had not decided how to allocate the money. The government then held consultations with stakeholders, a process that led to the

selection of the fund-of-funds model as the preferred approach to address the challenges of the Canadian venture capital market.

We found that the government initially faced difficulty in convincing private sector investors to participate in the action plan, which contributed to delays in implementation. Among the factors behind their reluctance were low returns, as well as strict international regulatory requirements for certain private sector investors. Further, management fees could amount to approximately \$250 million of the total amount of \$1.35 billion committed by the federal government and other investors to funds of funds over the lifetime of the action plan.

We found some significant shortcomings in the process to select fund managers. In our opinion, the call for expressions of interest, the review of applications, and the selection of fund managers did not entirely adhere to sound practices and had a negative impact on fairness, openness and transparency.

● (1540)

[*English*]

The audit also looked at how the three entities planned to monitor activities in the short term and measure the success of the action plan against the stated objectives and outcomes in the long term. We found that the action plan activities were properly monitored, but better performance indicators would help to measure the policy outcomes of the action plan initiative and inform future policy decisions. Better public disclosure of the action plan's performance could also benefit the Canadian venture capital market.

Mr. Chair, the Department of Finance Canada and also Innovation, Science and Economic Development Canada have agreed to our three recommendations and have prepared a detailed action plan.

[*Translation*]

Mr. Chair, this concludes my opening remarks.

We would be pleased to answer any questions the committee may have.

Thank you.

[*English*]

**The Chair:** Thank you very much, sir.

We'll now move to Mr. Botham, please. Again, welcome.

**Mr. Richard Botham (Assistant Deputy Minister, Economic Development and Corporate Finance Branch, Department of Finance):** Thank you, Mr. Chair.

Since you've already introduced my colleagues, I won't do that. We certainly represent a team that worked on both the analytical aspects as well as the development, implementation, and ongoing management of the venture capital action plan initiative, or as I'll refer to it, VCAP.

I would like to take a few moments to provide you with a bit of the context for the initiative, some of the process elements that led to the development of the initiative, and some of the preliminary results.

In 2010 and 2011, McKinsey and Company, on behalf of the BDC, and the expert panel reviewing federal support to research and development, which was chaired by Mr. Tom Jenkins, examined the venture capital industry in Canada and found that there was a significant financing gap.

It was largely attributable to key structural challenges facing the venture capital market, including a shortage of experienced managers, subscale fund sizes, and a lack of institutional investment in the asset class. These factors led to persistent low returns, decreased the attractiveness of this asset class, and subsequently limited firms' access to venture capital financing.

The BDC also assessed the forecasted demand from Canadian fund managers looking to raise funds, as well as the forecasted supply of venture capital, and confirmed that there was a significant gap. While the BDC had been supporting the venture capital industry for some time, it was recognized that new approaches would be needed to address the structural challenges in the market.

These analyses led to the announcement in budget 2012 of a commitment of \$400 million for venture capital activities, for which the government would conduct further analysis before defining its approach. The government rolled out an extensive consultation process, receiving 75 submissions through an online portal, and hosting meetings with more than 250 industry stakeholders in Toronto, Montreal, Vancouver, Calgary, and Halifax, which included a number of members from Réseau capital and the Canadian Venture Capital and Private Equity Association.

In addition to these domestic perspectives, meetings were also held in Boston and Silicon Valley with a number of top-tier venture capitalists and other participants in the market. The government also conducted analyses on international best practices in Israel, Australia, Europe, and the United States.

As with any consultation, while there are differing opinions, consensus formed around some of the following overarching themes, which informed the design features of the venture capital action plan:

The new approach should be private sector-led and market-based, focused on demonstrating superior returns to investors. Although welcome, the funding announced in budget 2012 would be insufficient on its own to create a sustainable industry, and would need to lever significant resources from the private sector. Institutional investors left the venture capital asset class due to poor returns and the absence of large funds that fit their investment mandates, and they would likely only return if incented to do so in a different kind of structure. Venture capital in Canada was shifting away from early-stage investments towards later-stage companies where it was perceived that risk was lower. The funding in budget 2012 should be deployed to increase the number of private sector-led funding sources for venture capital funding managers. Investment should focus where Canada has existing strengths, such as information technology, life sciences, and clean technology. Finally, some funding should be deployed quickly into the market, given the immediate capital needs of innovative companies.

● (1545)

[*Translation*]

In early 2013, the VCAP was launched. It included a commitment by the government of up to \$350 million to create four new private sector-led funds of funds with private sector investors and interested provinces. It also included \$50 million for investment in four existing high-performing venture capital funds as a means to quickly flow capital to the market.

[*English*]

Selection processes were designed to allow the government to leverage the knowledge, expertise, and capital of private sector partners. A private sector expert panel was named to lead a competitive selection process for the general partners to manage the funds of funds, and for the general partners of the high-performing funds.

The panel established the information requirements for applications, defined the selection criteria and evaluation methodology using industry benchmarks, and shortlisted candidates for in-person interviews prior to making final recommendations to the Minister of Finance. In the case of the selection process for the funds of funds, recommended candidates made presentations to and were vetted by initial lead investors. Fund managers were selected by all lead investors, including governments.

While the funds of funds have sectoral priorities—information and communication technologies, life sciences, and clean technology—these importantly reflected investor interests, fund managers' experience, and dominant market opportunities.

During the design of the VCAP, the government considered various venture capital models from international jurisdictions, including those that had incentives to leverage private sector investment. While a variety of incentive models have been used across the world in different jurisdictions, including those that allow the private sector partners to purchase the public sector position, the government chose a different incentive structure.

In addition to the incentive structure, a number of other elements were negotiated by all lead investors, private and public. Negotiated elements enshrined in partnership agreements include the selection of the fund managers and the compensation arrangements for fund managers, including management fees.

The VCAP has already been successful in achieving many of the intended outcomes. It has secured the expertise of four talented funds-of-funds managers, including HarbourVest, a U.S.-based leading global manager which has opened an office in Toronto, and Kensington Capital Partners, which has established a new office in western Canada. These new office locations are important, because venture capital tends to be heavily involved in its local market.

Although fundraising started early, investors wanted to commit only once fund managers had been identified and vetted. The VCAP attracted a spectrum of diverse private sector investors, many of whom were new or returning to the asset class after a long absence. Fund managers were successful in attracting sufficient interest from investors based in Canada. A critical mass of domestic investors is an important signal of confidence in the domestic market to foreign investors, and it helps VC fund managers tap a broader pool of investment.

The government's investments in the fund-of-funds model leveraged significant private sector investment, both at the fund-of-funds level and at the underlying funds level.

The four funds of funds have surpassed their target sizes and have raised a total of more than \$1.35 billion in new venture capital financing, including more than \$900 million from the private sector. Each fund met its fundraising target in less than 18 months, which compares very favourably with industry standards.

Yesterday, the Minister of Innovation, Science, and Economic Development released VCAP data demonstrating that, as of March 31, 2016, the VCAP funds of funds had committed \$693 million of their total capital to funds and companies. This includes \$555 million to 17 Canadian funds focused on different stages of company development and industry sectors. These 17 funds have gone on to raise a total of almost \$2.5 billion for investments in entrepreneurs at the underlying funds level. In fact, 126 innovative, high-potential Canadian companies across various sectors all over the country have already received more than \$420 million in financing.

You will have seen the Auditor General's report and the government's responses, so I won't reiterate those findings. Together, Innovation, Science and Economic Development, BDC, and Finance Canada have developed an action plan, which you have also seen, to respond to the recommendations of the Auditor General and follow through on those commitments. Should the government develop a new initiative similar to the Venture Capital Action Plan, we would certainly consider the Auditor General's findings and recommendations as part of our analysis and development.

• (1550)

[Translation]

I am pleased to note that the performance measurement framework has been updated and that VCAP data is available online on ISED's website. These address the Auditor General's recommendation on increased metrics and reporting.

[English]

I hope this information assists you in your understanding of the VCAP. We thank the Auditor General and his team for the report. We will act on these recommendations according to our commitments in the action plan.

We would be happy to respond to any questions from the committee. Thank you.

**The Chair:** Thank you very much to our guests.

We will now move into the first round of questioning.

From the government side we have Ms. Mendès, please.

**Mrs. Alexandra Mendès (Brossard—Saint-Lambert, Lib.):** Thank you all for your presentations and for your presence here today.

[Translation]

My first question is for Mr. Ferguson.

In point 5 of your presentation, you say that the government faced difficulty in convincing private sector investors to participate in the plan. You mention returns and management, among other things.

Is the very design of the plan not part of the problem?

