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Financial Institutions Division
Financial Sector Policy Branch
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Dear Sir/Madame,

RE: Consultation Document for the Review of the Federal Financial Sector Framework

TMX Group Limited (**"TMX Group"**) appreciates the opportunity to comment on the Consultation Document (**"Consultation Document"**) for the Review of the Federal Financial Sector Framework from the Department of Finance Canada (**"Finance Canada"**). TMX Group is supportive of the policy objectives of stability, efficiency and utility guiding the review. Below we have set out suggestions on how these policy objectives could be better met to support domestic growth in the exchange and clearing sector and in capital markets and the economy more generally. As such, our suggestions below are generally in response to Question 4 of the Consultation Document which asks what actions could be taken to strengthen the financial sector framework and promote economic growth.

TMX Group

TMX Group's key subsidiaries operate cash and derivative markets for multiple asset classes including equities, fixed income and energy. Toronto Stock Exchange, TSX Venture Exchange, Alpha Exchange, The Canadian Depository for Securities (**"CDS"**), Montréal Exchange, Canadian Derivatives Clearing Corporation (**"CDCC"**), Natural Gas Exchange, Boston Options Exchange, Shorcan, Shorcan Energy Brokers and other TMX Group companies provide listing markets, trading markets, clearing facilities, data products and other services to the global financial community. TMX Group is headquartered in Toronto and operates offices across Canada (Montreal, Calgary and Vancouver), in key U.S. markets (New York, Houston, Boston and Chicago) as well as in London, Beijing and Singapore.

How should the financial sector framework support innovation and competition while maintaining stability of the system?

i. Creating a level regulatory playing field

TMX Group would suggest that with respect to the clearing and exchange industry, creating a level regulatory playing field between domestic exchanges and clearing agencies and their foreign peers operating in Canada would help to achieve this objective. Currently, TMX Group exchanges and clearing agencies (i.e. Canadian companies) are subject to considerable direct regulatory oversight (CDS and CDCC, for example are directly regulated by three securities commissions in addition to the Bank of Canada) while larger foreign entities that operate as clearing agencies and/or exchanges in Canada are almost entirely exempt from Canadian regulations. A level playing field would better maintain the stability of the system because there would be a consistent regulatory framework across similar entities, allow for more fair competition and support increased Canadian innovation because Canadian entities would be better positioned to innovate and make business changes at the same pace of their foreign peers

From a policy perspective, given the similarity in regulations between provinces, it is unclear why a Canadian entity regulated in one province, must also be directly overseen by regulators in other provinces, while foreign entities regulated under a non-Canadian regulatory regime would be either exempted from any regulatory oversight or only regulated in one province. TMX Group has written numerous comment letters to securities regulators when foreign exchanges and clearing agencies have applied for exemptive relief from recognition.[1] TMX Group also commented on National Instrument 24-102 *Clearing Agency Requirements* (**"NI 24-102"**) which suggested that even recognized

[1] See, for example comments regarding: Chicago Mercantile Exchange Inc. at http://www.osc.gov.on.ca/documents/en/Marketplaces/com_20130614_cme_kloett.pdf; Chicago Mercantile Exchange group of exchanges at http://www.osc.gov.on.ca/documents/en/Marketplaces/com_20130923_cmeg_tmx-group.pdf; Nodal Exchange, LLC at http://www.osc.gov.on.ca/documents/en/Marketplaces/com_20140905_oosterbaanj.pdf; ICE Clear Credit LLC at http://www.osc.gov.on.ca/documents/en/Marketplaces/com_20131122_ice-clear_miquelona.pdf; LCH.Clearnet Limited at http://www.osc.gov.on.ca/documents/en/Marketplaces/com_20130318_lchcl_kloett.pdf; LCH. Clearnet LLC at http://www.osc.gov.on.ca/en/Marketplaces_ca_20140220_rfc-app-exempt-lch-clearnet-llc_comments.htm; Nodal Clear LLC at http://www.osc.gov.on.ca/documents/en/Marketplaces/com_20160602_dobrowskyd.pdf. TMX Group also commented on the issue more generally in its comments on National Instrument 24-102 Clearing Agency at http://www.albertasecurities.com/Regulatory%20Instruments/5218744-v1-NI_94-102_CSA_Notice_all_Annexes.PDF.