Do you think that the very fact that the government would create such a venture capital fund was part of the problem?

**Mr. Michael Ferguson:** No, the government's policy was simply to set up such a system. It had to determine how best to prepare the system. Our place was not to question the policy, but simply to identify the few issues present during the first stages of this program. The government's participation in this program did not concern us.

**Mrs. Alexandra Mendès:** I was not referring to your concerns, but to those of potential investors.

Your role was not to determine if this was a good policy or not, and I understand that well. However, were certain potential investors concerned by the fact that this was a government initiative?

**Mr. Richard Domingue (Principal, Office of the Auditor General of Canada):** We noted that in the beginning, these people had a lot of work to do to convince private investors to join the project. As we indicated in the report, the fee structure and the tracking of performance, which was a hindrance for the entrepreneurs, were part of their concerns.

Concerning achieving the full funding of these funds, we noted that for some of them, the funding period ended last March. So it was difficult to convince the businesses. The regulatory framework was also an issue. Under some Basel regulations, this type of asset was indeed not recognized in the calculation of admissible assets. Consequently, the financial sector, particularly the banks, were quite reluctant to join this initiative.

**Mrs. Alexandra Mendès:** Thank you.

I am still a bit confused about the reasons.

• (1555)

[English]

In point seven in your presentation, Mr. Ferguson, you say that better disclosure of the action plan's performance could benefit the Canadian venture capital market. How would that disclosure be done? What would be your recommendation for better disclosure?

**Mr. Michael Ferguson:** Again, this is a program that's dealing with \$400 million of federal investment into the program. There need to be ways of being able to determine whether the program is being successful. I think we've heard some indicators that were mentioned just now in the opening statement about some of the things that are coming out of the venture capital fund.

The problem with something like an investment in venture capital is that from a profitability point of view, you don't know whether it's going to be profitable until maybe 15 years from now.

What indicators can be used to identify whether the companies that are actually being invested in.... I think this is one thing that keeps interesting me in this whole conversation. We talk about how much money the government, the provinces, and private sector have committed, and how much money has gotten into the hands of fund-of-funds managers, and how much into the hands of funds managers and again, there was a number about the amount of money that has been committed to companies.

What's interesting is understanding how much money has actually gotten to the companies. What are they doing with it? What are the indicators that they have their ideas and their ideas seem to be leading to commercialization and leading to something that is going to be profitable? I think it's trying to get down a little bit more into that level of detail which is the information that people really need to be able to understand that, okay, yes, this program seems to be on the road not just to creating that ecosystem of venture capitalists, but also creating successful companies.

**Mrs. Alexandra Mendès:** That brings me to the question of all the layers of management in this. It was confusing to see that you have the managers, the managers of managers, the layers of intermediaries in all of it. How do you distil that into the ISED website and show where the money is going and how it's becoming a reality in terms of eventual profitability? As far as I understand it, there are at least five levels of disbursement of funds somewhere in here.

**The Chair:** Are you asking Finance or the—

**Mrs. Alexandra Mendès:** It could be, and it could be BDC, actually, too. From what I understand there are capital funds to companies but there are Canadian funds focusing on different stages of company development. Then there are 17 funds that go and raise a total of  $x$  billion dollars for investments in entrepreneurs at the underlying funds level, and then 126 innovative high potential Canadian companies finally getting some funding.

**The Chair:** Our time is up, so if there's a question, maybe we can come back.

**Mrs. Alexandra Mendès:** There isn't really a question. I'm just making a statement, yes.

**The Chair:** Thank you, Ms. Mendès.

We'll now move to the opposition.

Mr. Poilievre, you have seven minutes.

**Hon. Pierre Poilievre (Carleton, CPC):** Help me to understand the management fees. The Auditor General's report indicates that roughly \$250 million out of a total \$1.35 billion was committed to the fund of funds over the lifetime of the action plan. What does that work out to in percentage terms on an annual basis?

**The Chair:** I think we will go to Finance or BDC.

Go ahead, sir.

**Mr. Neal Hill (Vice President, Market Development, BDC Capital, Business Development Bank of Canada (BDC)):** Thanks for the question. I'm Neal Hill with BDC. We're the managers of the program for the government. Venture capital is not an easy—

**Hon. Pierre Poilievre:** The question is what does it work out in percentage terms on an annual basis?

**Mr. Neal Hill:** There are two levels of fees. The fund-to-funds managers collect approximately, on average, across the life of the program 0.56% of the committed capital that flows through their hands per year. That's the average across the life of the program for each of the fund-to-funds managers.

Similarly, there is a second layer of fees. This is where the bulk of the fees actually go, the underlying Canadian venture capital funds, who are receiving the bulk of the financing, charge anywhere between a 2% and 2 1/2% per year—

• (1600)

**Hon. Pierre Poilievre:** I'm not actually looking for a breakdown. I'm looking for a total, which is the opposite of a breakdown. What is the total annual percentage management fee for this initiative?

**Mr. Neal Hill:** Over the life of the program, it is 19.6%—that's our calculation—of the total capital, and then the life of the program is 12 to 13 years, depending on how things turn out.

**Hon. Pierre Poilievre:** It's 19.6% divided by 12.

**Mr. Neal Hill:** Exactly, sir. Yes.

**Hon. Pierre Poilievre:** Okay.

I want to ask about opportunity cost. My questions here are based on two primary assumptions. One is that money is real and that money invested is not merely digits on a screen, but represents real value. Two, a dollar can only be in one place at one time.

The Auditor General has said that the initiative needs better performance indicators analysis, but I have found, with all manner of government programs geared toward economic development, that they miss half the balance sheet. They only focus on the purported benefits, not the unseen costs.

Therefore, \$400 million invested through the 2012 budget is \$400 million subtracted from somewhere else. That money had to have been taken out of the Canadian economy. Perhaps it was borrowed at the time, because there was a deficit in that year, but ultimately, it has to be paid back.

What methodology will Finance Canada employ to ascertain the damage done to the Canadian economy by the removal of \$400 million from the hands that earned it in order to fund this initiative?

Mr. Botham.

**Mr. Richard Botham:** Maybe I'll start and then turn it over since you focused the question on Finance Canada.

We have not done any analysis specific to this \$400 million. We haven't done that analysis, but there is one clarification, I think, that's required to understand your question better, and that is actually whether this is an expenditure or an investment.

It does differ, in that respect, from some other categories of expenditure that governments have undertaken. I think it's worth passing that on to my colleague to explain to you how it is treated as an investment.

**Mr. Jérôme Nycz (Executive Vice President, BDC Capital, Business Development Bank of Canada (BDC)):** The money that BDC uses is put to work in funds, the funds invested in companies. We at BDC have been involved in the asset class for over 20 years. We follow and monitor performance of investment at the company level and at the fund level, and we aggregate that to BDC.

In terms of investments made in the company at day one, \$1 invested is worth \$1 of value—

**Hon. Pierre Poilievre:** Presuming you get it back.

**Mr. Jérôme Nycz:** At day one, the presumption is that it's worth \$1.

**Hon. Pierre Poilievre:** On day one.

**Mr. Jérôme Nycz:** That investment in the company is invested against promises of hitting a milestone at the company level. While your sales increase by 10%, while your revenues increase by  $x$ , or your profitability, we monitor the performance of the company, and we monitor it as well with other fund investors. The \$1 we invest is worth something. A year later, if the company has not met their milestone, there's a reduction of the value of that investment by 25%.

Opposite to that, if that company is hitting the milestone, is progressing, and needs additional financing, if an external investor comes into the round and validates the value of the company, then there is an increase of the fair value. There's the cost aspect, and then there's the fair value.

At BDC, we monitor the cost—the \$1 going into the company—and we monitor the fair value of that investment over time, validated by external investors and often U.S. investors. We report the value of that investment on fair value, and that fair value is a contribution to the net income of the bank.

• (1605)

**Hon. Pierre Poilievre:** If I may, though, BDC got its money through a public offering to the Government of Canada for this initiative. Basically, it sold more shares to the Government of Canada, right? Is that a summary?

The Government of Canada had to take \$400 million from somewhere. Now, you might currently account for that as an accounts receivable or say that the government has an increased asset in its share of BDC, but the bottom line is that \$400 million is here, so it cannot be there. It came from somewhere. We know that.

What I'm asking is, in your doing this analysis, are you treating the \$400 million as though it was created from scratch? Or are you treating it as though it was displaced, it was moved, it was taken.... It was either borrowed out of the economy or taxed out of the economy, but one way or another, it was taken away from some other place and some other use. Therefore, there is an opportunity cost. Are you considering that in your full analysis of the success or failure of this initiative?

**Mr. Richard Botham:** It's treated as an investment.

**The Chair:** Thank you.

**Mr. Richard Botham:** In balance sheet terms.

**The Chair:** Thank you, Mr. Poilievre. Your time is up.

We'll now move to Mr. Christopherson, please, for seven minutes.

**Mr. David Christopherson:** Thank you, Chair.

Thank you all for coming today. We appreciate it.

For the benefit of our international auditors, I want to point out that I'm a member of the third party and there aren't many benefits to not being the government, but one of them on this committee is that I'm never on the defensive because I'm never being audited. I never have to defend anything, and I always have the greatest respect for particularly the government members, who are caught in a really tough spot. They have to defend their government because they're part of a team—and that's expected of all of us—but also as a member of this committee, where we try to stay as much as we can above the partisan fray.

I make reference to my earlier comment, which calls on government members—in this case it's the former government members who are sort of defending, if you will, or have that aspect—to be willing to legitimately criticize their own government when they've done something wrong, or not as well as they should, or wasted taxpayer money. That higher calling calls upon them, while they know they have staff and others right behind them, freaking out in some cases, as they go forward and say “This is wrong and we need to ensure that it doesn't happen again.”

The reason I'm saying all of this to our guests is that this is a lot to ask of a member, and I've been on this committee for a very long time and I know how difficult it is. The other part of the equation is that someone like me, who never has to play that role, I think has an obligation when there's something close to good that the government has done, to be willing to say so. As much as colleagues will know, I just love ripping into these things. I see a colleague joining me who has been around for a long time. He knows how much I love to rip into these things when we have massive waste, and get right into it.

I have to tell you—

**Hon. John McKay (Scarborough—Guildwood, Lib.):** Nothing has changed, right?

**Mr. David Christopherson:** You're right, except—hang on, John, hang on—every now and then there's an audit that comes along where somebody needs to say that with one exception, this is a pretty good audit. I had to get to page 13 before there was a recommendation. What I'd run into twice before then was that we made no recommendations in this area of examination. When there are no recommendations, that tells me a lot as a member of this committee. So I think it behooves me to say that, on balance, if everybody's audit came in roughly where this one was, a lot of the work that we do would be in the past. We would have achieved what our ultimate goal is, which is to change behaviour so that people follow the rules, are focused on following the right procedures and making sure that all those pesky little boxes are actually ticked, that there's a reason for them.

I'm going to go to an area that's a bit problematic, but it won't be my usual style because it's not deserved. I want to compliment all of you on what I would say is a relatively good audit. I would hold you up as an example to the rest of the government on a lot of key areas, in terms of the things that you got right.



Today's one of those days, Chair, where man bites dog and I'm complimenting the former Conservative government—and I give the Conservatives their due—that this was not a bad audit, given some of the nightmares we've seen come across our table. So thank you very much for the job that you did. These kinds of compliments don't come very often from me, so if that's worth anything at all to you, hold it close because it's sincere and heartfelt. It's a good audit, not a bad audit, and I wish we could see more of these.

Having said that, I don't have too much time. In fact, how much time do I have left, Chair?

• (1610)

**The Chair:** You have a couple of minutes left. I was just going to say, on behalf of the former government, that I'm starting to worry when we have you outside.

**Voices:** Oh, oh!

**Mr. David Christopherson:** Don't extrapolate too much from it.

**The Chair:** Go ahead.

**Mr. David Christopherson:** On this committee, you have to take the blame when you've done wrong, but give credit where credit is due. I want to make sure that we do that. Otherwise, we're talking hot air when we talk about our lofty goals of being non-partisan and holding whatever government to account regardless of their partisanship.

The only reason I had to put a disclaimer in my comments was that, in the one area, whenever I see the Auditor General use words like “significant shortcomings”, that's an alarm bell. The Auditor General is careful about the language he uses. When that office says “significant shortcomings”, that needs to be paid attention to. That was the one thing that stopped you from getting an even more glowing report.

I still have three minutes later, but I have one more question.

On this one, the thing that troubles me is that you reserve the right.... It's stated on page 13 of the Auditor General's report, “it indicated that it reserved the right to make changes to the selection process and to select any firm that it preferred.” Then I hear that you had some trouble in the beginning getting people to sign in.

Things like that would certainly jump out to me. May I just ask, what was the rationale for you determining that was fair?

**The Chair:** Mr. Botham, please.

**Mr. Richard Botham:** There are two things.

With the difficulty that was referenced to get participation, I believe, and I can be corrected by the Auditor General and his office, that is in reference to investors. I think what you are referring to is the selection of fund managers. That's just one of the—

**Mr. David Christopherson:** The two aren't related? The investors weren't looking at the way you were selecting the fund managers and having a problem? It's totally unrelated?

**Mr. Richard Botham:** I think the criticism of the process is in relation to the selection of fund managers rather than.... The investors are a separate issue.

**Mr. David Christopherson:** Okay. Fair enough.

**Mr. Richard Botham:** With the selection of the fund managers, the rationale for including that was twofold.

This was a process that we were developing, in part, as we went. There were significant uncertainties with the reactions of investors. We were trying to make this a process that would meet a perception test in the market for the final outcome and who was selected, and that the fund managers would be seen to be credible.

We wanted to build in flexibility for lead investors to have a role in the selection of the fund managers. If government alone selected fund managers, and then went out to private investors—pension funds, banks, corporations—and said, “Please commit \$100 million to this fund manager that you have had no role in selecting or vetting”, then we would have had even more difficulty in raising funds than we did with the challenges we faced that have been highlighted.

We did try to adhere to the normal standards of disclosure, openness, and transparency, which a standard government procurement would follow, knowing that this was not a standard government procurement. Governments were committing, in the end, a small proportion of the capital under management. For every \$1 of government funding, the private sector dollars were three times that. That was the reason for that.

• (1615)

**The Chair:** Thank you very much.

We'll now move back to the government side, and we will go to Ms. Shanahan, please.

Ms. Shanahan, you have seven minutes.

**Mrs. Brenda Shanahan (Châteauguay—Lacolle, Lib.):** Thank you very much, gentlemen, for being with us today.

Thank you, again, to the Auditor General for reminding us what our role is here, and that is not to question policy, much as we might want to question policy of a previous government. The fact is that we are here to review how the policy was undertaken, how the program was undertaken. It really is a learning exercise for us to see if there are any changes we need to make to where the existing program is now, and then what we would want to do in the future.

I get that even though they are big numbers and it's disconcerting, costly, and so on, we're talking about venture capital and new businesses, and there is a cost attached to searching out those new businesses. Not all of them are going to make it—a bunch of them will fail—but we're hoping we're going to get that next Google, are we not? We're hoping that we're going to really encourage the ecosystem here in Canada, so I get that.

That being said, what concerns me is that with regard to the public sector participation, the government's participation, no exit strategy was chosen.

My first question is for the Auditor General.

You mentioned in the report that the absence of early exit options for the public sector partners “could send a message that the public sector's participation is intended to be permanent”, while the intention of course is that we would get out eventually. Could you please explain that a little bit more for us?

**Mr. Michael Ferguson:** I think fundamentally we were looking to see whether there was that type of an exit strategy. We had seen that, perhaps, in models used in other places, and we just raised the issue so people would be aware that some could see the lack of a structured exit strategy as a signal that perhaps the government was planning on staying in on a more permanent basis.

I'll ask Mr. Domingue if he has anything else that he'd like to add to what we've already stated there.

**Mr. Richard Domingue:** Mr. Chair, I think one can see an exit strategy as the ultimate performance indicator. When the government decides that the system is sustainable enough and the ecosystem is led by the private sector, and it's time for it to divest itself of the investment made by the taxpayers, that's the ultimate performance indicator. It's in that context that we suggest that next time, if there is ever a follow-up to this VC initiative, maybe you'd want to consider an exit strategy.

The way the VCAP was designed did not allow for that, but next time, if there is a follow-up to more public funding in the VC world, maybe you'll want to consider that ultimate performance indicator, which is the exit strategy.

**Mrs. Brenda Shanahan:** Thank you very much.

I will continue, then, with the gentlemen from the Department of Finance and from the BDC.

We have money invested right now and I'm sure we're not the only ones who are concerned about how those 126 companies are doing and how they're performing. What are the performance metrics being used now?

**Mr. Richard Botham:** I'll turn that over to my colleague from Innovation, Science and Economic Development, because their ongoing role is to develop that kind of framework, to report on it, and to make that information public.