foreign clearing agencies could be exempted from key requirements of NI 24-102 if such clearing agency faces a conflict or inconsistency between Canadian and foreign regulations. In foreign jurisdictions these entities can make certain business changes without waiting for a regulator's prior approval or they are able to use an efficient self-certification process. Permitting these foreign clearing agencies and exchanges to follow foreign rules when operating in Canada can enable them to make substantial business changes much more quickly than Canadian exchanges and clearing agencies. The slower regulatory process for domestic exchanges and clearing agencies relative to foreign ones can have the effect of delaying the pace of domestic change and innovation and puts Canadian entities at a disadvantage relative to their, often much larger, foreign competitors.

While we understand the benefits of providing Canadian investors access to foreign exchanges and clearing agencies, we would ask that Finance Canada work to develop policies that ensure that Canadian exchanges and clearing agencies are not placed at a disadvantage relative to their foreign peers due to a regulatory regime that creates an uneven playing field that slows their relative ability to innovate and respond to market demands and trends. The financial industry is important to the Canadian economy and while related regulations must protect investors, they should also support innovation by Canadian companies rather than creating an environment that eases innovation by foreign companies while slowing down domestic companies. While we have advocated this issue repeatedly with provincial securities regulators, it has not been a high priority item. As more and more foreign exchanges and clearing agencies begin offering services in

[2] See http://www.osc.gov.on.ca/en/Marketplaces_xxr-onechicago_20150618_exemption.htm.

Canada every year, however, the lack of a level playing field becomes an increasingly larger concern.

ii. Creating new investment opportunities by applying the flow through share program more broadly to technology and innovation sectors

Flow-through shares are a successful Canadian financial innovation introduced into the *Income Tax Act* more than 60 years ago and has proven effective to help spur the growth of Canadian resource companies. Replicating the success of the flow-through program into Canada's technology and innovation sectors would help drive growth and stimulate additional financing for the commercialization of discoveries in the this sector, which is comprised of the technology, clean technology and life sciences sectors.

Where the development of Canada's natural resources industry has demonstrably benefited from the visionary and innovative flow-through share program to encourage capital formation for oil & gas and mineral exploration, fiscal programs to foster capital formation for the commercialization of substantial investment into research and development in the technology and innovation sectors tend to fall short.

There is a social and financial cost to Canada if we do not close the measurable gap between the excellent Canadian research in these fields and the eventual commercialization of the fruits of that research.

There are structural parallels between the resource and innovation sectors:

- High risk/reward;
- Significant up-front expenditures required;
- Long timeframe between expenditures and revenues; and
- Expenditures that are, in many cases, never offset against revenues for tax purposes.

Flow-through shares allow qualifying expenditures to be used by those bearing the economic risk of the expenditures - the shareholders providing the capital. In the same way that flow-through shares have sustained the resource sector, in particular the mining sector, a similar incentive in the technology and innovation sector can be an important stimulus to enable the commercialization of activities that evolve from expenditures eligible under the Scientific Research and Experimental Developments (**"SR&ED"**) Tax Incentive Program.

Like the resources sector, innovation is about discovery and commercialization, and requires significant, calculated investment to enable success. A market with accessible risk capital will draw innovators, entrepreneurs and investors and create a self-reinforcing cluster that is continuously replenished with new talent and intellectual capital. We have a unique opportunity to leverage the strength of Canada's world-class capital markets and our world-leading scientific research by extending an existing program with a proven track record of success. Applying the benefits of the flow-through-share program would allow the government to facilitate and attract new growth capital to the technology and innovation sector, while also generating investment activity for local economies across Canada.

iii. Create a level playing field for innovative Canadian Small and Medium-Sized Enterprises under the Scientific Research and Experimental Development Tax Incentive Program

Canada's small and medium-sized enterprises operating in the technology and innovation sector need additional sources of financing to grow their businesses as they eventually reach the commercialization and scale up stages.

Currently, many early stage Canadian technology and innovation companies are faced with the choice of either accessing capital by listing their shares on a stock exchange, or staying private to maintain their eligibility to access significant financial benefits provided by the enhanced, refundable tax credit under the SR&ED program. We believe that these options should not be mutually exclusive.