Just with regard to the exit strategy, the investment made into the funds of funds is not an ongoing investment. If there is a sense that there is an ongoing commitment that further funds are being made available, that is not the case. It is a single, one-time investment into funds, and for making that investment, there is a return.

There isn't an option for the government capital to be withdrawn from the funds early. That is absolutely true. It was designed so that the investment would actually be deployed and that returns would be provided back to the government. So it's not ongoing forever; it is within the life of those funds.

• (1620)

**Mrs. Brenda Shanahan:** Would you comment further, then, on what would bring about an exit strategy? When would be the time? Is that a political decision, or...?

**Mr. Richard Botham:** I'm a little curious about the notion of an exit strategy, because the Government of Canada is active in the venture capital space through its financial crown corporations, each one of them. Export Development Canada, Business Development Canada, Farm Credit Canada, they are all active in the venture capital space.

Is there a time at which governments will get out of that space? Absolutely, if it is a self-performing industry, but that would be—

**Mrs. Brenda Shanahan:** I don't mean the whole space; for that \$400 million.

**Mr. Richard Botham:** But I'm curious as to why it's an objective for the \$350-million investment in the funds of funds to be withdrawn before the investment is actually made and the returns are received. I'm not certain why that would be an objective.

**Mrs. Brenda Shanahan:** What is the expected life of the investment?

**Mr. Richard Botham:** It will vary, but it's 12 years on average.

**Mrs. Brenda Shanahan:** Okay, so there is some timing around that.

**Mr. Richard Botham:** Oh, absolutely. It gets deployed in companies. Companies grow, they pay back their investors, and as an investor the government gets a return.

That's just a bit of context, I guess, from my perspective.

**The Chair:** Yes, Mr. Padfield.

**Mr. Christopher Padfield (Director General, Small Business Branch, Small Business, Tourism and Marketplace Services, Department of Industry):** Mr. Chair, just to be clear, we have a performance management framework for the initiative. We're happy to share it with the committee, if they want to see it afterwards.

The framework is really built around three key themes: how the VCAP is impacting the venture capital ecosystem; how it's supporting the underlying companies; and how it's building the next calibre of fund managers in Canada. We have a whole series of indicators. It's been complemented by some of the recommendations that the Auditor General made in his report really targeting down in terms of some of the performance of the actual underlying companies and those things. It gives you a bit of a flavour of how much follow-on investment we're seeing for funds after the VCAP and some of the performance of the actual firms within it.

I would be happy to share that, if that would be useful.

**Mrs. Brenda Shanahan:** Yes. Perhaps you could file that with the committee.

**The Chair:** Thank you very much. Unfortunately, the time is up. *[Translation]*

Mr. Godin, you have five minutes.

**Mr. Joël Godin (Portneuf—Jacques-Cartier, CPC):** Thank you, Mr. Chair.

It is my turn to thank the witnesses for taking part in this exercise.

What I find interesting is that this process was prepared in advance, announced and implemented in 2012.

I would like to thank my colleague for having pointed out the good work done by the previous government, but I think there is always room for improvement, and that is why we are here today.

The Office of the Auditor General recommended that the Department of Finance and Innovation, Science and Economic Development Canada expand the venture capital Action Plan's performance measurement framework by considering the inclusion of performance metrics.

How did the OAG develop this list of additional performance metrics? You refer to measures such as “recipient companies' export growth and their financial performances, new patents and patent citations; the number of new or additional key investment personnel and lead investors”.

I do not want to repeat what is in the report, but how did you develop this list of additional performance metrics?

**Mr. Richard Domingue:** Mr. Chair, we looked at what other countries were doing. Exhibit 1.4 refers to New Zealand, Finland and the United Kingdom. In their performance reports on their venture capital activities, they include this type of performance indicators.

I would also like to add that the departments replied that when the data became available, they would include indicators such as expenditures on research and development and the number of jobs created. Patents are one of the key indicators of innovation, as mentioned in exhibit 1.4. This idea of commercializing innovations is also an extremely relevant indicator to measure whether venture capital investments have led to technological innovations or not.

• (1625)

**Mr. Joël Godin:** What I understand is that the data is not available. As it becomes available, you are going to use it to include indicators; is that correct?

**Mr. Richard Domingue:** Is the question addressed to us, or to the Department of Finance?

**Mr. Joël Godin:** I saw Mr. Nycz react earlier, when you replied.

**Mr. Jérôme Nycz:** We track our investments as regards the funds and the companies. We are in a position to know how many employees these companies have. These are companies that hire, in the technology sector, employees who often have advanced diplomas, doctorates and the like. And so we have figures regarding positions, the companies' growth, and their sales. In the case of several of our companies—I speak for the BDC—we follow patent applications, because this validates the investment concept.

We have a lot of matrices at our disposal and we like to follow the performance of these companies regarding the Venture Capital Action Plan. And so we will be receiving information as these companies develop. Often, we invest when the company starts up. There are two or three people who hire personnel. It takes a year or two before we really see the technological attraction, before the technology is defined, validated and before sales are generated afterwards. That is part of the figures and matrices we follow in our portfolio at the BDC. This will apply to the Action Plan program.

**Mr. Joël Godin:** In fact, what you are telling us is that the performance metrics the OAG has added are performance indicators you already had. So the recommendation of the OAG is mentioned, but as far as you are concerned that is already being applied.

**Mr. Jérôme Nycz:** Yes, and we are most definitely going to have data on the companies in the Action Plan portfolio as they develop.

**Mr. Joël Godin:** In another connection, let's take the case of a new business just being started up. It has experience in another sector of activities, but there is a new sustainable development technology that is available and it needs venture capital in order to acquire it.

Could you describe the process that is required on the part of the small entrepreneur—we have some in all of our ridings—who is looking for some funds in order to start up his business with good technology, but is lacking funds?

[English]

**The Chair:** Go ahead, but very quickly, please.

[Translation]

**Mr. Jérôme Nycz:** First, in the case of a startup company, the government supports several accelerators throughout Canada. The BDC supports 13 in certain specific sectors. In the case of green technologies, there is Foresight, and we have another accelerator in Montreal. So that is a good place to obtain financing in the initial stages of starting up a business.

These companies can spend 6 to 18 months in incubation. They have access to services, professionals, and also to other venture capital firms. They are introduced to the venture capital firms and a dialogue begins. We measure the interest investors have and the capacity of the team to deliver the technology. A first investment is made at the very beginning. That can be a cheque of \$500,000 or \$1 million. This helps the company to develop the technology and accelerate its development and sales. Afterward, other investors answer the call.

So there are funds, accelerators, specialists in these sectors. What we want to do is bring together the skills of the fund managers and the needs of the entrepreneur. In our portfolio we support more than 700 companies through these accelerators, our funds and our direct investments.

[English]

**The Chair:** Thank you very much.

We'll go to Mr. Chen, please.

[Translation]

**Mr. Shaun Chen (Scarborough North, Lib.):** Thank you, Mr. Chair.

How much time do I have?

[English]

**The Chair:** You have five minutes.

**Mr. Shaun Chen:** The report from the Auditor General highlighted the delicate balance that needs to be reached between commercial confidentiality and greater transparency. Within the report, it points out that the departments of Finance and Innovation, Science and Economic Development did not release the information that was collected by the Business Development Bank of Canada, a crown corporation, on the activities arising from VCAP, the venture capital action plan.

My question for the departments is in terms of making that information available to the public or reporting it to Parliament. What are the concerns? What are the risks of making that information available?

•(1630)

**Mr. Richard Botham:** If I'm not mistaken, I think the report from the Auditor General was highlighting that, as the initiative moved forward and as money was put out into the economy, there should be better reporting to Canadians on results and how the money was being deployed. I think it was on a go-forward basis, and that is part of the reason that the Minister of Innovation, Science and Economic Development released information as part of an annual reporting cycle that was released yesterday. My colleague can give more information.

**Mr. Christopher Padfield:** I think you can make reference to the action plan we put forward in response to the audit, being clear that we're going to start reporting on an annual basis in May. It really is the last fund of funds. It closed its fundraising not that long ago, so we're still very early days. Some of the metrics the guy went through in terms of our performance framework aren't going to be that meaningful because companies are only just beginning, and investments are going forward. We were looking at it for the period for when those performance metrics would make the most sense and look the most real. If you look at the release we made just yesterday, I've highlighted where some of the investments have gone to date.

I'm not sure we have any kind of concern in terms of confidentiality. We know what pieces are covered under confidentiality agreements with the fund managers. Otherwise, we're making as much information available as possible, because again, we're happy to let everyone know the performance of the funds and the activities underneath.