Under the current SR&ED eligibility criteria, Canadian entrepreneurs and early-stage private companies are led towards private sources of funding, such as Venture Capital (**"VC"**) or Private Equity (**"PE"**), because doing so allows them to retain access to the full benefits under the SR&ED program (the enhanced, refundable 35% tax credit). However, once a company goes public the investment tax credit (**"ITC"**) drops from 35% to 15% and becomes non-refundable—this applies to all public companies regardless of size or cash flow.

However, Canadian-controlled private corporations (**"CCPCs"**) and companies listed on TSX Venture Exchange, Canada's public venture capital market, are often similar in terms of stage of development, size and value. Eligibility criteria under SR&ED already has a threshold that considers the size and stage of financial maturity of the applicant company. This is an appropriate cut-off that, if surpassed, renders the applicant ineligible. That said, we believe that the supplemental eligibility test requiring the company to be a CCPC to access the enhanced, refundable ITC is not only redundant, it works against the public policy objective of the SR&ED program itself.

There are over 275 technology and innovation companies listed on TSX Venture Exchange, many of which are burgeoning—the majority of them have revenues under $1 million. However, these young companies still develop promising innovative technologies, and funding provided by SR&ED is often a crucial source of operating funds. We believe more entrepreneurs would consider taking their idea or business to new heights if launching an initial public offering did not negatively impact their SR&ED status.

Moreover, extending the benefits of SR&ED to small and early stage technology and innovation companies listed on a public market in Canada would also help keep them growing at home and grow the base of Canadian businesses. In many cases, VC or PE-funded companies who stay private to enjoy the full benefits under SR&ED end up being acquired by large firms outside of Canada. Conversely, by offering SR&ED's full benefits to early stage public companies on the same basis as CCPCs of the same size, the program would serve the very companies that it is designed to support. This would also provide further incentive to access public growth capital in Canada to position these companies for further expansion beyond start-up and initial commercialization.

How can the financial sector framework best promote competition, including by encouraging new entrants and fostering the growth of small entities and other players?

Reconsidering the Regulatory Burden Facing Independent Brokers/Dealers

The independent broker/dealer community has been shrinking in recent years. The increasing and substantial regulatory burden on these small dealers is impactful and is a contributing factor to the decline of the smaller dealer. We would support reconsidering of requirements to determine whether adjustments could be made to allow for the continued existence of more brokers. The smaller dealers are often responsible for attracting investment in early stage companies that may struggle to retain dealer representation by larger financial entities. Having dealers to facilitate access to capital is crucial to the growth of small and medium-sized enterprises.

Smaller brokers/dealers have faced declining earnings in recent years due to both lower investment banking revenues and increasing costs, largely resulting from increased regulatory burdens. Since 2012, 28 institutional firms have left the industry either through amalgamation or shutting down and 35 retail boutiques left the industry. In 2015, 53 small independent firms, or nearly one-third of the independent firms in the industry lost money and many of these have been losing money through the past four years and are in danger of leaving the industry over the coming years. It is expected that many of the estimated 40 retail firms that have been losing money are also likely to leave the industry given further increased costs resulting from the client relationship model (**"CRM"**) rule framework and the client best interest standard. It is further expected that fewer than 100 IIROC-registered firms will exist within the next five years. There are concerns that insufficient attention was paid to considering a cost benefit analysis of the impact that the CRM rule framework and point of sale rules for mutual funds would have so that the complexities of compliance only became evident upon implementation.[3] We understand that the Canadian Securities Administrators has recently stated its intention to carry out a post-implementation review of the regulations which may assist with some of the issues that the industry faces.

[3] Investment Industry Association of Canada Letter from the President, July 2016 at http://iiac.ca/wp-content/uploads/IIAC-Letter-from-the-President-Vol-97.pdf.

TMX Group appreciates the opportunity to provide comments with respect to this Consultation Documentation. We hope that you will consider our concerns and suggestions and would be happy to discuss these at greater length. Please feel free to contact Jennifer Oosterbaan, Legal Counsel, TMX Group at Jennifer.oosterbaan@tmx.com if you have any questions regarding our comments.

Yours truly,

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