**Mr. Shaun Chen:** Thank you.

To take that further, I know that the report looks at what other countries such as New Zealand, the United Kingdom, and Finland have done in terms of releasing performance metrics. You mentioned just now that information was recently released. Is that sufficient in terms of what has been made publicly available? What can we learn from what other countries are doing so that we can have greater transparency in the data we provide to the general public?

**Mr. Christopher Padfield:** I think the Auditor General could speak to the views on what we put forward originally, and they've given us some helpful suggestions in terms of some of their more company-level information.

We're always happy to evolve this as we go along and as we find more and interesting ways of making the information more accessible to folks. I think the plan for us is that we want to make the performance measurement framework public, and then we're going to report out against it. We've identified some of the pieces in the action plan, and the goal is to take the data for this fiscal year and have them reported out in May of next year so people can do overall performance and some of the underlying indicators there too.

**Mr. Michael Ferguson:** I think there are a few things in terms of all of the performance indicators. I think that we've heard today, for example, that BDC has a lot of information about the companies that are being invested in, what they're doing, and how they're how tracking, and Industry as well is tracking quite a bit of information.

I think our concern mostly is about what information you have as a parliamentarian. This is \$400 million that the government has put into these funds of funds. As has been described, that \$400 million is

not an expense, so it did not affect the government's deficit one cent at the time it was made because it's considered to be an asset. So BDC has to track very carefully to make sure that the asset continues to be worth \$400 million, and it tracks a lot of information. I get a bit concerned, as I said earlier, that a lot of what we keep hearing about is \$1.35 billion committed and all of that. This is for you as parliamentarians to decide, but I don't think there's really a lot of information about how much of this money has actually gotten into the hands of the companies, and I think that information was part of the report released yesterday, how much has actually gotten into the hands of the companies.

But we still don't really know, sort of, who those companies are. We don't really know what progress they're making. There's some categorization between whether they're a seed company or various different levels. What we were trying to point out is that it's not an issue of the information doesn't exist; in fact, the information does exist. It's more an issue of, okay it's \$400 million that the federal government has put into this investment, and it's being monitored and it's being watched by BDC and the other departments, but is there a certain amount of information at the public level that you as parliamentarians should be receiving so that you understand exactly where this money is going and what it's being used for? I think that's really what we were pointing out.

When we looked at things like what was going on in other countries, what academics were recommending, and that type of thing, it was all those types of possible public indicators to help give you, as the people who oversee everything, some information about progress being made, and it's not just the importance of building the ecosystem of fund managers, but fundamentally, to the extent that the companies are going to be successful, that's probably the number one key.

This is \$400 million, but based on the report yesterday, that \$400 million hasn't all yet gone into individual companies. I think it's just important that you understand all of those parameters of what this program is about.

•(1635)

**The Chair:** The time is up, but before we move on, I guess the question is what the rationale was for not reporting this information to Parliament and to the public. Was this information shared with the private sector partners who participated in the venture capital action plan?

Could one of you answer that?

**Mr. Richard Botham:** I'll take a run at it, but maybe my colleagues will chime in as well.

Private sector investors would have the same interest as the Government of Canada in monitoring their investment. They would certainly be watching the progress of the investment and its performance. That doesn't get [*Inaudible—Editor*]

**Mr. Jérôme Nycz:** In terms of funds-of-funds investment funds, investors participate at the annual meeting of all investors in the funds. At those meetings, the fund goes through each one of their invested companies and reports progress against the original intention or their original strategy.

BDC and other investors go through all of the companies under the fund portfolio and all of the fund performance under the VCAP. We get a full report on the progress of these companies.

**The Chair:** Are you telling me that every private investor would have that information? Would they have the aggregate rate of return that they would be expecting or that they would see?

**Mr. Jérôme Nycz:** Exactly. Each investor in the fund of funds, that fund of funds would invest in funds; if that investor is, for example, invested in Teralys investment funds, that investor would have a line of sight on all of the underlying portfolios.

**The Chair:** Getting back to what the Auditor General suggested—and I don't want to put words into his mouth—from what I heard, I'm not certain that he's satisfied that Parliament has yet received the information we would need in order to understand those things.

**Mr. Christopher Padfield:** Just to be absolutely clear, what the Office of the Auditor General commented on was our performance measurement framework. We had intended to release information publicly and they added a few additional indicators to it. There was never any intention of not reporting publicly. Every intention was there. What they commented on was an existing performance measurement framework that we had prepared, and they added a few other indicators to it. It wasn't that we weren't reporting, it was just they added a few additional indicators to the performance framework.

**The Chair:** We may come back to that.

Mr. Poilievre, please.

**Hon. Pierre Poilievre:** I realize the Auditor General is correct in saying that this is not an expenditure, the 2012 budget didn't expend \$400 million. In fact, there is an asset, which is the investment, but in order for that money to be provided for the investment, it had to be secured from the consolidated revenue fund. Is that accurate?

**Mr. Richard Botham:** Yes.

**Hon. Pierre Poilievre:** In a deficit year, which it was, even though money is fungible, we can assume the money would have been borrowed. Is that correct?

• (1640)

**Mr. Richard Botham:** That's correct.

**Hon. Pierre Poilievre:** Then we would be paying the going rate on that money. I'm not sure what the government marketable bonds were going for in 2012, but—

**Mr. Richard Botham:** Nor I.

**Hon. Pierre Poilievre:**—over the 12 years there is an accumulated cost, even just to money.

I guess what I'm trying to inculcate here is the notion that our analysis of these kinds of initiatives should not only take into account the purported benefits, but also the actual costs. Otherwise, we leave ourselves with the false notion that there are no costs and that this was just created out of nothing.

Do you have any intention of including any such analysis in what you publish, your performance indicators?

**Mr. Richard Botham:** If I understand you correctly, the government cost of capital should be taken into account when the government thinks about what the return is on that capital, and there

should be some kind of adjustment made for that to get a real rate of return given that the money was borrowed and that there is a cost to government capital for all expenditures, investments as well, but investments are performing investments until proven otherwise.

**Hon. Pierre Poilievre:** I do believe that, yes. I would suggest to you that we should also consider the harm that those net costs have, if there are any, on the economy that paid for it. You mentioned earlier that some of your indicators are the number of people who will be employed, but companies that pay taxes employ fewer people. The more tax they pay, the fewer people they employ. I realize these things are hard to measure, but I know that Finance Canada does have some methodology to measure these things. I know that when a proposed reduction in a corporate tax rate is made, Finance does an analysis on how many net jobs it will create or...an increase will reduce.... We get these reports as this process unfolds.

Would you consider matching the purported benefits with the actual economic costs of deploying the public money in the first place?

**Mr. Richard Botham:** As I indicated, I have not given it a lot of thought. But since you just raised it, it seems to me the relevant adjustment is the government cost of capital in this case.

**Hon. Pierre Poilievre:** Okay, we'll have to agree to disagree on that.

I'd like to move on to predetermined returns. In the Auditor General's report, it says, "Class B investors provide money earlier but receive distributions...after Class A investors receive a predetermined level of returns."

The class A investor is the private sector. The class B investor is the public sector. What is the predetermined level of return that the private sector investor is promised?

**Mr. Neal Hill:** Perhaps I could speak to that.

That's actually a rate of return. It's an interest rate that is covered by a confidentiality clause in the limited partners agreement between the investors and the managers.

**Hon. Pierre Poilievre:** I'm not asking for the actual rate, but just tell us how it works.

**Mr. Neal Hill:** Shall I just describe the flow of the funds on the way out?

**Hon. Pierre Poilievre:** Yes.

**Mr. Neal Hill:** We refer to it as the waterfall. When there are returns to be had, the capital comes out and the private investors get it first, and the private investors get all of the returns until they have been kept whole, brought whole, on the capital that they previously put in. Then they get the stated return, the preferred return. Then they get the management fees that they've paid into the funds of funds rebated to them. Then the government goes through the same cycle.

**Hon. Pierre Poilievre:** May I ask for a quick clarification?

**The Chair:** I can't take any more questions. We'll let them finish because your time is up.

**Mr. Neal Hill:** Then the government goes through the same cycle. Our capital that's been contributed comes back...the preferred return, the fees. Then and only then, after those two cycles are complete, does the fund manager have a right to start sharing in the profits of the fund.

• (1645)

**The Chair:** Thank you.

Mr. Arya, please, for five minutes.

**Mr. Chandra Arya (Nepean, Lib.):** Thank you, Mr. Chair.

[*Inaudible—Editor*] Mr. Botham gave big numbers: 126 Canadian companies [*Inaudible—Editor*] and \$420 million, but when we look at it, our original investment of \$350 million, not \$400 million...the funds of funds raised \$1.35 billion. Out of \$1.35 billion, \$555 million was invested in 17 Canadian funds, which in turn raised \$2.4 billion. Out of the \$2.4 billion, \$420 million has been invested. When you do the math, probably less than 10% of the government funds have been invested. Is that correct?

**Mr. Richard Botham:** That went by very quickly, but I would say I think the math...

**Mr. Chandra Arya:** Okay, let me repeat it slowly. I know sometimes when I talk fast, people have difficulty in understanding.

**Mr. Richard Botham:** No, that's fine. The math is a little different from that, I think. So \$350 million of Government of Canada money across four funds, which total \$1.35 billion.... I think the calculation is really, government accounts for 25% of the total capital—

**Mr. Chandra Arya:** Approximately. Correct. Out of \$1.35 billion, \$555 million was invested in 17 funds.

**Mr. Richard Botham:** So far...

**Mr. Chandra Arya:** That's approximately 40% of that.

**Mr. Richard Botham:** But there are two things, I guess. One is, that is a milestone along the way because not all capital has been committed, and not all capital has been deployed.

**Mr. Chandra Arya:** I'm talking about the percentage here. So, 40% of that was committed, but basically, you said you're adding additional metrics for reporting.

Does your report state how much of the government's \$400 million has actually been invested in these 126 companies?

**Mr. Christopher Padfield:** I don't think we separate it from our accounting responsibilities. We don't know exactly where every government dollar has gone. We look at the overall file.

**Mr. Chandra Arya:** Then what's the point of listing this \$420-million investment?

**Mr. Richard Botham:** The point is that the Auditor General has made it clear that one of the key indicators is how much money is going into companies, and what is company performance at the end.

**Mr. Chandra Arya:** I understand that.

**Mr. Richard Botham:** It's for that reason that's part of the reporting.

**Mr. Chandra Arya:** But if they can't claim the investment made that has been published toward the amount of the government's investments—

**The Chair:** Go ahead, Mr. Padfield.

**Mr. Christopher Padfield:** To be clear, it's our percentage of the overall investment, just on everything. We put in the \$350 million, and we raised another \$35 million.

**Mr. Chandra Arya:** No, we put in \$350 million, and we invested \$420 million.

**Mr. Richard Botham:** No. Maybe I'll walk you through it.

**Mr. Chandra Arya:** Quickly, I only have two minutes more, and I have another question.

**Mr. Richard Botham:** It's a complicated question. I'll walk you through it quickly. I'll even speak faster.

**Mr. Chandra Arya:** I have one question for the BDC.

Regarding the \$400 million, did you issue shares to the government for this \$400 million?

Did you have a separate category of classes of shares for this?

**Mr. Jérôme Nycz:** We track that investment as a VCAP program, issue shares in lieu of injection of capital, and report it separately. It gets rolled up in BDC capital which gets rolled up in BDC, and we report it as a separate segment of the BDC operation.

**Mr. Chandra Arya:** When you get the distribution from the investments you made, how will you transfer it back to the government?

**Mr. Jérôme Nycz:** We'll be tracking investment and the return of capital. The objective is to return more capital than we receive.

**Mr. Chandra Arya:** I understand. When you get the returns from the investments you made, how will you transfer that to the government?

**Mr. Richard Botham:** Typically, the BDC provides dividends.

**Mr. Chandra Arya:** I know, but if this \$400 million is merged into the equity capital of the BDC—

**Mr. Richard Botham:** No, Jérôme said it's tracked separately. Share purchases are separate as well.

**Mr. Chandra Arya:** So now, with the remaining \$400 million that you have not invested in the investment funds, obviously it must mean you're earning some returns.

**Mr. Jérôme Nycz:** The Government of Canada provides capital as we request. We only requested some capital to initiate the program, and we'll be doing a capital call some time in the next year or so.

**Mr. Chandra Arya:** How much has it released to you? How much have you requested until now?

**Mr. Jérôme Nycz:** It would be \$250 million out of the \$400 million.

**Mr. Chandra Arya:** Out of \$250 million that has been released, how much of that money has been invested in the 126 companies?

**A voice:** Twenty-five per cent.

• (1650)

**Mr. Jérôme Nycz:** Less than that.

**Mr. Christopher Padfield:** It's hard to say off the top of my head.

**Mr. Richard Botham:** We know it has to do with the timing of capital calls.

**Mr. Chandra Arya:** With the BDC, I've been after them regarding their investments in manufacturing start-ups which are close to nil. They invest hundreds of millions of dollars in unsecured loans, but when asked, they invested only \$24 million in manufacturing start-ups last year.

Out of the 126 companies, how many are in the manufacturing sector?

**The Chair:** On questions like that, and I'll tell you at the end of the meeting but also now, if you could get back to us on that, is it 25%? What is the number? Maybe you could provide a review of the money and what you've walked us through here in the last few moments.

Mr. Poilievre, for five minutes.

**Hon. Pierre Poilievre:** The money that goes into the company, that's through equity and not debt, right?

**The Chair:** I'm sorry, it's Mr. Christopherson's turn.

**Mr. David Christopherson:** Thanks, Chair.

I have only one question, unless I don't like the answer.

The question is relating to page 13, paragraph 1.64, and it actually goes back to that previous discussion. There are still parts of that which I find troublesome. I'm going to read this and ask for your comments. I'll jump to the end. It takes us to that difference between an investment and a procurement. I got that message earlier, but it's in this context. I'm just going to read 1.64:

During the consultations prior to the establishment of the Action Plan, there were many calls for a formal request for proposals or a competitive process. Among the stakeholders referring to this need were representatives of one of Canada's associations of venture capital firms. Initially, the Department of Finance Canada considered that the Action Plan would require a competitive process. In the end, the Department approached this as an investment, not a procurement process.

I understand that puts it in a different category and different rules apply, but still, I'm finding it hard to believe that you didn't take more seriously the request for proposals, a competitive process, particularly when one of the stakeholder groups.... It wasn't an individual firm—I could understand they might have a vested interest in seeing a certain outcome or nuance on a particular aspect—but here you had the umbrella group that represents them. I'm assuming they have tons of credibility and they're sort of the go-to umbrella group under venture capital firms.

Why did you so cavalierly set that aside and go off in your own direction?

**Mr. Richard Botham:** It was a competitive process. It was launched publicly. It was launched through Réseau capital and the Canadian Venture Capital and Private Equity Association. We worked closely with both associations, all through the process. All I can say—

**Mr. David Christopherson:** Well then, fair enough.

**Mr. Richard Botham:** —is that I am not aware—

**Mr. David Christopherson:** [*Inaudible—Editor*]

**Mr. Richard Botham:** —of any concern that the venture capital association has in that—

**Mr. David Christopherson:** Fair enough.

I will turn to the Auditor General. Obviously I misinterpreted your paragraph, or I'm not getting to the essence of what you were saying, based on the answer I just heard, which would suggest, “No, everything's okay, Dave, and here's why”.

So, Auditor General, help me understand. What was the issue that you're raising in paragraph 1.64 that I'm not getting right?

**Mr. Michael Ferguson:** I think the fundamental issue we were raising was, yes, they went through a process and that process was about trying to attract the interest in the market in this role. But as I think we lay out in the next number of paragraphs, because it was treated as an investment, it didn't follow the rigour that you would find in a normal procurement process.

In the end, it looks like it perhaps has not caused a big problem, but it could have caused a problem. Whenever there's this type of an arrangement and you have in the expression of interest that you reserve the right to pick anybody, I think we identified that the scoring mechanism was changed. I think it wasn't even developed until after the bids were in, and then it was changed during the process. One of the companies that was picked wasn't even a company that had put in a bid in the first place. There was just a number of things that could have made somebody question whether the process was or was not fair.

I think the warning here is less that there was necessarily a problem at the end of this one. I mean, they have companies in place. I think the warning is more that whenever a department decides that something is not a procurement process and therefore they can do some things that are outside a regular procurement process, it really raises the risk that at the end you could have people say, “Wait a minute, this process wasn't fair.”

• (1655)

**Mr. David Christopherson:** Very good. Thank you.

**The Chair:** Thank you.

We'll now move to Mr. Poilievre.

**Hon. Pierre Poilievre:** Back to Mr. Hill. Thank you for your very good explanation earlier on. I want to build upon it.

As I understand it, the money invested in the companies is equity. It's not debt.

**Mr. Neal Hill:** That's correct, yes.

**Hon. Pierre Poilievre:** When the private or class A investor is repaid, is it a share buy-back by the company?

**Mr. Neal Hill:** Rarely. The proceeds are generated, typically, when either the company goes public, and therefore their stock is liquid and the investors are able to sell their shares for cash, or they're acquired, and then the shares are then traded for cash or stock in the acquiring company, which then can become cash.

That's typically what happens. When the company down below reaches an exit event, as it's called, then those dollars flow back up to the fund that's invested into them, and that fund, in turn, pays their investors, one of which might be one of the VCAP funding issues.

**Hon. Pierre Poilievre:** Right, so the class As get paid out. They get a prescribed return, and then the government gets paid out, and then the manager gets a bonus if he's done all that.

**Mr. Neal Hill:** Exactly.

**Hon. Pierre Poilievre:** Okay. Then with respect to the question of early stage, as I understand it, the Auditor General defined venture capital as investments in early-stage enterprises. *The Globe and Mail*, though, had a report today on the VCAP and said, and I will quote from it, that the money also made its way down to "later-stage 'growth' investments (accounting for 35 per cent of the VCAP capital committed)".

Can you explain how a third of the money went to late-stage investments if it was supposed to be for early-stage investments?

**Mr. Richard Botham:** The agreements with the fund-of-funds managers specify the types of venture capital firms that they can invest in based on those firms' strategies, and those strategies extend from the early stage through the growth stage. That was part of the program from its legal inception.

**Mr. Jérôme Nycz:** I would suggest that there's very little late-stage money available in Canada. Fifty per cent of the money going into the late stage is coming from American funds. The size of funds in Canada is pretty small, so even the stages are much smaller in Canada. The size of cheques going into the later stage are half the money that an American company would typically have. At each stage, it's half of the money—

**Hon. Pierre Poilievre:** I don't mean to interrupt. It's just that the parameters of this program are very important, because we have extremely advanced capital markets in this country. I don't think there's any argument to be made that there is a generalized shortage of available investment for companies that are seeking it, across the economy.

The market failure purportedly addressed by this program is for venture capitalists and defined by the Auditor General in this report as "early stage". Is there mission creep here into areas that go beyond the purported market failure that we were supposed to be addressing?

**The Chair:** Also, in 2012, was it easy capital? Was there easy credit? Was there availability? Or was that part of the reason that we came out with this?

**Mr. Richard Botham:** I'll start. Sometimes there is a lot of variability in the way that people use terms. "Growth capital" has a different meaning for different actors. Is there mission creep? No,

because there are legal contracts that define the scope of the investments that fund-of-funds managers can make.

I'll turn to Neal, who would know more, but generally we're talking about series A rounds. We're talking about \$2-million to \$10-million investments in companies. The growth stage in the context that we're talking about means still relatively early and relatively small tickets. Others would be talking about a growth stage that is far beyond what these funds are operating in.

Neal.

• (1700)

**Mr. Neal Hill:** Growth-stage venture capital is what we're talking about, this being a venture capital program. Out of approximately 60 venture capital funds that are active in Canada now, there are only about three that have as their primary focus the growth stage. One major one of those happens to have been in the market when this initiative got under way. There's a bit of an accident of timing in terms of the concentration in that stage so far. We actually expect the concentration at that stage to decline as we go forward and additional commitments are made to earlier-stage funds and we return to a heavier early-stage focus.

**The Chair:** Thank you.

We'll move to Mr. Harvey, please.

**Mr. T.J. Harvey (Tobique—Mactaquac, Lib.):** I have only one quick question, really. I'm following up on Mr. Poilievre's earlier question. Seeing as how this money was generated initially from the consolidated revenue fund, is it not felt that it's necessary...? I follow Mr. Poilievre on this. I believe that we, as government, should be monitoring what the total cost of borrowing or the total cost of investing is.

The initial investments that went there came from consolidated revenue, and we should be monitoring that year over year, at least at different increments throughout the life of the investment, to determine what the total cost of that investment was. That's not only what the total cost was of the initial investment, but also the net cost associated with that investment.

Mr. Botham, I just want to ask you, do you believe that it is important or not important to Canadian taxpayers to know that they're getting tangible value for that asset, recognizing that venture market capital is a very risky business? I totally agree that the federal government has a responsibility to be in that marketplace, but I also think the Canadian taxpayers have a right to know how that investment is performing versus where that other money could have been.

**Mr. Richard Botham:** I think there's a narrow specific answer to that and a more general one. The narrow specific one is that the Government of Canada does not track a dollar of debt that is raised against a specific dollar of expenditure. It is not possible to say  $x$  dollar in  $x$  program is related to  $x$  dollar of debt raised. That's a difficult impediment to get over, but that being said, clearly Canadians have an interest in the debt levels of their governments, and that is transparent. There are costs to carrying that debt, and there is no doubt about that.



**Mr. T.J. Harvey:** The cost incurred with borrowing and the debt in 2012...because that's essentially what we did. We borrowed the money that we invested.

**Mr. Richard Botham:** I'm sorry, it isn't quite that way as the explanations have happened because—

**Mr. T.J. Harvey:** What I'm saying is the money that flows in—

**Mr. Richard Botham:** —but the money that flows in.... Sorry.

**Mr. T.J. Harvey:** There's still a tangible cost to that money that was invested.

**Mr. Richard Botham:** There was money committed.

**Mr. T.J. Harvey:** There was a tangible cost to the money committed.

**Mr. Richard Botham:** I'm making a distinction that's real. There's money committed. The money flows, as we've explained, over time through share purchases, some of which have happened, some of which will happen this year, and some of which will happen next year—

**Mr. T.J. Harvey:** I understand that.

• (1705)

**Mr. Richard Botham:** —and as that money flows in, or prior to it flowing in, government goes and raises money in the markets. It's not a question of tracking down when the government went to the market in 2012 and the cost of that capital—

**Mr. T.J. Harvey:** What I'm saying is that at each point along the way—I understand that all the money does not flow through all at once—and each time that money is committed from the federal government to this fund of funds, as its portion, there's still a cost associated when that happens over the life of the fund of funds. There's still a tangible cost there, along with the cost of administrating that fund, right?

**Mr. Richard Botham:** Which is built into the capital cost, but I take your point.

**Mr. T.J. Harvey:** There is a tangible, calculable cost.

**Mr. Richard Botham:** My assertion is that it's not calculable. It is in the abstract, but are we going to look at the 90-day bond that's released, the 10-year bond that's released, the 30-year bond, or the 50-year bond? Which one will be used? When governments go to the market to raise money, they do not tag that debt to a specific expenditure. It's used to cover government expenditures over time. In principle, I completely understand what you're saying. There is a cost to servicing debt, but it's not a calculation that can be made in respect to an individual dollar that is spent or invested.

**The Chair:** Thank you, Mr. Harvey.

I will now move to Mr. Godin.

[Translation]

**Mr. Joël Godin:** Mr. Chair, I think that Mr. Harvey has a good question. There is in fact a cost. Now we have to see how that cost is calculated and on what basis. I can appreciate that you have not yet determined how the cost will be calculated, but it is certain that there will be one. We put out \$400 million in 2012, and when the time comes to reimburse that amount, the return may not be at 12%—if 12% is the target—because we will not have paid any interest since 2012. I have some understanding of Mr. Harvey's question.

My question is about venture capital. I think that for our society, this financial lever to start up businesses is an investment. It is important for us as a society to encourage innovation, and it is in my opinion one of the missions of Innovation, Science and Economic Development Canada. In terms of results or percentages, your success rate is surely not 100%. What is your level of success?

In other words, of the businesses you have helped, what percentage unfortunately failed, and as a consequence caused the department and private partners to lose money? There are businesses, like the Googles of this world, that have prospered and succeeded, but there are others that unfortunately failed. Can you give me some indication? I understand that there's not much history since 2012, but have you noted any trends? Do you have any forecasts?

**Mr. Jérôme Nycz:** Thank you for the question.

We can track the performance of businesses and their lack of performance. Up till now there have been some successes, like Shopify, which was in the portfolio of one of the funds. That business was able to have a liquidity event. Up till now, four companies have failed. So they are out of the portfolio, they are a write-off for the funds. As the program progresses, some investments will not generate returns, but others will provide value added. There are companies that succeed well in the portfolios, and their investments will increase in value.

**Mr. Joël Godin:** Will there be compensation?

**Mr. Jérôme Nycz:** That is the objective of the program. I think that the selection of the funds of funds was done well. I think that the funds that are receiving funding at this time have a good investment team. The return on investments this year is higher than 5%. When we launched the program or even when we performed the strategic analysis at the BDC, it was less than 5%.

So there has been an improvement in the return on that category of investments, which is very positive, because this is what will allow us to bring in other investors who may see returns in this area. There are some very encouraging preliminary signs.

**Mr. Joël Godin:** Indeed, that is very encouraging.

Thank you.

[English]

**The Chair:** Thank you, Mr. Godin.

Ms. Mendès.

[Translation]

**Mrs. Alexandra Mendès:** Thank you very much, Mr. Chair.

Let's go back to *The Globe and Mail* article, because I would like to conclude on a positive note.

Gentlemen, you have certainly provided a lot of answers. I had several questions. I have to say that this is not my area and I was a bit lost, but I greatly appreciated the tenor of *The Globe and Mail* article, which provides a good explanation of the report that was released yesterday.

•(1710)

[English]

I'll just go to the last paragraph of the article which talks about the choices of a fund or a fund of funds, or whatever you want to call it, that are going to be made for the next stages. They mention that 79% of the money has been committed to ICT, information and communications technology, and that there's a certain preoccupation with that and that not enough has been put into the clean energy sector or the life sciences sector.

Have you been looking at this? Is this something where you would like to make some changes?

**Mr. Jérôme Nycz:** Seventy per cent of investment in venture capital is in the ICT sector. That's the industry norm. The funds of funds have some specificity in terms of areas of focus. HarbourVest is an ICT fund. Kensington has an ICT and a clean tech objective. Teralys has an allocation for a life science fund. We're seeing a normal distribution being established in terms of fund investments. So these funds of funds are making investment in different sectors. Genesys is one life science fund that got some fundraising from the VCAP and you're going to see an increased diversification.

There was a great pent up demand in 2012 because the fundraising was very difficult and some of the funds were IT funds. They got funded quickly, and now you're seeing other funds approaching and establishing relationships, so we're confident there will be diversification, and we're seeing it right now.

**Mrs. Alexandra Mendès:** Apparently there's perhaps a possibility of a VCAP2, based on what the article says. I presume that would be based on a somewhat measured evaluation of success. Would you say the department has judged that this has been working well if there is this possible enthusiasm for a VCAP2?

**Mr. Christopher Padfield:** I can't speak to ministerial decisions as to whether or not they'll move forward with a second round. That's really for ministers to consider.

**Mrs. Alexandra Mendès:** Can you speak to your general satisfaction with the way the fund has been managed?

**Mr. Christopher Padfield:** I think for the early indicators, attracting investment and bringing in fund managers, we've checked off a lot of the initial intent of the objectives of the program. I think Jérôme walked through a number of the activities that are coming, such as new offices being put in place for some of the fund-of-funds managers. However, in the long run, we're still looking to see positive returns. We're still waiting to see where some of those longer-term indicators, such as performance measures around firm stuff as well as overall returns for the investments, are going to be. We're still very early days. We're not yet seeing any substantial return data.

**Mrs. Alexandra Mendès:** Not yet.

Thank you very much.

**The Chair:** Mr. Poilievre has a question. Then I will ask a quick question, on behalf of our analysts, with regard to the preparation of our report.

Mr. Poilievre.

**Hon. Pierre Poilievre:** I have just a brief comment.

I do agree with Mr. Harvey that the cost of capital is calculable if only by a weighted average in the year in which it was borrowed. I mean, this year we're borrowing \$130 billion as a government. It's in two-year, five-year, 10-year, and I think there will even be some 30-year bonds. I'm sure there's a way to weight the average interest on those and calculate what we're actually paying to displace this money over the course of the 12-year life cycle.

I think we've had enough discussion on that. I thank you for all of your answers.

I'd like to move on to the opportunity cost for the money leveraged from the private sector. Do you have any modelling over at Finance to determine if the money contributed to these funds by private sector investors is actually incremental business investment for Canada, or simply money that would otherwise have been invested in the Canadian marketplace but was directed here because of this government incentive that is available for venture capital investments and not available for other forms of investments?

**Mr. Richard Botham:** Boy, that's a complicated question, because it speaks to the intent of the investors.

I guess one way I would look at it is this. The incentive structure that was put in place was the subject of very intense negotiations between the Government of Canada, other governments that are participating in this, and private sector investors. From the Government of Canada's perspective, we tried to minimize the level of incentive and at the same time attract capital.

Private sector investors have invested because they feel that the amount they put into this framework will return to them something they could not get otherwise. Absolutely the incentive skewed the investment decisions. It was meant to do that.

•(1715)

**Hon. Pierre Poilievre:** Right.

**Mr. Richard Botham:** A number of these are large, sophisticated investors who invest all around the world. An example is CPPIB. Did the money that CPPIB put into these four funds of funds come out of money that they otherwise would have invested internationally in ports, or airports, or roads? I guess so, because they have a fixed amount, but these are international investors, so I don't know how I could come to any calculation of the proportion they might have otherwise put in Canada. It also involves all the major banks, National Bank and some corporate investors.

It's tough for me to make that calculation, but I understand the question.

**Mr. Neal Hill:** Could I just tag on one specific thought?

**The Chair:** Go ahead, Mr. Hill.

**Mr. Neal Hill:** Thank you.

You used the word “incremental” to the space. That is one of the discussions around the program, because its intent was to generate incremental capital for venture capital investing in Canada. From speaking to the four fund-of-funds managers who bore the brunt of the fundraising, the \$904 million in private sector capital that's come in, their feeling is that at least two-thirds of the private dollars that came into their funds is net new money to the Canadian venture capital ecosystem, and that had it not been for this program, it would have not gone to Canadian venture capital.

Beyond that, I can't speak to it.

**The Chair:** Thank you.

I have a question coming from our analysts. I don't want to make it sound like it's my question. This is just for a little clearer input, I think, for our report.

Perhaps Mr. Hill or Mr. Botham could answer. The government and the private sector industries are getting information about the rate of return and the list of companies, but Parliament is not. Why is that the case?

**Mr. Richard Botham:** I'm going to have to defer to my colleagues on the list of companies. I'm not sure. But on the rate of return, there is no calculation right now of the rate of return. It is a dynamic concept. I'm not sure what to do with that, actually. Is there some point at which...? There certainly is some point at which there would be a reporting on rate of return.

Go ahead, Neal.

**The Chair:** Mr. Hill.

**Mr. Neal Hill:** Sure, thanks.

We're using industry standard measurements of fund performance. They're called TVPI, total value to paid in capital, and distributed to paid-in capital. I don't mean to get into jargon.

We are reporting on the financial performance of the funds, and that will certainly be part of the annual report to the performance management framework that Innovation, Science and Economic Development is responsible for compiling and providing. I'm assuming that will get to Parliament as it gets to everyone else.

Within that, though, the list of companies actually is a bit of a touchy matter because, if any of you have dealt with early-stage entrepreneurs, you know they are often very jealous of the quality and sensitivity of their idea. The investment funds that invest in these companies often have a confidentiality agreement with those companies that they cannot even disclose that they have invested in those companies.

● (1720)

**The Chair:** But other private sector companies would perhaps get the information, as would the government. Is that correct?

**Mr. Neal Hill:** There are some exceptions even for the private sector investors. Anything the private investors get, we can get access to through the program, and we will provide that. I'm just saying that there are instances where the list of companies might not be complete because of a confidentiality situation.

**The Chair:** All right. Thank you.

For some of the questions today, like the last one that has taken a fair bit of thought, you may want to respond in writing with an answer to better express your thoughts. That might help us understand a little more clearly. We would encourage you to do that if there is something that triggers you on the way home.

The other thing, Mr. Padfield, is that you also talked a bit about the performance management framework. If it would be possible for our committee to get a copy of that sent to our clerks or analysts, we would certainly appreciate that.

I want to thank you for coming. For the layman, this is very difficult. Regarding the viewership out there across the country, I'm not certain how many people would be watching the technical aspect of venture capital investment. For the people involved in the industry, they may find it very interesting. Start-up programs and new entrepreneurs may find this very interesting. I certainly recognize that we have a panel of experts here today, and we thank you all for your input.

To our Auditor General, thank you for doing a good job on this report. We look forward to seeing you again.

Thank you very much.

We will take a two-minute recess. You can say goodbye to our guests, then we would invite our friends from around the world, other auditors and auditors general from other countries, to come up here. We'd like to meet you and perhaps get a picture with you. We'll recess for two minutes.

● (1720)

\_\_\_\_\_ (Pause) \_\_\_\_\_

● (1725)

**The Chair:** We've had a good meeting. It's been a public meeting, and we are now going to adjourn and we will meet our friends from Cameroon, Ghana, and Vietnam.

The meeting is adjourned.





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